Written Testimony of
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Introduction

Chairman Baucus, Ranking Member Hatch, and members of the Committee, thank you for inviting me here today to discuss the potential impacts of a failure by Congress to increase the debt ceiling. This is an important moment in American history, and Congress has an important choice to make for the American people. Congress alone has the power to act to make sure that the full faith and credit of the United States is never called into question. No Congress in 224 years of American history has allowed our country to default, and it is my sincere hope that this Congress will not be the first. At the same time, Congress should pass legislation to fund the government and end the standoff.

State of U.S. Economy and Fiscal Position

Since February 2010, private employers have added about 7 and a half million jobs, and over the last year alone they added more than 2 million jobs. Manufacturing is expanding while the housing market continues to improve, posting gains in sales, prices, and residential construction.

At the same time, we have been working with Congress to achieve a sustainable fiscal path. In its most recent estimates, the Congressional Budget Office projected that the 2013 deficit would be less than half the more than 9 percent of GDP deficit the President inherited. The rapid deficit reduction of the past two years is the result of both a stronger economy and the deficit reduction that the President has already signed into law.

Among the risks that we control, the biggest threat to sustained growth in our economy is the recurrence of manufactured crises in Washington and self-inflicted wounds. Unfortunately, we now face a manufactured political crisis that is beginning to deliver an unnecessary blow to our economy – right at a time when the U.S. economy and the American people have painstakingly fought back from the worst recession since the Great Depression.

Private-sector economists have estimated that a two-week government shutdown could directly reduce real GDP growth in the fourth quarter by about a quarter percentage point at an annual rate. Some have warned that a longer shutdown would reduce economic growth as much as 1½ percentage points. These estimates typically do not include the additional spillovers that seem likely: household and business confidence in the government could fall sharply, and other spending that relies on a functioning federal government could be postponed or cancelled. Why would anyone want to do that to our economy?

In addition to the economic cost of the shutdown, the uncertainty around raising the debt limit is beginning to stress the financial markets. Yields on Treasury bills maturing in the second half of

October and early November have already surpassed the peaks on similarly affected maturities in July 2011. At our auction of four-week Treasury bills on Tuesday, the interest rate nearly tripled relative to the prior week's auction and reached the highest level since Oct 2008. Measures of expected volatility in the stock market have risen to the highest levels of the year.

The only way to avoid further self-inflicted wounds to our economy is for Congress to act. I know from my conversations with a wide range of business leaders representing industries from retail to manufacturing to banking that this is a paramount concern for them. That is why it is important for Congress to reopen the government and raise the debt ceiling, and then to work with the President to address our long-term fiscal challenges in a balanced and thoughtful way.

Potential Economic Impact of Failure to Raise the Debt Limit

The Treasury Department recently released a report examining the potential macroeconomic effects of political brinksmanship in 2011, and the potential risks of waiting until the last possible moment to increase the debt limit in the current economic environment. It points to the potentially catastrophic impacts of default, including credit market disruptions, a significant loss in the value of the dollar, markedly elevated U.S. interest rates, negative spillover effects to the global economy, and real risk of a financial crisis and recession that could echo the events of 2008 or worse.

If interest rates rose, it would have a real impact on American households. The stock market, including investments in retirement accounts, could tumble, and it could become more expensive for Americans to buy a car, own a home, and open a small business.

These additional costs of borrowing could not easily be undone and our actions would impact Americans for generations to come.

Failing to raise the debt ceiling will impact everyday Americans beyond its impact on financial markets. For example, doctors receiving reimbursements under Medicare would likely continue to provide services on a timely basis, but they would be operating with significant uncertainty about when they would be paid by the government for their services. For millions of low-income Americans who rely on Medicaid for their healthcare, the federal government's payments to states for the federal contribution would likely also be impacted. These providers still have to pay their doctors, nurses, and staff, but absent timely federal payments, many could face real liquidity challenges. And for those waiting on benefits who need those funds in order to refill their refrigerator – if that money doesn't flow, they won't go to the grocery store to shop, creating ripple effects that would be felt throughout the economy. The bottom line is that failing to raise the debt ceiling creates a very difficult and unfair situation, and one that is completely avoidable if Congress acts.

It is also important to note that the federal government has numerous large payments that are due shortly after October 17, when we will have exhausted our borrowing authority and will only have cash on hand to meet our obligations. Between October 17 and November 1, we have large payments to Medicare providers, Social Security beneficiaries, and veterans, as well as salaries

for active duty members of the military. A failure to raise the debt limit could put timely payment of all of these at risk.

We need to look no further than 2011 for evidence of what just an extended debate on the merits of raising the debt limit can do to our economy. In 2011, U.S. government debt was downgraded for the first time in history, the stock market fell, measures of volatility jumped, and credit risk spreads widened noticeably; these financial market effects persisted for months. To be sure, other forces both at home and abroad also played a role, but the uncertainty surrounding whether or not the U.S. government would pay its bills had a lasting impact on both markets and the economy.

History of Bipartisan Support for Increasing the Debt Limit

Republican and Democratic Presidents and Treasury Secretaries alike have universally understood the importance of protecting one of our most precious assets – the full faith and credit of the United States. President Reagan wrote to Congress in 1983: "This country now possesses the strongest credit in the world. The full consequences of a default – or even the serious prospect of default – by the United States are impossible to predict and awesome to contemplate. Denigration of the full faith and credit of the United States would have substantial effects on the domestic financial markets and on the value of the dollar in exchange markets."

Employers across the country also understand the importance of what is at stake if we default on our debts for the first time in American history. Last week, 251 business organizations, including the Chamber of Commerce, National Association of Manufacturers, and National Retail Federation wrote in a letter to Congress: "We urge Congress to act promptly to pass a Continuing Resolution to fund the government and to raise the debt ceiling, and then to return to work on these other vital issues."

No credible economist or business leader thinks that defaulting is good for job creation or economic growth. Henry Paulson, Treasury Secretary under President George W. Bush, said last month, "it is unthinkable that Congress wouldn't live up to our commitment to make good on past spending commitments and obligations." Chairman of the Federal Reserve Ben Bernanke said recently, "a failure to raise the debt limit could have very serious consequences for the financial markets and for the economy." And Warren Buffett said last week that "it makes absolutely no sense" for some in Congress to use the debt ceiling as leverage, saying "it ought to be banned as a weapon . . . . It should be like nuclear bombs, basically too horrible to use." They understand that Congress choosing not to pay the government's bills is unacceptable and could do irrevocable harm to our economy.

If Congress fails to meet its responsibility, it could be deeply damaging to the financial markets, the ongoing economic recovery, and the jobs and savings of millions of Americans. I have a responsibility to be transparent with the American people about these risks. And I think it would be a grave mistake to discount or dismiss them. For these reasons, I have repeatedly urged Congress to take action immediately so we can honor all of the country's past commitments.

James Baker, Treasury Secretary under President Reagan, made this point to Congress in 1987, saying, "Running out of cash means that the United States would default on its obligations both domestic and foreign, with all the negative financial, legal and moral consequences that implies. Our Founding Fathers regarded the full faith and credit of the United States as a sacred trust, and for over 200 years the United States has upheld this fiduciary duty. The United States has never defaulted on its debt obligations. To do so would be unthinkable and irresponsible. We would seriously erode this country's premier credit position and break faith with our citizens."

Treasury's Communication with Congress

Earlier this year, Congress enacted the No Budget No Pay Act that increased the debt ceiling through May 18. Upon reaching that date, Treasury began using what are called extraordinary measures to avoid defaulting on our obligations. The Treasury Department has been open and transparent, regularly updating Congress over the course of the last five months as new information has become available about when we would exhaust our extraordinary measures. In addition, Treasury has provided information about what our cash balances will be when we exhaust our extraordinary measures. As our forecasts have changed, I have consistently updated Congress in order to give Congress the best information about the urgency with which they should act. And last month, I met with the full membership of this committee to discuss these issues.

On August 26, I notified Congress that these extraordinary measures would be exhausted by the middle of October, and that I anticipated a cash balance of roughly $50 billion at the point of exhaustion. On September 25, I wrote to Congress again to notify that, due to lower-than-expected quarterly revenue collections and changes in the size and timing of certain large trust fund transactions, we then projected that extraordinary measures would be exhausted no later than October 17, and that our remaining cash balance would be closer to $30 billion. Most recently, just last week, I sent a letter to Congress that said, as of October 1, Treasury has begun using the final extraordinary measures. There are no other legal and prudent options to extend the nation's borrowing authority and provide Congress with more time to act.

Treasury continues to believe that extraordinary measures will be exhausted no later than October 17, 2013, at which point the federal government will have run out of borrowing authority. At that point we will be left to meet our country's commitments with only the cash on hand and any incoming revenues, placing our economy in a dangerous position. We will continue to monitor the impact of the protracted government shutdown on revenues and expenditures. If we have insufficient cash on hand, it would be impossible for the United States of America to meet all of its obligations – including Social Security and Medicare benefits, payments to our military and veterans, and contracts with private suppliers – for the first time in our history. At the same time, we are relying on investors from all over the world to continue to hold U.S. bonds. Every week, we roll-over approximately $100 billion in U.S. bills. If U.S. bond holders decided that they wanted to be repaid rather than continuing to roll-over their Treasury investments, we could unexpectedly dissipate our entire cash balance.

Let me be clear. Trying to time a debt limit increase to the last minute could be very dangerous. If Congress does not act and the U.S. suddenly cannot pay its bills, the repercussions would be serious.

Irresponsible Arguments Against Raising the Debt Limit

Raising the debt limit is Congress's responsibility because Congress, and Congress alone, is empowered to set the maximum amount the government can borrow to meet its financial obligations.

Some in Congress have suggested that raising the debt limit should be paired with accompanying spending cuts and reforms. I have repeatedly noted that the debt limit has nothing to do with new spending. It has to do with spending that Congress has already approved and bills that have already been incurred. Failing to raise the debt limit would not make these bills disappear. The President remains willing to negotiate over the future direction of fiscal policy, but he will not negotiate over whether the United States should pay its bills.

Certain members of the House and Senate believe that it is possible to protect our economy by simply paying only the interest on our debts, while stopping or delaying payments on a number of our other legal commitments. The United States should not be put in a position of making such perilous choices for our economy and our citizens. There is no way of knowing the irrevocable damage such an approach would have on our economy and financial markets.

As administrations of both political parties have previously determined, these "prioritization" proposals do not solve the problem. They represent an irresponsible retreat from a core American value: since 1789, regardless of party, Presidents and Congress have always honored all of our commitments. We cannot afford for Congress to gamble with the full faith and credit of the United States of America. At the same time, we should never be put in a position where we have to pick which commitments our nation should meet. How can the United States choose whether to send Social Security checks to seniors or pay benefits to our veterans? How can the United States choose whether to provide children with food assistance or meet our obligations to Medicare providers?

Rational decisions require assessing abstract risks – the alternative is trial and error. We are seeing with the government shutdown how those that denied there would be any impact are struggling every day to address real consequences with patches. This does not work. They need to open the government.

It is irresponsible and reckless to insist that we experience a forced default to learn how bad it is. If anything at all is learned from the shutdown, it will convince the deniers – or a majority who can work their will – to avoid putting the entire economy at risk in the name of an ideological fight.

There is a suggestion by some in Congress that the debt limit has traditionally been used as a tool to address budgetary and fiscal issues. This is not historically accurate. Since World War II, Congress has routinely raised the debt limit through standalone legislation signed by both

Democratic and Republican Presidents. Since President Reagan was inaugurated in 1981, Congress has enacted 45 different pieces of legislation to raise, extend, or revise the definition of the debt limit.

According to the Center on Budget and Policy Priorities, between 1981 and 2011, policymakers enacted nine bipartisan deficit reduction packages. Only three of those legislative packages also included debt limit increases:

- The Gramm-Rudman-Hollings budget compromises in 1985 and 1986;
- The Budget Enforcement Act in 1990; and
- The Balanced Budget Act in 1997.

In each of these three instances, the debate was driven by fiscal policy and how to achieve deficit reduction in a responsible, balanced manner. Neither political party thought that defaulting on our debt was a serious, credible option. In 1985, the need to raise the debt limit served as a deadline for budget negotiations. In 1990, Congress and the President worked together to avoid across-the-board cuts from the original Gramm-Rudman sequestration, which were universally viewed as the wrong way to reduce the deficit. In 1997, Congress added a debt limit increase at the end of negotiations, after the parties agreed on a deal to reduce the deficit responsibly and grow the economy. I participated personally in many of these negotiations, and I do not recall anyone ever seriously suggesting that the United States should fail to pay its bills.

The summer of 2011 was different. Certain Members of Congress argued that default was an acceptable outcome if they were unable to achieve their legislative objectives. Rather than enter into a good-faith compromise on fiscal issues, these Members argued that the United States should voluntarily fail to pay its bills if their position was not accepted. Our economy paid a significant price for these irresponsible and protracted threats. The full faith and credit of the United States is not a bargaining chip. It is reckless and irresponsible to put our full faith and credit at risk.

The President has been and is willing to negotiate over the future direction of long-term fiscal policy. He has repeatedly proposed a comprehensive and balanced package of deficit reduction proposals. And that is why he proposed a budget that reflects the difficult choices he believes we need to make as a country. Within that budget, the President included entitlement reforms, unpopular with many Democrats, and tax reform that would spur economic growth and cut our deficit. And he has made it absolutely clear that he is ready to sit down with Republicans and Democrats to find common ground. The House and Senate have each passed their own budgets, and on 18 separate occasions the Senate Budget Committee Chair has requested that a conference committee be convened so both sides can negotiate and iron out their differences. But Republicans have refused each of those requests. And so instead of negotiating a budget deal over the last 6 months, as Democrats have requested, we now find ourselves on the precipice with some Republicans once again threatening default.

Conclusion

Leaders have a responsibility to make our economy stronger, not to create manufactured crises that inflict damage. The very last thing we need now is a fight over whether we raise the debt ceiling. Not when we face serious challenges both domestically and internationally that require our full attention. And not when we know the kind of damage a financial and economic crisis can cause.

A great democracy does not lurch from one self-inflicted crisis to another. The time for discussions around the fiscal choices we need to make should not take place after we shut down the government or in the last seconds before a default. The time for these discussions is during the normal budget process. This is a stand that Democratic and Republican Presidents must take to make clear that under no circumstances will the United States fail to pay our bills.

I will close by noting that as we meet today, finance ministers from all over the world are gathered in Washington for the IMF and World Bank annual meetings, and it's worth taking a moment to recognize that our country has special role in global financial markets. The United States is the anchor of the international financial system. It is the world's largest economy with the deepest and most liquid financial markets. When risk rises, the flight to safety and to quality brings investors to U.S. markets. Other countries look to us for how to govern and how to maintain economic vitality. The United States cannot take this hard-earned reputation for granted. We have spent 224 years building the nation's credit as the strongest in the world, and only Congress can act to protect it. A default for the first time in our history could pose serious risks to our global standing.

The simple truth is Congress must get this done. The time to do it is now before any more damage is done to the U.S. economy.