COMPACT FOR AMERICA

The Default Clock Initiative

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Default Clock Is Reset to Four Minutes from Midnight Following Review

Default Clock Review Committee Finds the Federal Government's Fiscal Position Continues to Deteriorate

Today, the Default Clock Review Committee completed its second reset of the Debt Default Clock. The Debt Default Clock estimates how much time remains before the federal government's fiscal policies result in default. At the time of the first reset of the Debt Default Clock, in May 2018, the Review Committee set the Debt Default Clock's minute hand at five minutes from midnight. Today's update, which relies on a new and improved design of the Clock, indicates that the Debt Default Clock should stand at four minutes from midnight. Therefore, the Committee has seen a significant deterioration in the federal government's fiscal position compared to both its initial assessment and the first update.

Revision of the Debt Clock Factors

Following a June 26, 2018, forum in Washington, D.C., consisting of a group of experts from both the investment and fiscal policy communities, the Review Committee decided to revise and strengthen the definition of the Debt Default Clock's factors—a move that increases the Clock's accuracy. According to the revision, the current 12 factors are in continuous operation, but the Committee retains the discretion to choose to discount up to two factors at the time of any reset. Specifically, this revision removes one factor from the original design of the Clock, which was related to the dollar amount of Treasury securities held by the Federal Reserve, and also adopts three new factors. A full description of the Debt Default Clock instrument, including the databases used and graphs depicting the current calculations for the 12 factors, will be made available elsewhere on this website in the coming days.

The following describes the revised list of factors used to calculate the position of the Clock's minute hand relative to midnight:

Factor #1: Do federal outlays exceed 17.5 percent of GDP? Federal outlays have averaged 21.7 percent of GDP over the last 10 years. In the final year of the current budget period (2028), outlays will remain at 23.6 percent of GDP. Thus, Factor #1 remains set at buying zero minutes from midnight.

Factor #2: Is there a dollar-denominated debt ceiling in place, and if so, does the debt subject to limit stay under the ceiling during the budget period? Currently, there is no dollar-denominated debt ceiling in place because the debt ceiling law has been suspended. Thus, Factor #2 also buys zero minutes from midnight. Accordingly, there are no databases or graph associated with Factor #2 at this point. They will be provided when a dollar-denominated debt ceiling is put back into place.

Factor #3: Does the debt held by the public exceed 70 percent of GDP, and does the gross debt exceed 100 percent of GDP? Answering this question is the most widely accepted means for quantifying the debt burden of the federal government. The Review Committee, however, believes the debt-to-GDP ratio is relied on too heavily by the broad array of budget analyses. The debt held by the public is forecast to grow to over 96 percent of GDP in the final year of the budget period (2028), and the gross debt will also peak that year at over 113 percent of GDP (Congressional Budget Office [CBO] data). Since the debt held by the public exceeded 70 percent of GDP in 2012 and the gross debt exceeded 100 percent of GDP also in 2012 (Office of Management and Budget [OMB] data), and both are projected to grow, Factor #3 buys zero minutes from midnight.

Subsequently, if both the debt held by the public is forecasted to fall below 70 percent of GDP and the gross debt is forecasted to fall below 100 percent of GDP during the budget period, Factor #3 will then buy one minute from midnight. If both actually fall below the applicable thresholds, Factor #3 will then buy two minutes from midnight. It is important to note that since the debt held by the public is currently forecast to grow more rapidly as a share of GDP than the gross debt, this combined structure of Factor #3 is weighted in favor of the debt held by the public.

Factor #4: Will gross interest costs exceed 15 percent of federal revenues? Under the revised Default Clock, gross interest costs will exceed 15 percent of federal revenues later this year and remain above this threshold (CBO data). However, this remains an estimate. Accordingly, Factor #4 will continue to buy one minute from midnight. Nevertheless, it is likely that Factor #4 will buy no minutes away from midnight at the time of the next assessment.

Factor #5: Do gross federal interest payments, on a sustained basis, exceed 70 percent of the money the federal government brings in through the issuance of new debt? Factor #5 is a strong indicator of the lack of fiscal health by the federal government, mainly because it quantifies the extent to which the Treasury is increasing its debt to cover the growing interest costs on the pre-existing debt. The original version of the Default Clock estimated that the level of gross interest costs would exceed 70 percent of the money brought in by the issuance of new debt (in net terms) in 2023 (Department of the Treasury and CBO data). The updated version shows that the crossover point should be reached in the same year. Thus, Factor #5 continues to buy one minute from midnight.

Factor #6: Does the debt held by the public exceed 80 percent of the gross debt? Factor #6 addresses the issue of the relative decline in the debt held by other federal accounts, primarily the Social Security and Medicare trust funds. This projected decline stems from the demographic factors that are forcing reductions in the account balances in these two trust funds. Accordingly, this will lead the Treasury to raise relatively more money from investors. The investor-held debt is referred to as debt held by the public. This shift increases financial pressure on the Treasury securities market. The Default Clock estimates that the debt held by the public will exceed 80 percent of the gross debt starting in 2025 (CBO data). Factor #6 currently buys one minute from midnight.

Factor #7: Does the debt held by foreigners exceed 50 percent of the debt held by the public? Factor #7 assesses the exposure of the Treasury to manipulation of its position as a debtor by foreign entities for political reasons. Such manipulations could be intended to increase the risk of default, particularly following a successful attempt to remove the U.S. dollar as the world reserve currency. The Default Clock shows that the share of the debt held by the public owned by foreigners will exceed 50 percent in 2021 (CBO data). Thus, Factor #7 continues to buy one minute from midnight.

Factor #8: Is the structure of the debt, specifically regarding the dollar volume of the debt in Treasury inflation-protected securities (TIPS), Treasury Floating Rate Notes, and other debt instruments that mature in five years or less, undermining the position of the Treasury as a responsible debtor? As of the end of March 2018, the combination of debt in TIPS, Treasury Floating Rate Notes, and other debt instruments that mature in five years or less is a bit over 67 percent of the total debt held by the public (Treasury Department data). This is too high to protect the financial position of the Treasury against the effects of inflation and higher interest rates. Prudence dictates that this number should be no higher than 50 percent of the total. Ideally, it should go lower than 50 percent. Thus, it will take a concerted effort to restructure the debt. As current holdings of TIPS, Treasury Floating Rate Notes, and near-term maturing debt is more than 65 percent of the total debt held by the public, Factor #8 currently buys no minutes from midnight.

Given the sensitivity of this factor, it will buy one minute from midnight for each five-point decline. Accordingly, it will buy one minute from midnight if the value of the applicable securities declines to 60 percent or less; it will buy two minutes away from midnight if the number declines to 55 percent of the total or less; and so forth. Therefore, Factor #8 is unique in that it has the potential to buy more than two minutes from midnight.

Factor #9: Are federal revenues below 17.5 percent of GDP? Federal revenues in 2017 were at 17.3 percent of GDP. They will fall to 16.5 percent in 2019, but they will recover to the 17.5 percent of GDP in 2025 and exceed 18 percent before the end of the budget period (CBO data). Given that this is the only factor that moves in the right direction overall in the course of the budget period, Factor #9 is the only one currently discounted under the new design of the Debt Default Clock.

Factor #10: Does real U.S. economic growth, as measured in GDP, exceed 3 percent annually? While not sufficient to stabilize the fiscal position of the federal government, robust economic growth is an essential part of the solution to the fiscal problem. The reason is that a larger economy, all other things being equal, will generate more revenue for the government. Under Factor #10, an annualized rate of growth of 3 percent or more in the last-completed fiscal year at the time of any future update will buy one minute from midnight. When coupled with the same average annualized rate of growth forecast for the 10-year budget period, it will buy two minutes away from midnight. Real growth in 2017 was 2.6 percent (CBO data); thus, Factor #10 currently buys no minutes from midnight.

Factor #11: Has Congress enacted a law prohibiting the Treasury from resorting to "extraordinary measures" in the future? In the past, the Treasury has resorted to "extraordinary measures" to delay for limited times the point at which it reaches the debt ceiling and risks defaulting on a portion of its debt obligations during times of budget impasses. Generally speaking, these measures involve suspending the issuances of securities by the Treasury to certain entities, such as state and local governments, Civil Service Retirement and Disability Fund, Postal Service Retiree Health Benefits Fund, Federal Employees Retirement System, and Exchange Stabilization Fund. In general terms, the Treasury acknowledges these entities are "made whole" following the budget impasses. Typically, this involves making interest payments on the securities that otherwise would have been issued. The Debt Default Clock defines default as a failure by the Treasury to make a timely payment on a debt obligation. Thus, the admission that the entities involved have to be made whole is also an admission of a failure to make timely payments—that is, they represent default.

Accordingly, Congress should enact a law that prohibits the Treasury from resorting to "extraordinary measures" in the future. Specifically, if either house has passed such a bill during the current Congress, it will buy one minute away from midnight. If such a law is fully enacted and remains on the books at the time of the applicable review by the Default Clock Review Committee, it will buy two minutes away from midnight. Factor #11 is a purely qualitative factor and does not rely on a database. At this point, Factor #11 buys no minutes away from midnight.

Factor #12: Is Congress scaling back programmatic "mandatory spending" and eventually phasing it out? Mandatory programmatic spending, which sets aside net interest payments, does not require the annual appropriation of money by Congress. Effectively, these spending programs are on autopilot. According to CBO, programmatic mandatory spending was more than $2.5 trillion in 2017. CBO projects this spending to grow to more than $4.5 trillion in 2028. Congress needs to rein in these programs by moving them back into the appropriated accounts of the budget. If Congress returns enough of this autopilot spending to the appropriated category so that by the end of the 10-year budget period the mandatory category is less in dollar terms than what it was in 2017, it will buy one minute away from midnight on the Debt Default Clock. If the mandatory category is projected to be phased out altogether by the end of the budget period, it will buy two minutes away from midnight. Factor #12 currently buys no minutes away from midnight.

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