JOINT ECONOMIC COMMITTEE DEMOCRATS

Debt Prioritization Would Pay Foreign Borrowers Over Critical Programs That Help All Americans

Republican proposals on debt prioritization would not prevent a U.S. default on its bills, but would likely cause major legal, administrative, and economic disruption. Debt prioritization involves paying some federal bills ahead of others. It's the Republican answer to get around the default crisis they are creating by refusing to raise the debt ceiling. House Republicans' so-called Default Prevention Act would codify this reckless approach and prioritize foreign bondholders over funding vital government programs for seniors, veterans, and basic government functions. The plan would be unworkable for the Treasury, invite legal challenges that would disrupt payments, and put the country's credit rating at risk.

Debt prioritization would pay foreign bondholders before America's seniors and veterans

The Default Prevention Act places a higher priority on the Treasury paying off government bonds that come due over other types of government obligations. This effectively means that the Treasury would pay foreign holders of Treasury securities like China, the United Kingdom, and Japan before its own bills at home. There would be no distinction between domestic and foreign investors; all would be given first-priority treatment.

Social Security and Medicare payments would be prioritized next in the Default Prevention Act, while veterans' benefits, military pay, and defense would be prioritized second. Any other obligations—like Medicaid, infrastructure, education, and law enforcement funding—would be prioritized third. Foreign holders of Treasury securities would receive their payments before America's seniors, military, veterans, businesses, students, and children.

Paying some government bills before others is still default

If the Treasury did prioritize payments, experts say it would almost certainly pay investors in Treasury securities first to avoid defaulting on its debt obligations. But failing to pay *any* of its obligations would still mean default. Treasury Secretary Janet Yellen has repeatedly called debt prioritization "default by another name." Furthermore, assuming that prioritization is a legitimate option could push the United States closer to default with policymakers lacking urgency and not viewing a debt-limit breach as the impending catastrophe that it is.

The GOP prioritization scheme is not a practical or legal solution

Treasury's payments systems were purposefully designed so that the United States would pay all of its bills when they come due. The Treasury processes millions of payments every day. Changing this structure to allow them to sort through and determine which payments to prioritize would require a complete overhaul of Treasury's systems. Treasury Secretary Janet Yellen said last month that "our systems are built to pay all of our bills on time and not to pick and choose which bills to pay." The Secretary added that the plan "would be an exceptionally risky, untested, and radical departure from normal payment practices of agencies across the federal government."

Setting aside these technical challenges, there are major legal questions about such a scheme with many experts saying this would almost certainly invite a legal challenge. The legal uncertainty would likely lead bond investors to demand higher interest rates and could rattle financial markets. Experts note this could create a TARP-like moment with spiking interest rates, plunging equity prices, and frozen shorter-term funding markets while the government navigates this technical challenge.

Prioritization would hurt the U.S. economy and threaten our credit rating

The credit-rating implications of a debt-prioritization scenario are also unclear. Fitch Ratings noted it could downgrade the nation's credit rating if it failed to pay *all* of its bills, while Standard & Poor's downgraded the nation's credit rating for much less during the 2011 debt-limit crisis. Downgrading the credit rating of Treasury debt would cause interest rates and the cost of federal borrowing to rise and would have cascading credit implications for other entities. Moody's Analytics—a non-partisan analytical group distinct from the credit-rating agency—projects that even a short episode of debt prioritization (without a credit downgrade) would cause a decline in real GDP of nearly 0.5 percentage points (over $100 billion dollars), the loss of 1 million jobs, and the unemployment rate rising to almost 5%.

Difficulty predicting federal revenues would disrupt federal payments for seniors, veterans, and the military

Debt prioritization would jeopardize benefits, pensions, and salaries for seniors, veterans, and military personnel. The GOP proposal prioritizes paying for specific line items in the federal budget but does nothing to ensure the government has enough money to pay those bills at that precise time. Federal revenue varies considerably from month to month, and even day to day, and does not always align with when payments are due.

The Center for American Progress found that if debt prioritization was in effect in 2022, the federal government would have been unable to cover the full costs of interest payments, Social Security, Medicare, veterans' benefits, and defense spending in three out of seven months from June to December—and would have required deep cuts to other programs.

Debt prioritization could disrupt critical funding for federal, state, and local programs

Prioritizing certain payments over others would defund and disrupt critical programs that millions of Americans need and that keep the country operating every day. Proposals to prioritize some federal payments when the United States hits the debt ceiling could disrupt funding for food and nutrition assistance, health insurance premium support, child care funding, Pell grants, housing assistance, small business loans, federal law enforcement, military operations, intelligence gathering, air traffic control, and border security, among other items. The federal government would not have enough tax revenue to pay for all of the commitments Congress has already made over the last many decades and could not borrow to make up the difference after the United States has hit its debt limit.

Debt prioritization would also be disastrous for state governments and public jobs, disrupting federal funding for Medicaid, public education, infrastructure, and local law enforcement. The federal government partners with states to pay for critical services and programs, paying most of the share for vital state health care programs like Medicaid and the Children's Health Insurance Program. Abruptly stopping or slowing federal funding for these programs could push these programs to the brink of bankruptcy as they struggle to pay providers and get critical care to patients. Similarly, disrupting federal funding to states for infrastructure, public education, and local law enforcement could have devastating impacts on local economies and communities.

The table on the next page highlights just a few ways that prioritization could disrupt important government services in every state.

Republicans show their priorities with debt prioritization. Foreign holders of Treasury securities would be paid before America's seniors and veterans, while people who use Social Security, Medicare, and Medicaid would see a disruption in their benefits. Infrastructure, education, and law enforcement for states and localities would also feel the negative impact of a debt prioritization strategy as they would be at the bottom of the Republican's priority list.

Debt Prioritization Could Disrupt Medicaid, Education, and Infrastructure Funding in all 50 States				
State	Federal Medicaid Spending (Millions)	Federal Grants to Local Educational Agencies (ESEA Title I, Part A) (Millions)	Federal Highway Funding (Millions)	Federal Transit Funding (Millions)
Alabama	$5,258	$280	$1,005	$104
Alaska	$1,630	$50	$664	$94
Arizona	$14,275	$370	$969	$498
Arkansas	$5,818	$175	$686	$49
California	$70,965	$2,084	$4,862	$3,948
Colorado	$6,935	$174	$717	$310
Connecticut	$5,998	$155	$665	$282
Delaware	$1,667	$55	$224	$64
District of Columbia	$2,659	$59	$211	$442
Florida	$19,378	$997	$2,510	$609
Georgia	$8,992	$652	$1,711	$332
Hawaii	$1,915	$58	$224	$142
Idaho	$2,288	$60	$379	$57
Illinois	$17,436	$701	$1,884	$1,315
Indiana	$12,979	$274	$1,262	$457
Iowa	$4,319	$111	$651	$96
Kansas	$2,688	$117	$501	$57
Kentucky	$11,909	$274	$880	$90
Louisiana	$10,463	$363	$930	$107
Maine	$2,434	$59	$245	$56
Maryland	$8,672	$291	$796	$490
Massachusetts	$12,286	$265	$805	$785
Michigan	$15,680	$515	$1,395	$238
Minnesota	$9,201	$176	$864	$665
Mississippi	$4,851	$237	$641	$52
Missouri	$8,277	$268	$1,254	$180
Montana	$1,749	$54	$544	$50
Nebraska	$2,020	$70	$383	$38
Nevada	$3,642	$155	$481	$102
New Hampshire	$1,505	$48	$219	$32
New Jersey	$12,279	$418	$1,323	$1,066
New Mexico	$5,744	$136	$487	$96
New York	$45,534	$1,315	$2,224	$3,127
North Carolina	$12,332	$530	$1,382	$222
North Dakota	$943	$46	$329	$30
Ohio	$20,363	$622	$1,776	$406
Oklahoma	$4,169	$212	$840	$88
Oregon	$8,496	$147	$662	$189
Pennsylvania	$23,824	$699	$2,174	$818
Rhode Island	$2,023	$57	$290	$56
South Carolina	$5,393	$288	$887	$80
South Dakota	$694	$54	$374	$26
Tennessee	$8,041	$349	$1,119	$213
Texas	$30,801	$1,786	$5,168	$1,019
Utah	$2,744	$75	$460	$136
Vermont	$1,128	$40	$269	$28
Virginia	$10,403	$302	$1,348	$300
Washington	$11,443	$285	$898	$924
West Virginia	$3,854	$108	$579	$39
Wisconsin	$6,689	$216	$997	$239
Wyoming	$355	$42	$339	$18

Source: Medicaid and CHIP Payment and Access Commission, National Education Association, Federal Highway Administration, Federal Transit Administration

Note: Data are rounded to the millions. Data are from FY 2021 for Medicaid and FY 2022 for Title I education, highways, and transit funding. Funding for highways and transit infrastructure are allocations based on the Infrastructure Investment and Jobs Act.