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U.S. Budget

Obama Could Face Sophie's Choice As Country Approaches Debt Limit

As the nation again approaches its statutory debt limit this winter, President Obama may be forced to choose among potentially illegal or economically disastrous options, such as borrowing money without the approval of Congress or doing nothing as the country defaults on its debt.

The debt ceiling showdown of July 2011 demonstrated most importantly to the nation's investors that the routine approval by Congress to increase the borrowing authority of the Treasury can no longer be taken for granted.

Political dysfunction and failure to negotiate a sufficient deficit-reduction package led to the first-ever downgrade of the United States by a bond rating agency. And even more complicated and economically significant negotiations lie ahead.

House Speaker John Boehner (R-Ohio) has already issued an ultimatum. ''When the time comes, I will again insist on my simple principle of cuts and reforms greater than the debt limit increase,'' he said May 15 to the Peter G. Peterson Foundation.

One option contemplated, but quickly rejected, by the Obama administration last summer was for the president to unilaterally increase the nation's debt limit by citing Section 4 of the 14th Amendment to the Constitution. This so-called public debt clause of the Constitution states:

''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.''

Obama: Unilateral Action Not 'Winning Argument.' On July 22, 2011, just a few days short of reaching the last debt ceiling, Obama was asked at a town hall meeting at the University of Maryland about using the 14th Amendment.

''There's a provision in our Constitution that speaks to making sure that the United States meets its obligations,'' Obama responded. Some have suggested that a president could use this language to ignore the debt ceiling, which is found in statute and not in the Constitution, he said.

''I have talked to my lawyers,'' Obama said at the time. ''They do not—they are not persuaded that that is a winning argument,'' he said.

At the same time, Obama also said that default was ''not an option.''

''There are some on either side that have suggested that somehow we could manage our way through,'' he said.

The U.S. government sends out about 70 million checks every month, the president said. It has to refinance bonds that have been issued to investors every week, he said.

If these investors start thinking that the government might not pay them back on time, at the very least they would charge a much higher interest rate to allow the United States to borrow money, the president said.

Then the cost of servicing the deficit would go up, so that rather than save money, default would increase the deficit, the president said. ''It could also plunge us back into the kind of recession that we had back in 2008 and '09. So it is not an option for us to default,'' he said.

The White House did not respond to multiple requests by BNA for comment on the legal rationale for rejecting the 14th Amendment option.

House Resolution, CRS Report. During last summer's controversy, Rep. Jerrold Nadler (D-N.Y.) led a handful of Democratic lawmakers in sponsoring a sense-of-the-Congress resolution declaring that the president should take any and all actions necessary to preserve the full faith and credit of the United States.

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>
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The resolution, which failed to advance, stated that if the president could not negotiate an increase in the debt limit with Congress, he should use his authority under Section 3 of Article II to uphold Section 4 of the 14th Amendment, to ensure payments of all public debts. Section 3 of Article II is a general provision that states that the president ''shall take care that the laws be faithfully executed.''

Also last summer, the Congressional Research Service issued an analysis of many of the constitutional and legal issues related to the debt limit.

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In a July 12, 2011, congressional distribution memorandum, CRS stated that it is clear that Section 4 of the 14th Amendment does not grant any affirmative power to either the executive or judicial branches of government.

Neither the legislative history nor subsequent case law appear to contemplate or empower the other branches of government to deal with issues related to the national debt, according to the memo.

In addition to the public debt clause of the 14th Amendment, the 22-page memo discussed the authority of the executive branch to act independently in the absence of legislation.

It also addressed questions raised by the option of prioritization, which would require the Treasury to pay interest and principal to holders of debt before meeting any other obligations of the federal government.

Finally, the memo explored the conflict between the debt limit statute and the most recent appropriations act, the possibility of a judicial resolution, and the liability of the U.S. government in the event of a default on the federal debt.

Support for Unilateral Action. The idea of the president unilaterally raising the debt limit has its supporters in the legal community. One leading proponent of this option is Garrett Epps, a professor at the University of Baltimore School of Law.

Epps told BNA in an interview that the Constitution, on the question of whether the president has the authority to increase the debt limit, is sufficiently ambiguous to answer either way.

The president could in good conscience point to Section 4 of the 14th Amendment as a basis for unilaterally borrowing money, Epps said.

Much of the 14th Amendment has to do with what Congress either can or shall do, Epps said. By contrast, the construction ''shall not be questioned'' is clearly directed at the entire federal government, Epps said. And, he added, the language is dramatic.

It could have been written to say that Congress shall make adequate appropriations to pay the public debt of the United States, or the public debt of the United States shall be paid on time, or the public debt of the United States shall not be repudiated, he said.

''This is, I think, just as a matter of natural language the way anybody in 1868 or today would read it, a little broader than that. The government just can't call the debt into question,'' he said.

History of Clause. When the clause is considered in its historical context, as a measure aimed at reassuring investors who held U.S. securities, then the construction becomes a good deal more credible, Epps said.

There was virtually no national debt in 1861 when the Confederacy fired on Fort Sumter, Epps said. But, by 1868, the federal government had borrowed almost every penny it could from foreign lenders, banks, and individual investors to fund the Civil War.

Up until the war, Southern politicians wielded tremendous power throughout the federal government, Epps said. During reconstruction, these politicians were openly saying that they planned to return to Congress and make it pay off the Confederate war debt, or else they were going to repudiate the Union debt.

When the amendment was drafted, the thinking was that one party should not be able to take over Congress and repudiate the national debt because it did not support the policy, Epps said.

Later, the Supreme Court in a 1935 decision in *Perry v. U.S.* said in very strong terms that Congress may not at its whim refuse to pay the debts of the United States, Epps said. This is a complicated case that was brought by a bondholder as a challenge to the decision to take the United States off the gold standard, he said.

“It would be unwise for the president to unilaterally increase the debt ceiling. Borrowing done via this would be immediately challenged and tied up in the courts.”

Erwin Chemerinsky
University of California at Irvine School of Law

The court said Congress had no discretion to refuse to pay back the debt, but it did say the bonds could be repaid in comparable value, or in this case paper money, Epps said. ''That's the only case law,'' he said.

Conflict of Laws. Now, what happens if a majority party, or even a minority party in the Senate, refuses to allow the debt ceiling to be raised? Epps said. It means that at some point, the United States would not be able to pay back its bonds, which is the principle in *Perry v. U.S.*.

Someone with Treasury bills could find that the interest is not being paid on his bonds and could sue in federal court, Epps said. Under *Perry*, the United States has to repay its debts on time and has to repay them under the terms it borrowed, he said.

''So the question then becomes, how can Congress pass a separate law saying if the debt reaches a certain level, we will stop paying our debts. Is that really constitutional?'' he asked.

No one questions that the government cannot spend money from the Treasury that is not authorized by Congress, Epps said. That is the appropriations clause: No money shall be drawn from the Treasury, but in consequence of appropriations made by law.

''But bear in mind, repaying the debt of the United States is already authorized,'' Epps said.

It would violate the appropriations clause if the president were to decide the level of the budget and spend the money, Epps said. But this is different; this is repaying money that has already been borrowed and to which the credit of the United States is pledged, and which is authorized by law to be repaid, he said.

''Congress has already voted to spend this money, and that goes either for debt repayment or for program funds in a given fiscal year budget,'' Epps said.

Epps said he does not believe a debt limit in itself is unconstitutional. But there is an argument that it is unconstitutional to the extent that it requires the United States to default on its debts, he said.

Doctrine of Inherent Authority. Finally, if the United States is obligated to do something and Congress refuses to do it, there is much to support the view that the executive has the inherent authority to carry out the obligations of the United States, Epps said.

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Still, the president's unilaterally raising the debt limit would ''be a particularly radical expression'' of that power, Epps acknowledged.

An argument being made with more insistence is that the president does not have to repudiate the debt, but rather, simply take all the money appropriated for other things and pay the debt, Epps said. This option is sometimes called prioritization.

The problem is the president is not authorized to change the appropriation of money; that has to come from Congress, Epps said.

The argument that the president can violate part of the Constitution—not spending money as directed—and thus avoid violating a different part of the Constitution—not paying the debt—is not satisfactory, Epps said.

''Either way, Congress is putting the president in a position where he has to violate the Constitution, either by failing to spend authorized funds or failing to service the debt,'' he said.

''I think it's a question of faithfully interpreting and then executing the laws. And I think the way presidents have always looked at it, correctly, is that when they hit the debt limit they have to go back to Congress and get an increase if they want to borrow more money.''

MICHAEL STERN, FORMER SENIOR COUNSEL,
OFFICE OF GENERAL COUNSEL OF THE HOUSE

Article I, Section 8. Erwin Chemerinsky, founding dean of the University of California at Irvine School of Law, said in an email to BNA that the president cannot unilaterally increase the debt ceiling.

''Under Article I, Section 8, the power to borrow money is given to Congress. Moreover, the debt ceiling is set by statute and the president cannot unilaterally repeal a statute,'' Chemerinsky wrote.

The tradition always has been that raising the debt limit is done by a statute, and Section 4 of the 14th Amendment does not change that, he wrote.

''Moreover, it would be unwise for the president to unilaterally increase the debt ceiling. Borrowing done via this would be immediately challenged and tied up in the courts,'' Chemerinsky wrote.

In response, Epps advised reading Article I, Section 8 closely. It makes clear that Congress has the power to borrow money, spend money, and appropriate money, he said.

''There is not a provision that says no money shall be borrowed that is not authorized from Congress. So what it says is, Congress has the power to borrow, but it does not say no other part of the federal government has the power to borrow,'' Epps said.

This may seem like torturous parsing, but it is exactly the kind of close textual analysis that is often used in disputes over executive power, Epps said. Article II, which governs the presidency, is badly written, he said, and courts struggle to interpret it.

Shane: Least Illegal of Three Options. Peter Shane, a law professor at Ohio State University, told BNA in an interview that there is no judicial guidance that squarely resolves this issue.

During last summer's debt limit controversy, law professors wrote extensively on both sides of the issue, and the most compelling argument in favor of presidential authority was written by Epps, he said.

On the other side, Shane noted that Laurence Tribe, professor at Harvard Law School, wrote that nothing in the 14th Amendment could be read to give the president that power.

Shane's own view, he said, was somewhat convoluted. There is something to be said for Tribe's argument, he said. It is probably unlikely that when the 14th Amendment was drafted, it was intended to give the president some new, unprecedented power to incur debts on behalf of the United States, he said.

But Shane said there is ambiguity in the sense that Congress has authorized a set of expenditures, which, if they go beyond existing revenues, can only be funded from borrowing. The problem is that the president does not have the authority not to spend what Congress has appropriated, he said.

So, if Congress appropriates, the president must spend it, and if revenues fall short, it could be said in a sense that Congress has authorized some additional debt, Shane said.

But, as a matter of reading the statutes, Congress provides in a different statute what it wants the maximum debt of the United States to be, thus creating conflicting laws, Shane said.

''So that is exactly the problem,'' he said.

Three Possibilities. Shane sees three possible outcomes if Congress does not increase the debt limit:

■ *Default.* The president continues to spend what Congress has told him to spend, but does not borrow any additional money. At the point where spending exceeds revenues, the president must stop paying existing debt.

■ *Unilateral action.* The president ignores the debt limit statute and continues to borrow money, but only up to the amount he needs to carry out the expenditures that Congress has appropriated.

■ *Prioritization.* The president calculates how much is in the Treasury and how much it will cost to pay off the interest on loans through the fiscal year. There would be some money left over, but likely not enough to pay the amounts Congress ordered the president to spend.

The default scenario is the one everyone wants to avoid; the second scenario is the unilateral debt raising scenario; and the third is a sequestration or a prioritization scenario, Shane said.

As an abstract proposition, there is some reason to think that Tribe is right—that the president does not have the authority to unilaterally raise the debt limit.

Authority in 1974 Budget Act. What the president probably could do under a very literal reading of the Congressional Budget and Impoundment Control Act of 1974 (Pub. Law No. 93-344), is claim authority for the sequestration scenario, Shane said.

Under this authority, the president could claim an emergency and postpone certain expenditures in order to pay off debt, even if it meant he could not spend at the level the Congress directed, Shane said.

This scenario, however, presents a paradox that could lend support to the unilateral debt raising scenario, despite Tribe's arguments, Shane said.

The paradox is this, Shane said: Even if the Budget Control Act of 1974 could be read to allow the president not to make certain expenditures, it would be almost the exact opposite of why Congress enacted the act, he said.

The whole point of the act was to prevent, except in very limited circumstances, the president from deciding on his own that he could impound or not spend funds, Shane said.

''The point of the [1974 law] was precisely to keep the decisions about appropriation levels in Congress, not the executive branch,'' he said.

Still, there are emergency exceptions, and if read in a literal way, the president could get away with across-the-board government austerity measures, Shane said. But that really was not what Congress thought it was enacting in 1974, he said.

Respectful of Checks and Balances. If the president decided to impound or prioritize payments, he would have to make a lot of decisions, Shane said.

If the premise is that he cannot spend what Congress directed, would he cut evenly across the board? Or cut defense 50 percent and everything else by less? he asked.

''And each of those decisions would arguably be in violation of an appropriations statute,'' Shane said. ''On the other hand, if the president ignores the debt limit, he's ignoring that one statute. But that's the only statute he's ignoring,'' he said.

And if he ignores that one, it would not be out of an independent policy judgment, but because Congress has said this is the amount of money that must be spent, Shane said.

The 14th Amendment says the debt shall not be called into question, and the best that the president can do, given his obligation to take care that the laws be faithfully executed, is to continue borrowing money to avoid default, Shane said.

Even though such unilateral action is constitutionally the more adventurous course, it is the one that most respects of checks and balances, Shane said. The only alternatives are going into default, which would result in an economic disaster, or having the president make a lot of decisions about the appropriate levels of expenditures, he said.

It could be argued that the president would be making a lot more policy on his own by not breaking the debt limit, ''and that that would actually be a more troublesome subversion of the separation of powers than if the president just ignores the debt limit,'' Shane said.

Two Basic Questions On the other side of the issue is Michael Stern, who writes a legal blog called Point of Order. He served as senior counsel in the Office of General Counsel of the House from 1996 to 2004.

The history and purpose of the public debt clause was to ensure that the Union debt would remain valid and that the Confederate debt would be invalid, Stern told BNA in an interview. From that, he said, there are two basic questions: 1.) What does it mean to question the validity of the U.S. debt? 2.) Assuming a violation of the public debt clause has occurred, what is the remedy?

Beyond its original intent, the public debt clause could mean ''repudiate'' the debt, Stern said.

''I think there's a pretty strong argument that [repudiation] would constitute questioning the validity of the debt, because you're essentially saying you're not bound by this debt,'' he said. ''It might have been valid, but you're avoiding it. I think that's a pretty easy jump.''

However, what happens if the president does not repudiate the debt, but rather, says he is not going to pay it, either now or ever, because he does not have the money or wants to spend the money on something else, Stern said.

Or, what if the president is not repudiating the debt or refusing to pay it, but simply cannot pay it because he has run out of money, Stern said. Is that questioning the validity of the debt?

''And once you get to that point, in my opinion, I don't see that as questioning the validity of the debt. The fact is debtors don't always pay their debts. It doesn't mean they're questioning the validity or repudiating or anything, they just don't have the money. If you don't have the money, you can't get blood out of a turnip,'' he said.

Some, including Epps, are taking the argument further by saying the public debt clause prohibits the government from doing anything that might cause it to run out of money, or make it impossible or very difficult in the future to pay its debts, Stern said. That is about as far as anyone can go, he said.

Epps's position is that it is a violation of the public debt clause to do something that will make it impossible or extremely difficult to repay the debt, which means in this case refusing to raise the debt ceiling, Stern said. And the remedy, in this view, is that the president can on his own ignore the debt ceiling and issue new debt.

But Epps's answer to the first question goes too far, Stern said. And Epps's answer to the second question has to be wrong, because if it were true, then the president would also be able to refuse to spend money by arguing, for example, that the only way to repay the debt is to cut the defense budget in half, Stern said.

There is no limit to how far the argument can be taken, Stern said. And it is essentially incompatible with the way the system has always worked, he said.

Power of the Purse. What is clear is that Congress has the power of the purse, Stern said. The president cannot spend money that has not been authorized by Congress.

''And he shouldn't be able to borrow money that hasn't been authorized by Congress either,'' Stern said.

Stern said that the government has run out of money before and that there are procedures in place that the Treasury secretary has used in the past where obligations are paid in order.

This, however, gets back to the question: If the government does not have money, then is that questioning the validity of the debt? Stern said. ''I don't think so—you just run out of money,'' he said.

Running out of money does not give the president the authority to raise funds that the Congress has not authorized him to raise, even if Congress has authorized the obligations, Stern said.

For example, someone might claim to have a debt against the United States and get a judgment, but the

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court cannot order Congress to appropriate the money, even when there is a debt, Stern said.

In the same way, the president cannot take it on his own authority to raise money either by borrowing or raising taxes, Stern argued.

Conflict a Separate Argument. Any conflict between appropriations and the debt limit statute is a different argument than the 14th Amendment argument, Stern said. Congress sometimes makes laws that conflict with each other, and the courts must reconcile them, he said.

In terms of the statutory debt limit, the argument some are making is that when Congress appropriates money, it is implicitly authorizing borrowing, Stern said.

Historically that is not accurate, Stern said. Up until the early part of the 20th century, Congress explicitly authorized all new borrowing. The debt limit statute was a substitute for that, so that instead of authorizing borrowing for specific purposes, the Treasury secretary was given blanket authority to borrow—up to an overall cap, he said.

Once the secretary hits that cap, he has to go back to Congress, because he does not have any more authority to borrow money, Stern said. The statutory debt limit sets the absolute maximum amount that can be borrowed, he said.

So the answer is congressional intent, which is widely understood, Stern said. Once the debt limit is reached, the government has to stop spending and do whatever it can, including using accounting tricks. But it has to get another authorization to raise the debt ceiling, he said.

''I think it's a question of faithfully interpreting and then executing the laws. And I think the way presidents have always looked at it, correctly, is that when they hit the debt limit they have to go back to Congress and get an increase if they want to borrow more money,'' Stern said.

'Significant' Economic Consequences. Marc Goldwein, senior policy director at the Committee for a Responsible Federal Budget, said he has looked at this argument as a budget expert, not a legal expert.

''In some ways, the president can pretty much do whatever he wants,'' Goldwein said. Then it is up to the courts to decide whether it will be accepted into law or ruled illegal on constitutional grounds, he said.

When it comes time for a standoff, the White House will have to decide if it wants to go down that road, Goldwein said. But if it does, it will create a lot of legal and economic uncertainty, he said.

While it is unclear how the courts would rule on a 14th Amendment argument, the markets clearly would not appreciate either exceeding the debt limit or not knowing whether the debt limit had been exceeded, Goldwein said.

''Not knowing whether we're legally borrowing beyond our means or not, I just think the economic consequences of it would be significant,'' he said.

If the president unilaterally raised the debt limit, it would be challenged in court, and that uncertainty would make investors just as nervous, Goldwein said. Still, default would be worse, he admitted.

Prioritization Alternative. There is a third option that the administration can do, which also may or may not be legal, which is to try to prioritize payments and interest on the debt first, Goldwein said. There was a lot of discussion of doing that back at the last debt standoff, he said.

There is still uncertainty surrounding that, but the legal challenges would not be as vigorous or complex, Goldwein said. ''But obviously none of these are good alternatives; the right thing to do is to raise the debt limit,'' he said.

CRFB is advocating both an increase in the debt limit, and at the same time putting forward a deficit reduction plan that gets the country on a more sustainable fiscal path, Goldwein said.

Despite the dramatic showdown last summer, it is important to recognize that it did produce some deficit reduction, Goldwein said. And, most importantly, the debt limit ultimately was raised, he said.

The credit downgrade came about because there was not enough deficit reduction, Goldwein said. It also put creditors on notice that basically they could not trust the U.S. political system, he said.

Although the United States deserved a downgrade, essentially its bonds were reduced from extremely strong to very strong, which was not a big reduction in global confidence for the U.S. Treasury bond, he said.

''But it makes it that much easier to get to the next downgrade and the next, and suddenly we become one of those European countries that we're trying to avoid,'' he said.

Goldwein said it could happen again, either by continuing to play chicken with the debt limit or by failing to address long-term deficits. ''Either situation could lead to further downgrades,'' he said.

Action-Forcing Mechanisms. Looking ahead, there are a lot of action-forcing mechanisms coming around the debt ceiling, although not exactly at the same time, Goldwein said.

The Bush-era income tax cuts are set to expire at the end of the year, and few from either party want to see all of them end, Goldwein said. There is a $1 trillion automatic sequester set to start in January, which no one should want, he said.

Then, congressional action is needed to head off a nearly 30 percent cut in Medicare payments to physicians; the alternative minimum tax is suddenly going to go from covering 4 million taxpayers to 30 million taxpayers; and unemployment benefits and the payroll tax cut also are set to expire, Goldwein said.

''And that's potential for disaster, but it's also an opportunity. It's an opportunity to take all of these action-forcing mechanisms and pass a plan that avoids the fiscal cliff, increases the debt limit, and at the same time makes medium and long-term reforms to put our debt on a sustainable path,'' he said.

By Cheryl Bolen

The CRS memo on constitutional and legal issues related to the debt limit may be found at http://op.bna.com/der.nsf/r?Open=csaz-8vetcw.