Center for American Progress Action Fund

Testimony before
the Congressional Democratic Policy and Steering Committee
on "The Risks of Debt Default on the Economy and Jobs"

Heather Boushey,
Senior Economist, Center for American Progress Action Fund
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Thank you for inviting me here to testify today on the implications for jobs and the economy of not raising the debt ceiling. My name is Heather Boushey and I'm a Senior Economist with the Center for American Progress Action Fund.

This is a critical issue and one, as Professor Blinder has said, that should not be controversial. It's absolutely necessary to raise the debt limit and it should be done immediately. But in many ways, this conversation is not about the pros and cons of forsaking the full faith and credit of the United States. It's about pivoting from job-creation policies to deficit reduction and potentially sharp cuts in spending.

The government debt has been rising. It was high before the Great Recession, as tax cuts for the wealthy and two unfunded wars drained America's coffers. We spent too much and took in too little in taxes during the good economic years when we should have been shoring up our budget situation.[1]

Now, however, we face an even more daunting economic problem: sustained high unemployment. We will not be able to solve our nation's budget woes until we get people back to work. Sustained high unemployment has caused revenues to fall sharply over the past two years, even as expenditures have become more necessary.

Just like families cannot solve their household budget woes while a breadwinner is unemployed, our nation cannot solve its problems with sustained high unemployment. With nearly one in ten out of work and the federal funds rate already hovering at zero for years now, austerity will not only exacerbate unemployment but will likely worsen the budget situation.

Allowing the economy to slam into the debt ceiling will undoubtedly create an immediate economic shock that will in all likelihood have significant consequences for our economy and will certainly exacerbate unemployment. But passing a debt ceiling increase alongside sharp spending cuts at this point in the fragile economic recovery will also harm our economy, both now and in the years to come. Neither of these two options will help the unemployment situation.

To maintain the full faith and credit of the United States, we must follow up on our commitments to pay for the expenditures that Congress has already approved. The United States has never failed to pay its creditors and there is no good reason to fail to pay now.

Congress places a limit on how much the U.S. government can borrow. In some ways, this is nonsensical: Congress has already approved spending through the regular appropriations process. Even so, the debt limit forces Congress to vote a second time to approve to borrow the funds necessary for already-approved spending.

In April the White House proposed a "clean" vote on the debt limit, asking Congress to increase the debt ceiling without any additional conditions. A clean vote is exactly what has happened six times in the past 10 years.[2] Since 1962 Congress has increased the debt limit 74 times and during President George W. Bush's tenure, the national debt increased by nearly 75 percent, from $6 trillion to a total of about $10.6 trillion.[3]

If the debt ceiling is not lifted, the government will need to immediately reduce spending by 40 percent, which will lead to higher unemployment.[4] Currently, the government borrows about $125 billion a month to finance expenditures, which is equal to 2.3 percent of gross domestic product, or GDP. If the government is forced to limit spending to what it takes in in revenues, the resulting deterioration of economic conditions could very well be deeper than the worst quarter of the Great Recession: Between the third and fourth quarter of 2008, the economy contracted by 2 percent and shed nearly 2 million jobs.[5]

If the debt ceiling is hit, spending reductions could take a variety of forms, from withholding Social Security checks to furloughing massive numbers of federal workers to not paying government contractors in Iraq and Afghanistan. It's almost shutting down the government.

Reaching the debt ceiling will, in all likelihood, trigger a sharp fall in the stock market, which also will likely reduce employment. The drop in stock prices will have an immediate effect on the economy, but also on families. Families with 401(k)s would likely lose all the gains they have made in 2010 and much of their gains in 2009, moving them further below where they were at the end of 2007 after the stock market fell sharply.[6] This is magnified by the fact that the very first of the baby boom generation—the largest generation thus far in U.S. history, and the first generation where a majority (near 60 percent) will retire with 401(k)s rather than pensions—is now retiring.[7]

Both immediately and down the road, bondholders will likely require higher interest rates on U.S. Treasuries. This in and of itself will increase the deficit as the interest the federal government pays on its debts will rise as old debt is turned over into new bonds. Third Way estimates that "bond rate increases alone would eliminate nearly 650,000 jobs in the United States."[8]

Even if the United States only defaults for a few days or weeks, the long-term effect could be significant. When the United States had a short-lived default in 1979 due to a technical glitch with word-processing equipment and the slowness with which Congress acted on a debt ceiling vote, bond yields spiked 60 basis points and remained elevated.[9] Defaulting now will also most likely impede our future ability to borrow as Treasury bills will no longer be seen as "safe as houses."

Lower-income families would quickly see their debt payments go up in the wake of higher interest rates. Lower-income families are more likely to owe adjustable interest rate debt, such as credit cards, installment loans, and adjustable rate mortgages. If the Treasury rates immediately go up by 0.5 percentage points, the household debt service burden for the average U.S. family would also increase by at least 0.5 percentage points, an amount that is larger than the increase in the amount spent on gasoline for that same family from the fourth quarter of 2010 to the first quarter of 2011.[10]

The U.S. housing market would most likely experience a severe double-dip contraction marked by much-lower home sales and depressed house prices. Mortgage interest rates typically rise more than U.S. Treasury rates. A debt default would likely cause an increase in the 10-year Treasury rate by half a percentage point, which could translate into a jump in the mortgage rate equal to 0.66 percentage points, the highest levels since 2008.[11] This will further depress the housing market.

Clearly, raising the debt ceiling should be done and should be done now. Failure to do so will harm our economy, increase unemployment, and likely push us back into recession. The fundamental problem facing the U.S. economy is not the debt ceiling but rather the nearly 14 million workers who remain unemployed.

The United States has had an unemployment rate above 9 percent for 23 months since the recession began, more months than at any time since the Great Depression.[12] This poses enormous challenges for our economy and sharply cutting federal spending now, before unemployment has fallen back down, will make it that much harder to pull ourselves out of the jobs gap left by the Great Recession and do irreparable damage to the well-being of millions of families.

Our nation's young workers continue to see excruciatingly high unemployment, even as budgets for education are being cut. Our nation's many unemployed older workers are seeing dimming chances of ever working again at their pre-recession employment or earnings levels.[13]

I was in Louisville, KY, last weekend, and when my mother in-law heard I was testifying this week, she told me of her many friends—many with college degrees—who were out of work or employed at $7.25 an hour, but who could not afford to retire as we walked through her neighborhood where she pointed out the homes that had been on the market for years. This is what's going on in communities all across America. Certainly, she and her friends are concerned about the nation's debt, but they are more worried about their ability to find jobs, keep their homes, and support their families.

The economic disaster before us is the millions who are languishing in un- and underemployment while Congress considers austerity packages that will only make the situation worse. Our economy cannot thrive until unemployment is brought back down.

The reality is that we have the tools to solve the unemployment, and eventually the debt and deficit problems, but holding the economy hostage to the debt ceiling is only making the situation worse.

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1 Michael Ettlinger and Michael Linden, "Who's to Blame for the Deficit Numbers?" (Washington: Center for American Progress, 2009), available at http://www.americanprogress.org/issues/2009/08/pdf/deficit_blame.pdf.
2 Justin Murray, "Votes on Measures to Adjust the Statutory Debt Limit, 1978 to Present" (Washington: Congressional Research Service, 2011), available at http://www.fas.org/sgp/crs/misc/R41814.pdf.
3 Ibid.
4 Michael Ettlinger and Michael Linden, "Frozen Federal Debt Could Do Serious Damage to the Recovery" (Washington: Center for American Progress, 2011), available at http://www.americanprogress.org/issues/2011/06/frozen_debt.html.
5 Ibid.
6 Christian Weller. "The Federal Debt Ceiling and Your Finances" (Washington: Center for American Progress, 2011), available at http://www.americanprogress.org/issues/2011/05/debt_ceiling.html.

[7] Jesse Bricker and others, "Surveying the Aftermath of the Storm: Changes in Family Finances from 2007 to 2009" (Washington: The Federal Reserve Board, 2011), available at http://www.federalreserve.gov/pubs/feds/2011/201117/201117pap.pdf.
[8] Ibid.
[9] Terry Zivney and Richard Marcus, "The Day the United States Defaulted on Treasury Bills," *The Financial Review* 24 (3) (1989): 475–489.
[10] Weller, "The Federal Debt Ceiling and Your Finances."
[11] Ibid.
[12] "Table A-1. Employment status of the civilian population by sex and age," available at http://bls.gov/webapps/legacy/cpsatab1.htm.
[13] Unpublished data from the Center for Economic and Policy Research analysis of the Current Population Displaced Worker Survey found that in January 2010, among displaced workers between ages 55 and 64, nearly two-thirds of women (62.8 percent) and men (62.3 percent) were not working at all. By contrast, among workers aged 35 to 44, half of men (50.3 percent) and nearly 6 in 10 women (57 percent) were working.