THE DEBT LIMIT

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

JANUARY 22, 2013

Serial No. 113–FC01

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PUBLISHING OFFICE
21–129 WASHINGTON : 2017

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
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THE DEBT LIMIT

TUESDAY, JANUARY 22, 2013

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The Committee met, pursuant to call, at 1:34 p.m., in Room 1100, Longworth House Office Building, Hon. Sam Johnson presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
Tuesday, January 15, 2013
No. FC–01

CONTACT: (202) 225–3625

Camp Announces Hearing on the Debt Limit

House Ways and Means Committee Chairman Dave Camp (R–MI) today announced that the Committee will hold a hearing on the statutory debt limit. **The hearing will take place on Tuesday, January 22, 2013, in Room 1100 of the Longworth House Office Building, beginning at 1:30 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The U.S. Constitution grants Congress the authority to fund government, including the power to "lay and collect taxes," and to "borrow [m]oney on the credit of the United States." Congress provided the President with a limited delegation of borrowing authority in 1917, and created the first statutory aggregate debt limit in 1939 to pay obligations authorized by Congress.

As of December 2012, the public debt is currently at the statutory limit of $16.4 trillion, and the U.S. Department of the Treasury (Treasury) is currently operating under "extraordinary measures" that give it additional, but limited, means to manage funds. According to Treasury, it is expected that the government's ability to meet its current obligations will be exhausted between mid-February and early March of this year.

In announcing the hearing, Chairman Camp said, **"The Congress created the debt limit as a check on the delegated borrowing power of the President and it is critical that all parties understand the implications of increasing the debt limit. This hearing will examine the role and purpose of the debt limit, review past practices regarding its increase, and explore solutions that ensure responsible management of the government's finances."**

FOCUS OF THE HEARING:

This hearing will examine the history of the debt limit, how past Congresses and Presidents have negotiated and raised the limit, and whether the Constitution provides options to the Executive Branch when the debt limit is reached.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "Hearings." Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Tuesday, February 12, 2013**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–3625 or (202) 225–2610.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TDD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://www.waysandmeans.house.gov/*.

Mr. JOHNSON OF TEXAS. We are expecting votes, so we are going to go ahead and get started. The Chairman is on his way. He will be landing in a couple of minutes. But we are going to get started.

Good afternoon. Welcome to today's hearing on the debt limit. The Chairman has been delayed, but given the votes this afternoon, he asked we go ahead and start the hearing so Members may have as much time as possible with our distinguished witnesses.

Before hearing from our witnesses, I will read Chairman Camp's prepared opening statement and then turn it over to Mr. Levin for his usual opening statement.

Good afternoon. Thank you for joining us today, all of you.

The topic of today's hearing is the debt limit, which has increased higher and faster under President Obama than any President in our Nation's history. Since the President first took office in 2009, there have been four increases in the statutory debt limit, totaling more than $5 trillion, a 55 percent increase.

As of December 31, 2012, our Nation reached the current debt limit of nearly $16.4 trillion, and the Treasury Department has been using extraordinary measures to avoid exceeding the debt limit. According to a letter from Secretary Geithner, those measures will be exhausted between mid-February and early March.

In the simplest of terms, the debt limit helps hold Washington accountable to hardworking taxpayers, who ultimately foot the bill for Washington's spending habits. Without a limit, Washington would be free to borrow as much as it wanted without even a review of the bills we have racked up and those that are still coming due.

Now, as I have said many times before, no one party is solely to blame. During 8 years of the previous Bush Presidency, deficits increased by $2.4 trillion. President Obama ran up twice that much during just his first term.

The debt is not just some number; it has a direct impact on American families. During the President's fiscal commission, we heard nonpartisan testimony that stated when the debt is this large in comparison to the economy, it costs the country the equivalent of about 1 million jobs. Think about that. If Washington got its debt and spending under control, 1 million more Americans would be working today.

As if that wasn't sobering enough, the staggering size of our debt and lack of a plan to deal with it also threaten to drive interest rates up. The Fitch Ratings agency recently warned that the failure to make progress on our structural debt would likely still result in a downgrade of the U.S. credit rating. A lower credit rating is sure to mean higher interest rates, which means families will face higher credit card payments, higher car payments, higher student loan payments, and certainly higher mortgage payments.

In 2006, when speaking in opposition to increasing the debt limit, then-Senator Obama said, "The fact that we are here today to debate raising America's debt limit is a sign of leadership failure." Those comments hold true today. That is why it is disappointing that the President has declined to engage in a meaningful dialogue to identify a responsible, balanced approach to reducing spending and, by extension, reducing the deficit, which the President promised to cut in half during his first term.

Of course, it is tough to cut the deficit when the Senate, which is controlled by the President's own party, will not or cannot even produce a budget. It has been 4 years since the Democrat-controlled Senate has passed a budget. That is a disgrace.

I fully expect Republicans and Democrats will disagree about what the budget should look like. Even when one party has a majority in both the Senate and the House, the two bodies often disagree. Disagreeing isn't the problem; the failure to resolve those differences is the problem. And how can we even start to find common ground if Senate Democrats won't tell us where they stand?

In the first place, having the House and Senate pass a budget is the first step toward getting our finances back in shape.

I want to thank the witnesses for agreeing to testify today and sharing your expertise on the debt, the debt limit, and what it means for the country. I thank you for your being here.

And I would also like to welcome and thank our witnesses for appearing before us. Before we hear from them, I recognize now the Ranking Member, Mr. Levin, for his opening statement.

Mr. LEVIN. Thank you.

Welcome to all four of you.

Today's hearing appears to have been originally designed to give the veneer of credibility to the notion that it might be appropriate, thinkable, or manageable to default on our debt. It is none of these. The debt ceiling is about paying the bills of the United States of America, for spending that this institution authorized. Manipulating it today, next week, or in 3 or 4 months damages our economy and our credibility.

In the summer of 2011—and I urge we all try to remember it—Republicans in this Congress pushed our Nation toward default. There were clear consequences—clear consequences. Today, they are prolonging another debt-ceiling showdown instead of a long-term extension. This continues and increases the economic uncertainty.

Our Nation's economic wounds from 18 months ago are simply too fresh to ignore. August 2011 was the single worst month for job creation in the last 3 years. The Dow Jones plunged 2,000 points in July and August of 2011, including one of its worst single-day drops in history, tumbling 635 points on August 8th. The Treasury was forced to spend $1.3 billion more in interest payments, according to GAO. The Bipartisan Policy Center estimates that the higher costs will be almost $19 billion over the next decade.

And, of course, who could forget that the U.S. credit rating was downgraded for the first time in our history? One Standard & Poor's senior director said shortly after the credit agency downgraded the U.S. credit rating that the stability and effectiveness of American political institutions were undermined by the fact, and I quote, "that people in the political arena were even talking about a potential default."

The *Washington Post* unequivocally stated in a story this week that, and I quote, "In 2011, the debt-ceiling dispute traumatized the economy." A senior principal economist with IHS Global Insight was one of the many economists who have warned against a repeat. He wrote in a report last week, and again I quote, "If the political bickering over the debt-ceiling issue reaches a fever pitch, as it did in the summer of 2011, then consumer confidence will nose-dive further into recession territory."

We are hearing today that instead of quickly enacting a clean increase to the debt ceiling, there may be some other options. Some of the witnesses seem to suggest that it might be possible to instruct Treasury to pay bondholders while delaying payments to others. Whose bills should be delayed or cut? The Social Security checks of 56 million seniors and people with disabilities? The salaries of more than 2 million American personnel, many of whom are currently in harm's way?

The idea is so troubling that it drew a strong rebuke from The Post Fact Checker last week. And he said, I quote, "By available evidence, it appears all but impossible for the Treasury Department to pick and choose among payments." It is reported, as I read, that our Chairman, Chairman Camp, also cautioned his colleagues last week that such an approach is unworkable.

I also urge—and I went back and checked it—that it embellishes history to imply that threatening to default has historically been used as leverage for deficit reduction, such as with Gramm-Rudman, which I voted for. In the House in both cases, the debt-ceiling bill was deemed passed, and the Senate then used it as a vehicle, not as a threat, for deficit-reduction legislation.

Over the past 2 years, we have achieved $2.5 trillion in deficit reduction—I repeat: $2.5 trillion in deficit reduction—and set an important precedent for future further balanced deficit reduction that includes both spending cuts and new revenue. And I close firmly urging we should proceed with this effort, focusing further on economic growth and jobs, not damaging this effort by attempting to use the debt ceiling for political leverage.

Thank you, Mr. Chairman.

Mr. JOHNSON OF TEXAS. Thank you, Mr. Levin.

It is my pleasure to welcome the panel of witnesses before us today. We have four witnesses on today's panel.

We will first hear from Lee Casey, a partner at the law firm of BakerHostetler. Mr. Casey is a former official in the Department of Justice Office of Legal Policy and Office of Legal Counsel.

Second, we will welcome William Hoagland, Senior Vice President of the Bipartisan Policy Center. Mr. Hoagland is also the former Director of Budget and Appropriations for the Senate Majority Leader, Bill Frist, and former Staff Director of the Senate Budget Committee.

Third on the panel is Dr. J.D. Foster, the Norman B. Ture Senior Fellow in the Economics of Fiscal Policy at The Heritage Foundation.

Finally, we will hear from Dr. Simon Johnson, the Ronald A. Kurtz Professor of Entrepreneurship at the Massachusetts Institute of Technology's Sloan School of Management.

I appreciate all of you being here with us today. The Committee has received your written statements. They will be made part of the formal hearing record. Each of you will be recognized for 5 minutes for your oral remarks.

Mr. Casey, we will begin with you. You are recognized for 5 minutes.

STATEMENT OF LEE A. CASEY, PARTNER, BAKERHOSTETLER, WASHINGTON, DC

Mr. CASEY. Thank you, Mr. Chairman and Members of the Committee. It is an honor and a privilege to appear here today to discuss the critical issue of the Federal debt ceiling.

Although there are many important policy questions raised by the current debate over the debt ceiling, I would like to address the more fundamental constitutional questions of whether there must be a congressionally mandated limit to Federal borrowing and the extent to which the President may ignore these restraints or simply raise that limit and borrow money on his own authority.

I believe that the answer is clear: Under the Constitution, Congress alone has the power to decide how, when, and why Federal spending should take place, and the extent to which that spending may be supported by taxation and/or borrowing.

The debt limit is, of course, a statutory device that dates to the First World War. Although the debt limit in its current form is not constitutionally mandated, some type of congressionally controlled limit on executive branch borrowing is required and, whatever precise form that limitation takes, it is constitutionally protected. The President can neither ignore nor alter the debt limit without fundamentally subverting the Constitution's separation of powers and violating his oath of office.

There are two principal mechanisms by which the Federal Government may obtain resources in order to operate: through taxation and through borrowing. The Constitution makes both of these mechanisms the peculiar province of the legislative branch. Congress alone is granted the authority to lay and collect taxes, to pay Federal debts, and to borrow money on the credit of the United States. The executive branch then carries out these functions; that is, its role is to execute what Congress has enacted in these areas. The President has no independent authority to raise taxes or to borrow on the Nation's credit.

This was, of course, the purpose and intent of the Constitution's Framers. In a basic division of governmental power, they gave Congress the power of the purse, a grant they viewed as especially empowering the House of Representatives, where all revenue bills must originate.

Moreover, as James Madison explained in the Federalist No. 58, the Framers fully anticipated and intended that congressional power over Federal taxation, borrowing, and spending would be used as a political weapon. I quote, "This power over the purse may, in fact, be regarded as the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people, for obtaining a redress of every grievance, and for carrying into effect every just and salutary measure."

It follows, of course, that the President cannot raise the debt ceiling on his own authority and is bound to respect this limitation on Federal spending, even if this requires him to make difficult decisions and take actions he would not otherwise support. Claims that section 4 of the 14th Amendment grants the President such power are mistaken. Section 4 forbids repudiation of Federal debts lawfully incurred. Permitting the President to raise the debt ceiling on his own authority under section 4 would upset the Constitution's basic separation of powers. And it is also plainly inconsistent with the 14th Amendment's language that, I quote, "The Congress shall have power to enforce, by appropriate legislation, the provisions of this article."

It is also important to understand that the public debt guaranteed by section 4 does not include ordinary Federal spending programs but extends only to debt instruments issued in exchange for money on the credit of the United States.

Thus, as a constitutional matter, Congress has the authority and obligation to regulate Federal borrowing. It can exercise this power in a number of different ways, including by voting on individual debt issues as was the case before the First World War, or by establishing an overall limit on the amount of debt the Federal Government may incur without further congressional action.

The President is bound by such limits. He can neither ignore the debt ceiling, nor can he raise it on his own authority.

And I would be pleased to answer any questions the Committee may have. And thank you.

[The prepared statement of Mr. Casey follows:]

Written Statement of
Lee A. Casey
Hearing on the Statutory Debt Ceiling
Before the Committee on Ways and Means
House of Representatives

January 22, 2013

Thank you, Mr. Chairman and Members of the Committee.

It is an honor and privilege to appear here today to discuss the critical issue of the federal debt ceiling. At the outset I must emphasize that I am speaking on my own behalf, and not on behalf of my Firm or any of its clients.

There are really two questions before the Committee today, one of policy and one constitutional. The policy question involves the extent to which the so-called "debt ceiling" is a sensible place to do battle over what everyone must concede is an unsustainable level of federal spending. The second question involves the constitutional ramifications of the debt ceiling, whether there must be a congressionally mandated limit to federal borrowing, and the extent to which the President may ignore these restraints or simply raise that limit and borrow money on his own authority.

It is this second question I will address and I believe that the answer is clear: under the Constitution, Congress alone has the power to decide how, when and why federal spending should take place, and the extent to which that spending may be supported by taxation and/or borrowing.

The debt limit or ceiling is, of course, a statutory device that dates to the First World War. Before that time, Congress customarily voted on individual borrowing measures. In 1917, the Liberty Bond Acts were passed to help fund America's war effort. Although these measures continued limits for individual debt issues, the Second Liberty Bond Act of 1917 became the basis for the modern debt limit ceiling now codified at 31 U.S.C. § 3101.[1] Although the debt limit *in its current form* is not constitutionally mandated, some type of congressionally controlled limit on Executive Branch borrowing is required and, whatever precise form that limitation takes, it is constitutionally protected. The President can neither ignore nor alter the debt limit without fundamentally subverting the Constitution's separation of powers and violating his own oath of office.

There are two principal mechanisms by which the federal government may obtain the resources it needs to operate – through taxation and through borrowing. Both of these mechanisms are the peculiar province of the legislative branch.[2] Under Article I, section 8 of the Constitution, Congress alone is granted the

[1] *See generally*, D. Andrew Austin & Mindy R. Levit*, The Debt Limit: History and Recent Increases* 7-8 (Cong. Res. Serv. Dec. 27, 2012).

[2] A third mechanism for raising revenue, sales of federal assets, is also subject to congressional control. *See* U.S. Const., art. IV, § 3, cl. 2 ("The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States.").

authority to lay and collect taxes, to pay federal debts, and "[t]o borrow Money on the credit of the United States." The Executive Branch then carries out these functions – that is, its role is to execute what Congress has enacted in these areas. The President has no independent authority to raise taxes or to borrow on the Nation's credit.

This was, of course, the purpose and intent of the Constitution's Framers. In a basic division of governmental power, they granted the President the sword (as Commander-in-Chief), the Courts judgment (in actual cases and controversies), and Congress the power of the purse. Vesting the legislature with this power was, of course, inherited from the British system and was especially viewed as empowering the House of Representatives, where all revenue bills must originate. *See* U.S. Const., art. I, § 7, cl. 1. Moreover, as James Madison explained in Federalist No. 58, the Framers fully anticipated and intended that congressional power over federal taxation, borrowing and spending would be used as a political weapon:

> The house of representatives cannot only refuse, but they alone can propose, the supplies requisite for the support of government. They, in a word, hold the purse; that powerful instrument by which we behold, in the history of the British Constitution, an infant and humble representation of the people gradually enlarging the sphere of its activity and importance, and finally reducing, as far as it seems to have wished, all the overgrown

> prerogatives of the other branches of the government. *This power over the purse may, in fact, be regarded as the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people, for obtaining a redress of every grievance, and for carrying into effect every just and salutary measure.*

The Federalist No. 58 at 394 (James Madison) (Jacob E. Cooke ed. 1961) (emphasis added).

It follows, of course, that the President cannot "raise the debt ceiling" on his own authority and is bound to respect this limitation on federal spending, even if this requires him to make difficult decisions and take actions he would not otherwise support. Those who have suggested that section 4 of the 14th amendment grants the President such power are mistaken. That provision vests the President with no additional or independent authority.

Section 4 of the 14th Amendment forbids repudiation of federal debts lawfully incurred. It was adopted shortly after the Civil War (ratified July 9, 1868) to ensure that the debts incurred by the federal government fighting that conflict would be honored and those of the Confederate States permanently nullified. Section 4 provides in full that:

> 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. But neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be held illegal and void.

U.S. Const. amend. XIV, §4. A constitutional amendment was necessary to guarantee this result because, once representatives of the southern States returned to Congress, Congress otherwise could have reversed these decisions under the fundamental principle that the simple legislative actions of one Congress do not bind future Congresses.

Whatever the circumstances of section 4's enactment and ratification, its language is not limited to the public debt incurred during the Civil War, and the Supreme Court has suggested a broader application. In *Perry v. United States*, 294 U.S. 330 (1935), one of the actions spawned when Congress abandoned a gold currency in 1934, the Court noted with regard to section 4 that:

> While this provision was undoubtedly inspired by the desire to put beyond question the obligations of the government issued during the Civil War, its language indicates a broader connotation. We regard it as confirmatory of a fundamental principle which applies as well to the government bonds in question, and to others duly authorized by the Congress, as to those issued before the amendment was adopted.

294 U.S. at 354.[3] This provision should, of course, give confidence to those who have loaned money to the United States, through the purchase of various debt instruments, that their investment is safe. Unlike other sovereigns, the United States cannot repudiate or dishonor its debts.[4]

However, claims that this fundamental rule permits the President to raise the debt ceiling on his own authority are specious. Not only would such power upset the Constitution's basic separation of powers – and there is no evidence that the Framers of the 14th amendment had any such purpose – but it is also plainly

[3] Significantly, there is evidence in the amendment's drafting history that this broader effect was specifically intended. *See* Andrew M. Grossman, *Heritage Foundation Legal Memorandum: The Fourteenth Amendment is No Blank Check for Debt Increases* 2 (July 11, 2011) (quoting the statement of Senator Benjamin Wade that "I believe that to do this will give great confidence to capitalists and will be of incalculable pecuniary benefit to the United States, for I have no doubt that every man who has property in the public funds will feel safer when he sees that the national debt is withdrawn from the power of Congress to repudiate it and placed under the guardianship of the Constitution.").

Moreover, in *Perry* eight justices (four among the majority and four in dissent from the Court's decision) found the obligation to honor such debt instruments not merely in the 14th amendment, but inherent in the power to borrow "on the credit of the United States" in the first instance:

> The binding quality of the promise of the United States is of the essence of the credit which is so pledged. Having this power to authorize the issue of definite obligations for the payment of money borrowed, the Congress has not been vested with authority to alter or destroy those obligations.

294 U.S. 353, 372-379.

[4] Under current law, were federal payments on debt stopped or interrupted, injured bondholders would likely be able to obtain relief in the United States Court of Federal Claims. *See* 28 U.S.C. § 1491 (granting United States Court of Federal Claims Jurisdiction over damage claims against the United States founded in the Constitution, statute or contract). *Cf. Hatter v. United States*, 953 F.2d 626 (Fed. Cir. 1992) (Claims Court had jurisdiction over claim by federal judges that their salaries had been reduced in violation of the compensation clause, U.S. Const. Art. III, § 1).

inconsistent with that amendment's language. The 14th amendment, including section 4, gives the President no additional authority. Indeed, section 5 of the 14th amendment specifically vests the power to enforce its requirements *in Congress*: "The Congress shall have power to enforce, by appropriate legislation, the provisions of this article."

The next question, of course, is what is the "public debt" that section 4 renders sacrosanct. The most obvious interpretation is that the public debt consists of debt instruments issued by the United States in exchange for money – the results of Congress' exercising its power under Article I, section 8, to "borrow Money on the credit of the United States." This certainly was the usage adopted by the *Perry* Court, although its actual holding was limited to determining that the plaintiff had not been damaged by the government's refusal to pay in gold or the equivalent amount in currency. *See Perry v. United States*, 294 U.S. at 356-57, 361.

What is clear is that this "public debt" does not include federal spending programs, including "entitlement" programs, simply because the government has in some general sense made a commitment to them. In *Flemming v. Nestor*, 363 U.S. 603 (1960), the Supreme Court ruled that even the Social Security program created no vested right to benefits thereafter immune from legislative change. Indeed, even at that early date the Court recognized that the future vitality of such programs depends on Congress's legal right to make changes in the available benefits: "[t]o engraft upon the Social Security system a concept of 'accrued property rights' would deprive it of the flexibility and boldness in adjustment to ever-changing conditions which it demands." *Id*. at 610.

Thus, as a constitutional matter, Congress has the authority and obligation to regulate federal borrowing. It can exercise this power in a number of different ways, including by voting on individual debt issues as was the case before the First World War, or by establishing an overall limit on the amount of debt the federal government may incur without further congressional action. The President is bound by such limits. He can neither ignore the debt ceiling, nor can he "raise" it on his own authority. Section 4 of the 14th Amendment does not grant the President this power. Although it forbids any repudiation or dishonoring of the existing federal "public debt," it does not require or itself authorize new or additional borrowing.

I would be pleased to answer any questions the Committee may have.

Mr. JOHNSON OF TEXAS. Thank you, Mr. Casey. I appreciate your comments.

Mr. Hoagland, you are recognized for 5 minutes.

STATEMENT OF G. WILLIAM HOAGLAND, SENIOR VICE PRESIDENT, BIPARTISAN POLICY CENTER, WASHINGTON, DC

Mr. HOAGLAND. Thank you, Mr. Chairman, Mr. Levin, and Members of the Committee. It is a privilege for me to be here this afternoon.

Fundamentally, the debt-ceiling discussion emerges from the most basic tenet of our legislative sovereignty, and that, of course, is the power of the purse.

I began my career here on Capitol Hill with the Congressional Budget Office in 1975. Later, as staff on the Senate Budget Committee and in the Senate Majority Leader's office, I witnessed and participated in many budget standoffs. But one of the first and most memorable was the one that the Ranking Member mentioned, the 1985 Gramm-Rudman-Hollings Act. I believe Mr. Levin and Mr. Rangel were the only two who were here at that time in 1985. That legislation came about because of the need to raise the statutory debt limit over $2 trillion for the first time in the country's history.

The debt-limit bill has always been politically sensitive, but as the country's debt has continued to increase, the need to legislate an increase has become more frequent—78 times since 1940—and more difficult. Further, based on the actions that the 112th Congress took at the end of the 112th, I estimate that the debt held by the public will continue to rise, reaching 77 percent of GDP by 2022, and the debt subject to limit will exceed $27 trillion.

My statement addresses two issues: First, what we call the X date, the date at which extraordinary measures will run out and there will be insufficient cash to pay our Nation's bills; and, second, one of the foci of this hearing, what options are available to the Executive when that X date is reached.

On the first question, the cash flows of the past week have largely been, as we have anticipated, with no large fluctuations. And we at the BPC base our estimates of those cash flows on known cash flows and scheduled payments during this time period and on previous years' patterns of payments. And at this point, we are projecting the windows of the X date between February 15th and March 1st, the same as Treasury.

On the second issue, what actions might the Treasury take post-X date, the President and Treasury officials will face two potential scenarios: First, the Treasury could prioritize payments, choosing to pay some and not others. In 1985, the Comptroller General issued a letter to the then-Chairman of the Senate Finance Committee, Bob Packwood, concluding that the Secretary of the Treasury does have the authority to choose the order in which to pay obligations of the United States. I asked the GAO general counsel last week if this opinion has changed and have been told that GAO has not issued an opinion on this question since 1985. It stands.

Now, while prioritization may be legal, the actual implementation of it may not be practical. Treasury must make over 5 million payments on each business day. Treasury's computer systems are set up to confirm and process all payments as they come due. Implementing prioritization would be a dramatic overhaul and extremely difficult. Further, should Congress take to itself the responsibility of setting payment dates, possibly having to overturn the Prompt Payment Act or Title X of the Budget Act dealing with impoundment and other existing laws, one must be realistic as to how long such a legislative debate would last.

The second scenario, should the Treasury deem prioritization to be implausible, the Secretary could instead announce that the government will make payments on daily obligations but in the order in which they come due on a delayed schedule. Assuming, as we do, that the X date is February 15th, the Treasury enters that date with precisely enough cash to fund the $30 billion interest payment due that day, and all other interest payments are prioritized and paid on time.

In this situation, there would be $22 billion of noninterest payments owed on February 15th, which include military pay and unemployment benefits. They would be delayed until February 20th. Similarly, over $30 billion of payments due on February 20th, which include Social Security benefits, would have to be delayed until February 25th. These delays would continue to cascade. Payments due March 1st, which include Social Security benefits, military salaries, and veterans benefits, among others, would be delayed until March 15th, half a month late. The government could face legal challenges under the Prompt Payment Act, not to mention the real impact on individuals and businesses across the country.

Finally, under normal conditions, Treasury issues new debt to the public in order to raise cash to pay off outstanding securities as they mature. However, in a situation where Treasury has begun to delay payments on noninterest obligations, there is a possibility that such auctions would be disrupted. Investors might demand a significant premium on their debt purchases or, in the worst-case scenario, Treasury could find itself with insufficient buyers for an auction.

Were this to occur, it would force Treasury to step in with enough cash to pay off the redeeming bondholders or face a default on the U.S. debt, and it would further delay noninterest obligations—a vicious circle. We expect that there will be over $500 billion of debt that will need to be rolled over from February 15th to March 15th.

In conclusion, Mr. Chairman, the Bipartisan Policy Center strongly believes that the imbalance in our Federal budget ledger does need to be addressed. Risks are risks, and while no one can know for sure what ramifications the largely unprecedented scenario of passing the X date would have, those risks clearly grow day by day and eventually could become catastrophic. These are considerations I know the Members of this Committee will keep in mind as you deliberate this important issue.

Thank you.

[The prepared statement of Mr. Hoagland follows:]

Statutory Debt Ceiling

Hearing

Committee on Ways and Means

U.S. House of Representatives

January 22, 2013

G. William Hoagland

Senior Vice President

Bipartisan Policy Center

Mr. Chairman, Mr. Levin, and members of the Committee – it is an honor for me to testify before your Committee. My name is Bill Hoagland and I am a Senior Vice President at the Bipartisan Policy Center (BPC), established in 2007 by former Senate Majority Leaders Howard Baker, Bob Dole, George Mitchell and Tom Daschle.

Fundamentally, the debt ceiling discussion emerges from the most basic tenet of legislative sovereignty – the power of the purse. Thomas Jefferson wrote James Monroe in April 1791 saying: "We are ruined, Sir, if we do not over-rule the principles that 'the more we owe, the more prosperous we shall be,' 'that a public debt furnishes the means of enterprise…' "[1]

I began my career here on Capitol Hill with the establishment of the Congressional Budget Office in 1975. Later, as staff on the Senate Budget Committee and in the Majority Leader's office, I witnessed and participated in many budget standoffs, but one of the first and most memorable was the one that you Mr. Levin and Mr. Rangel will recall in 1985 – the Gramm-Rudman-Hollings Act. That legislation came about because of the need to raise the statutory debt limit over $2 trillion for the first time.

The debt limit bill has always been politically sensitive. But as the country's debt has continued to increase as a share of our economy, the need to legislate an increase in the debt limit has become more frequent and more difficult. Since 1940, Congress has increased the debt limit 78 times and based on the actions at the end of the 112th Congress, I estimate that the debt held by the public will continue to rise, reaching 77% by 2022. This must be addressed.

As announced by Secretary Tim Geithner, Treasury officially reached the statutory borrowing limit (to be exact, $16,393,975,000,000, or just $25 million under the $16.394 trillion statutory limit) on December 31, 2012. To raise additional funds for paying the nation's obligations, the Secretary has begun to use the approximately $200 billion in available so-called "Extraordinary Measures."

These legal financial maneuvers that are at Treasury's disposal allow it to increase cash on hand and continue paying all of the federal government's obligations. The measures are limited in size, meaning that they will only provide a finite amount of additional capacity to ensure timely payments during the period when Treasury is unable to issue debt as it normally would (since it is up against the limit).

In general, Extraordinary Measures temporarily reduce the debt held by certain restricted government funds, thus enabling the Treasury to issue additional securities to the public (while remaining under the debt limit) and raise cash to pay bills. For example, federal employees invest some of their retirement savings in government bonds. One measure allows Treasury to temporarily disinvest these bonds. After the debt limit is raised, Treasury must reimburse the

[1] Meacham, Jon. *Thomas Jefferson: The Art of Power*. New York: Random House, 2012

retirement fund in full, including both the principal and whatever interest would have been earned.

Several reports by the Government Accountability Office (GAO) and the Congressional Research Service (CRS) provide details on how particular Extraordinary Measures work.[2] This year, there is one fewer measure available to Treasury than there was in 2011, when the debt limit event coincided with maturing debt in a government trust fund that contains pension assets. The measure is unavailable this time around because that trust fund has no debt maturing in this time frame.

Using this information along with the current size of the various funds, BPC estimates that $200 billion are available to help Treasury meet its financial obligations, some of which are already being used.

Absent an increase in the debt limit, a day will come when Treasury runs out of extraordinary measures to stay under the ceiling and further run out of cash to pay our nation's bills. The staff at BPC projects that date – which we call the X Date – would occur sometime between February 15 and March 1. Last week, the U.S. Treasury similarly concluded approximately this time frame.

This testimony will address two issues: first, provide a brief update on the BPC analysis that estimated daily cash flows to determine the X Date and second, look at what will happen when the X date is reached should the U.S. borrowing limit not be increased.

When is the X Date?

On the first question, the cash flows over the past week have been largely as anticipated, with no large fluctuations. We base our estimates of cash flows on known scheduled payment dates during this time period and on previous years' patterns of payments. The BPC staff also reviewed the Internal Revenue Service announcement of the delay in the start date of the tax filing season to January 30. We did not find it would have a significant impact on total tax refunds paid in February. Thus, at this point, our projected window for the X Date remains unchanged.

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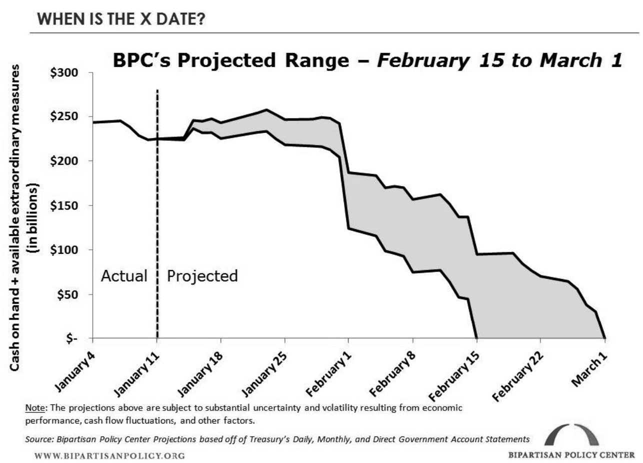
[2] Government Accountability Office. *Analysis of 2011-2012 Actions Taken and Effect of Delayed Increase on Borrowing Costs.*" July 2012. Available at: http://www.gao.gov/assets/600/592832.pdf.
Government Accountability Office. *Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market.* February 2011. Available at: http://www.gao.gov/assets/320/315843.pdf.
Congressional Research Service. *Reaching the Debt Limit: Background and Potential Effects of Government Operations.* May 2012. Available at: http://www.fas.org/sgp/crs/misc/R41633.pdf.



What Actions Might Treasury Take in a Post-X Date Situation?

Once the X Date is reached, the president and Treasury officials will find themselves in largely uncharted waters and be forced to choose a path forward.

Two potential scenarios:

1. Treasury could "prioritize" payments, choosing to pay some and not others until after the nation's borrowing authority is restored. The Comptroller General issued a letter to the then Chairman of the Senate Finance Committee Bob Packwood on October 9, 1985 concluding that the Secretary of the Treasury does have the authority to choose the order in which to pay obligations of the United States. The Comptroller General further stated that the "Treasury is free to liquidate obligations in any order it finds will best serve the interest of the United States." I have asked the GAO staff if this opinion has changed since 1985 and have been told that GAO has not issued an opinion on this question subsequent to the 1985 opinion to Senator Packwood.

   While prioritization may be legal, the actual implementation of it may not be practical. On average, Treasury must make over 5 million payments on <u>each</u> business day in the month following the X Date. Treasury's computer systems are set up to confirm and process all payments as they come due, so implementing prioritization would be a dramatic overhaul, and extremely difficult on short notice. The projections in BPC's report of daily cash inflows and outflows demonstrate the difficult decisions that Treasury would confront, as it would be unable to fulfill all of the country's financial obligations.

Further, from a timing perspective, should Congress – the legislative branch – take to itself the responsibility of the executive branch and attempt to pass legislation to set the order of government payments, overturning the Prompt Payment Act, Title X of the 1974 Budget Act addressing agency impoundment and other existing laws, one must be realistic as to how long such a debate would last.

2. In the event that Treasury deems prioritization to be illegal or implausible, the secretary could instead announce that the government will make all payments for each individual business day (with the likely exception of interest on the public debt, which would be paid on time and in full) once enough revenue has been received to cover that day's bills. In other words, all post-X Date obligations would be paid in the order in which they come due, but on a delayed schedule.

The Treasury Department's Office of Inspector General (OIG) released a report last year in response to Members of Congress who inquired about Treasury's planning during the debt limit event of 2011.[3] Among the OIG's findings was that some Treasury officials determined prioritization to be an unlikely course of action due to the concerns I have raised, and that delay of payments was the most likely outcome because the officials considered it to be feasible and the least harmful among a variety of bad options.

Treasury officials realized that delays would cascade dramatically within a short amount of time due to the nation's large deficit, resulting in significant consequences for individuals and organizations expecting government payments or tax refunds. The result: a further slowdown in the broader economy.

BPC has estimated the consequences of this payment delay scenario under a set of assumptions, including (for illustrative purposes): that the X Date occurs at the beginning of the BPC estimated window (February 15); that Treasury enters the X Date with precisely enough cash on hand to make that day's $30 billion interest payment on the debt; that all interest payments are prioritized and paid on time; and that federal trust fund operations continue as normal.

In this situation, the $22 billion of non-interest payments owed on February 15, which include military pay and unemployment benefits, would be delayed until February 20. Similarly, over

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[3] Thorson, Eric M. Letter to Senator Orrin G. Hatch. 24 Aug. 2012. Department of the Treasury, Washington, DC 20220

$30 billion of payments due on February 20, which include Social Security benefits, would not be made until February 25. Delays would continue to grow – payments due February 22 would be made a week late on March 1. And payments due on March 1, which again include Social Security benefits, as well as payments for all Medicare Advantage and Part D prescription drug benefit plans, military salaries, and veterans' benefits, would be delayed until March 15, half a month late. This process would only cascade the longer a debt limit increase is delayed.

FEDERAL PAYMENTS AFTER THE X DATE

Illustrative Potential Payment Delays
(assuming a Feb 15th X Date)

Payment	Due Date	Delayed Until
Military Active Duty Pay	February 15	February 20
Unemployment Insurance	February 15	February 20
Social Security	February 20	February 25
Defense Vendor Payments	February 22	March 1
Food Stamps	February 25	March 5
Tax Refunds	March 1	March 15
Social Security	March 1	March 15
Veterans Benefits	March 1	March 15
Medicare and Medicaid Payments to Providers and Plans	March 1	March 15

Note: These projections incorporate a set of assumptions, including (for illustrative purposes) that the X Date occurs at the beginning of the BPC estimated window (February 15); that Treasury enters the X Date with precisely enough cash on hand to make that day's $30 billion interest payment on the debt; that all interest payments are prioritized and paid on time; and that federal trust fund operations continue as normal.

Source: Bipartisan Policy Center projections off of Daily Treasury Statements

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Setting aside the fact that the government could face innumerable challenges under the Prompt Payment Act as these cascading payment delays multiply, there would be a real impact on individuals and businesses across the country. Consider a point at which payments are delayed for multiple weeks. Both the first- and second-order effects of such a delay would be very tangible: a senior who depends on Social Security benefits and has no other source of income might be unable to pay rent when due; or a small government contractor may be unable to pay a subcontractor on time. These and many other similar circumstances would all be possibilities under a delayed-payment scenario.

Rolling Over Debt

Under normal conditions, Treasury issues new debt to the public in order to raise cash to pay off outstanding securities as they mature. Many buyers of U.S. government debt routinely roll over their debt at maturity, and Treasury has never been unable to find sufficient purchasers for its auctions.

In a situation where Treasury has begun to default on its obligations, however – meaning a post-X Date environment where certain payments owed by the federal government have not been made – there is a possibility that such auctions would not go smoothly. Investors might demand a significant premium on their debt purchases, or in a worst-case scenario, Treasury could find itself with insufficient buyers for an auction. Were this to occur, it would force Treasury to step in with enough cash to pay off the redeeming bondholders or face a default on the U.S. debt.

The OIG's report found that this was a serious concern among Treasury officials during the summer of 2011, as there was a large auction scheduled to take place in early August of that year. BPC staff has researched the upcoming bond rollovers and finds that there will likely be over $500 billion of debt that will need to be rolled over from February 15 through March 15, 2013. (Very short-term securities that would be due in that period have yet to be issued; therefore, we cannot determine exact total quantities at this point.)

DEBT ROLLOVER AND THE X-DATE

Debt Maturing After February 15

Date	Debt Maturing
February 15	$20 billion
February 21	$60 billion
February 28	$115 billion
March 7	$86 billion
March 14	$60 billion
March 15	$40 billion

Note: Does not include estimates of 4-week maturities that have yet to be auctioned.

Source: TreasuryDirect

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Fitch Warns of Downgrade

Last week, fearing some of the potential impacts and consequences laid out above, Fitch Ratings issued a sharp warning:

"With no legal authorization for net debt issuance, the Treasury would be forced to immediately eliminate the deficit - a fiscal contraction twice as great as the recently avoided 'fiscal cliff' - by delaying payments on commitments as they fall due. It is not assured that the Treasury would or legally could prioritize debt service over its myriad of other obligations, including social security payments, tax rebates and payments to contractors and employees. Arrears on such obligations would not constitute a default event from a sovereign rating perspective but very likely prompt a downgrade even as debt obligations continued to be met."

In addition to threatening a downgrade, Fitch is alluding to the overnight cutback in government spending – and thus, economic activity – that would result from only having enough cash on hand to pay approximately 60 percent of the bills. The impact of this type of pullback for any extended period of time is unknown, but could very well be calamitous.

Conclusion

If the U.S. goes past the X Date without an increase in the debt limit, the country should be prepared for a likely downgrade. This would most likely lead to higher interest rates on our already large borrowing portfolio, and therefore in turn, further add to an already excessive deficit. The goals for our country should be to spur economic growth and control our debt and deficit going forward; I am concerned that a prolonged dispute over the debt limit could, in fact, produce the opposite effect. For example, BPC analysis, based off of GAO modeling, estimates that the debt limit event of 2011 cost the U.S. taxpayer an additional $19 billion over 10 years from the interest rate premium that the federal government was forced to pay on its debt during that period.

We at BPC strongly believe that the imbalance in our federal ledger does need to be addressed. Prolonged negotiation over the debt limit, however, has the potential for substantial downsides to our economy – increased uncertainty, instability in the markets, disruption to individual and families' lives – and our standing in the world as having the currency of choice.

Risks are risks, and while no one can know for sure what ramifications the largely unprecedented scenario of passing the X Date would have, those risks clearly grow by day and eventually could become catastrophic. These are considerations that we hope all policymakers keep in mind as they deliberate these vital issues for the future of our country.

Mr. JOHNSON OF TEXAS. Thank you, sir. I appreciate that.

Dr. Foster, you are recognized for 5 minutes.

STATEMENT OF J.D. FOSTER, PH.D., NORMAN B. TURE SENIOR FELLOW IN THE ECONOMICS OF FISCAL POLICY, THE HERITAGE FOUNDATION, WASHINGTON, DC

Mr. FOSTER. Thank you, Mr. Chairman, Mr. Levin, Members of the Committee. Good afternoon. It is nice to be back.

My name is J.D. Foster. I am the Norman B. Ture Senior Fellow at The Heritage Foundation. The views I express today are my own and should not be construed as the position of The Heritage Foundation.

Mr. Chairman, once again we find ourselves in dire straits. The President's position on the debt ceiling I believe could be summed up simply as: Kick the can, and then we will have a conversation; we will engage in a dialogue. The Senate's position can be summed up simply as: Hoping not to be noticed. And so it falls, as it so often does, on the House to lead.

On the debt ceiling, I believe we face basically three options—two drastic, and one, which is sound. The first drastic one: Congress could simply leave the debt ceiling in place. While perhaps tempting to some, and understandably so, I think we all know this would be unwise and irresponsible, with consequences we can only begin to imagine—consequences that do not include, however, defaulting on the Nation's debt, a suggestion the President frequently makes in awesome irresponsibility.

Second, Congress could raise the debt ceiling by some large amount or repeal it altogether, as the President has suggested, and do nothing else. Raising it substantially and doing nothing else would continue a pattern of reckless, irresponsible fiscal policy with no end in sight and, for this reason, would with certainty also bring terrible consequences. To be sure, the date of onset of these consequences is uncertain, which makes this course so appealing in a political environment often favoring perfect myopia.

The Federal Government's debt trajectory is dangerous—dangerous to our economy, dangerous to our future as a Nation. And surely that, at least, we can all agree on. Fiscally, the rise in the debt means more of the government's resources will be crowded out in the future into paying interest expense, making less resources available for other priorities. Americans generally are willing to pay taxes, but they expect services in return. Servicing the government's debt is not what they have in mind.

Economically, it also means that savings that would otherwise be available for productive investment in the private sector have been captured by the government. Less private saving means a smaller economy and lower wages. Soaring public debt also means that when interest rates begin to rise—and rise they most assuredly will—they are now set to rise much farther and much faster. The consequences of these higher interest rates will be the most terrible of all, for families, for businesses, for the economy. And there will be nothing then that Congress can do to stop them.

What Congress should do is raise the debt ceiling while enacting concrete programmatic spending reforms, especially to entitlements, to reduce the deficit in the short run and especially the long run. There are sound, bipartisan, commonsense, options for restraining entitlement spending while ensuring these programs preserve economic security for the elderly and the poor. Indeed, it is possible through reform to remedy key failings, such as the woefully inadequate minimum benefit in Social Security and the lack of a catastrophic benefit in Medicare, while doing these reforms. Our mantra should be "reform and improve" while slowing the growth of spending.

If the President led on these issues, he could help shape these vital programs to ensure their sustainability and effectiveness and, in the process, transform himself from the most fiscally irresponsible President to arguably the most fiscally responsible President in our history.

Which brings us back to the debt limit. Modern history provides fertile ground for doubt when process solutions substitute for concrete decisions, such as the House is considering. Thus, I have my qualms over the course the House leadership has set. But I understand the difficulties the House faces, and I accept as sincere assurances that there is a firmer strategy. I accept this.

I agree entirely that if we are to make sustained progress in restraining spending and deficits, Congress must return to the regular order in a budget process, however much the other body would like to do otherwise. The House is correct to press for a regular, disciplined budget process.

I don't know whether the House can compel a change in course. I acknowledge the difficulties. For all our sakes and the sake of my children and yours, I fervently hope you succeed.

I do know the House can take a stand to present the American people a clear alternative to soaring debt and a dimmer future: To choose to stand with deficits and debt and decline, or to stand with the economic security and prosperity of future generations of Americans. The American people deserve at least to know this much from the U.S. House of Representatives: Where the Nation is heading and what the House would do differently.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Foster follows:]

The Heritage Foundation
LEADERSHIP FOR AMERICA
214 Massachusetts Avenue, NE • Washington DC 20002 • (202) 546-4400 • heritage.org

CONGRESSIONAL TESTIMONY

Debt Limit vs. Limiting the Debt

Testimony before
House Committee on Ways and Means
United States House of Representatives

January 22, 2013

J.D. Foster, Ph.D.
Norman B. Ture Senior Fellow in the Economics of Fiscal Policy
The Heritage Foundation

My name is J.D. Foster. I am the Norman B. Ture Senior Fellow in the Economics of Fiscal Policy at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

Congress must soon consider its options as the U.S. government reached its statutory debt limit of $16.4 trillion at the end of 2012, exhausting its authority to borrow from credit markets.[1] Facing a 2013 budget deficit of roughly $1 trillion and unable to finance additional deficit spending by issuing new debt, the Treasury Department has once again resorted to extraordinary measures to pay all its incoming bills. These extraordinary measures, essentially cash and debt management tools, are expected to last into late February. Even augmenting its traditional tools with even more radical measures, Congress and the President will need to decide soon whether and under what conditions to raise the debt limit and thereby permit continued borrowing.[2]

In recent years, President Barack Obama and Congress have squandered multiple opportunities to control federal spending, reform the nation's unsustainable entitlements, and put the nation's fiscal house on a path to balance for the present and for the future. Annual budget resolutions, the 2011 debt ceiling debate, the ensuing "supercommittee" flameout, and most recently the fiscal cliff fiasco all provided such opportunities. Time and again President Obama and Congress have put their faith in processes to force difficult decisions at a later date, and time and again the President and Congress have found a way to maximize political drama while minimizing progress on spending reduction and true fiscal consolidation.

Every recent occasion for constructive action was met with a perfect lack of leadership on the part of President Obama except to achieve the utterly tangential and economically counterproductive accomplishment of raising income tax rates on a few. Consequently, every other recent opportunity to change course met with total failure. The debt ceiling debate now unfolding provides yet another opportunity—perhaps the last, best hope for serious, credible progress toward balancing the budget. Failure ought not be an option. Congress should take a stand in the debt limit debate.

Deficits and Debt on the Rise

In January 2009, as President Obama first took office, the national debt stood at $10.6 trillion. In just the past four years the President has increased the national debt by a stunning $5.8 trillion. Under current policies the total debt will likely to rise by about $1 trillion per year for the next four years.

Of course, a portion of the debt increase over the past four years and the likely increase

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[1]The dollar limit on the public debt is set by law. 31 U.S. Code § 3101. The debt limit is also sometimes referred to as the "debt ceiling." The two expressions are entirely synonymous.
[2]One such more radical measure is to operate the government on a cash flow basis after Congress has provided the Administration with the legal authority to prioritize spending, allocating incoming receipts to their highest priorities. See J.D. Foster, "A New, Extra-Extraordinary Debt-Ceiling Tool," Heritage Foundation *Issue Brief* No. 3814, January 3, 2013, http://www.heritage.org/research/reports/2013/01/debt-ceiling-and-extraordinary-measures-to-fund-budget-shortfall.

over the next few years are due to the deep, ongoing weakness in the U.S. economy. President Obama's policies have failed to rejuvenate the economy. Output and employment remain far below normal. Thus, federal tax receipts remain far below normal even with the tax hike from the fiscal cliff legislation. Regrettably, the President's success in raising marginal tax rates, first through the 3.8 percent Medicare surcharge as part of Obamacare and more recently through higher individual income tax rates, will only further delay a full economic recovery.

However, recent deficits are not due solely to weak receipts traced to an underperforming economy. Under President Obama, federal spending has shot up from a normal level of about 20 percent of the economy to about 23.5 percent in 2012. In dollar terms, 2012 federal spending was over a half trillion dollars above what would have been the modern norm. When combined with the revenue shortfall, this meant the federal government had to borrow 30 cents for every dollar spent.

While racking up enormous deficits, President Obama has fiercely resisted even modest efforts to reform and restrain the growth in the nation's major entitlement programs: Social Security, Medicare, and Medicaid. Indeed, the President's health care bill materially worsened the fiscal picture.[3] Yet the underlying facts about the fiscal plight of these programs are not in serious dispute: All of the major entitlement programs are poorly designed to achieve their goal of meeting needs while being grossly unsustainable and unaffordable in their current form.[4] Substantial reforms to improve performance and reduce costs are coming, and the sooner the better. The current debt ceiling debate provides an excellent opportunity to start those reforms.

Consequences of Rising Government Debt

The debt limit applies to the public debt, also known as the "gross debt," which includes debt the government has sold in the credit markets plus debt the federal government has issued internally to record certain intergovernmental transfers, such as transfers from the general fund to the Social Security Trust Fund. Credit markets, naturally enough, are concerned primarily with the "publicly held debt, "debt that is sold to and traded in the markets.

Whether the focus is on public debt subject to limit or publicly held debt sold by the Treasury and traded in credit markets, the amount has soared in recent years and is projected to continue to rise rapidly under current policies. A useful method for depicting the implications of the level of debt is its size relative to the economy because the economy is the ultimate source of government revenues used to pay the interest expense on outstanding debt. The modern norm for publicly held debt is around 40 percent of the economy. In 2013, publicly held debt will reach 76 percent according to the

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[3]See James C. Capretta, "Obamacare Remains a Budgetary and Policy Nightmare," Heritage Foundation *Issue Brief* No. 3689, August 2, 2012, http://www.heritage.org/research/reports/2012/08/obamacare-remains-a-budgetary-and-policy-disaster.

[4]For a comprehensive discussion of these issues, as well as a comprehensive program how to address them, see Stuart M. Butler, Alison Acosta Fraser, and William W. Beach, eds., *Saving the American Dream: The Heritage Plan to Fix the Debt, Cut Spending, and Restore Prosperity*, The Heritage Foundation, 2011, http://savingthedream.org/about-the-plan/plan-details/.

Congressional Budget Office (CBO), rising to near 90 percent by 2022.[5] CBO's long-term projections clearly show this ratio continues to increase in later years under current policies because of rapidly rising costs in Social Security, Medicare, and Medicaid.

This projected increase has profound implications for America's economy and the well-being and economic security of America's workers. At the most basic level, this rapid increase in debt means a rapid increase in government interest expense. According to CBO's baseline projections, federal net interest expense is projected to increase from about $220 billion in 2012 to $570 billion in 2022.

The rise in the ratio of publicly held debt to the size of the economy also suggests strong upward pressure on future interest rates.[6] However, this interest rate effect appears to be missing entirely from the economic assumptions in the CBO's budget analysis. It also appears to be missing from the Administration's economic assumptions.[7] For example, the CBO projects the interest rate on the bellwether 10-year Treasury note will average 5 percent in the latter half of the next decade. This projection is actually *lower* than the CBO projected for the long-term rate prior to the recent run-up in publicly held debt.[8] Far more likely, interest rates will permanently increase due to the recent run-up in debt.

The most immediate consequence of such an interest rate jump would be even higher government interest expense. According to the Administration's own analysis, a 1 percentage point increase in interest rates—a reasonable, rough estimate of the effects of the increase in debt—would increase interest expense in 2022 by $206 billion and by over $1.3 trillion from 2013 to 2022.[9] The implication is that both the CBO and the Administration appear to ignore the recent run-up in debt as they project future interest rates and thus appear to underforecast substantially future interest expense.

Higher future interest rates have major consequences beyond their effects on future budget deficits. Higher future interest rates necessarily imply significantly lower levels of productive capital employed in the U.S. economy. Increasing capital drives productivity growth, which leads to a stronger economy and higher wages. Higher interest rates therefore mean lower wages and potentially fewer jobs. They also mean a smaller economy, which means lower government revenues than would otherwise be generated and thus even more upward pressure on federal budget deficits.

Recent academic studies confirm these are not merely theoretical or hypothetical

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[5]See Congressional Budget Office, "An Update on the Budget and Economic Outlook: Fiscal Years 2012 to 2022," August 2012, http://www.cbo.gov/publication/43539 (accessed January 17, 2013).

[6]The term "interest rates" as used here refers to nominal interest rates. There is little reason to believe the issues under discussion would alter the path of inflation. Thus, real interest rate movements would parallel nominal interest rate movements.

[7]See U.S. Office of Management and Budget, "Budget of the United States Government, Fiscal Year 2013: Mid-Session Review," July 27, 2012, http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/13msr.pdf (accessed January 17, 2013).

[8]For example, see "The Budget and Economic Outlook: An Update," Congressional Budget Office, August, 2007, at http://cbo.gov/sites/default/files/cbofiles/ftpdocs/85xx/doc8565/08-23-update07.pdf.

[9]U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2013: Analytical Perspectives* (Washington, DC: U.S. Government Printing Office, 2012), http://www.whitehouse.gov/omb/budget/Analytical_Perspectives (accessed January 17, 2013).

considerations. According to a study by Kumar and Woo, countries with debt levels of 90 percent of GDP or more (commonly labeled "high-debt status" countries) experience a loss in annual real GDP growth of about 1.3 percentage points compared to their low-debt counterparts.[10] That means if the U.S. economy were otherwise projected to grow about 2.5 percent annually—a common mid-range assumption—then reaching high-debt status would be expected to cut that growth rate roughly in half.

A second, oft-quoted study by Reinhart, Reinhart, and Rogoff reached a similar conclusion.[11] A third study by Cecchetti, Mohanty, and Zampolli also arrive a similar conclusion, but importantly using a different methodology.[12] They find that at high debt levels, a 10 percentage point increase in the ratio of debt to GDP tends to reduce real GDP growth by 0.18 percentage point per year over the next five years.

Beyond the economic analysis, the consistent implication for American families is that families will have less income to spend, and they will have fewer career opportunities, and the opportunities they have will tend to pay less. It also means young families will need to work harder and save more as a share of their income to save for a down payment for a home. Then, they will struggle more to save for the children's college education or retirement. Rising government debt will also mean employers will have a more difficult time competing in the global economy, and Americans overall will face greater challenges from the world's newly ascending powers. Rising government debt will mean higher interest expense for the government, which means either higher taxes or less spending on other priorities, or both.

The bottom line is that the federal debt held by the public—the total outstanding debt Washington has borrowed from the financial markets, setting aside the borrowing the government does from its trust funds—stood at $3.4 trillion in 2001 and rose to $5.8 trillion by 2008. Assuming current tax-and-spending policies continue, publicly held debt will top $19 trillion by 2022 according to Administration projections.[13] Leaving future generations such a legacy of debt is unacceptable. It is also financially unsustainable and will leave American families with far less economic security.

A change of course is inevitable. The question is whether it will be an orderly, beneficial change brought by design or a disorderly change brought by congressional and presidential gridlock or by credit markets increasingly intolerant of Washington's fiscal imprudence. In their August 2011 explanation of why they downgraded U.S. federal government debt from the highest rating of AAA to AA+, Standard & Poor's observed, "Our lowering of the rating was prompted by our view on the rising public debt and our

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[10]Manmohan S. Kumar and Jaejoon Woo, "Public Debt and Growth," International Monetary Fund *Working Paper* No. 10/174, July 1, 2010, http://www.imf.org/external/pubs/cat/longres.cfm?sk=24080.0 (accessed January 17, 2013).
[11]Carmen M. Reinhart and Kenneth S. Rogoff, "Growth in a Time of Debt," *American Economic Review*, Vol. 100, No. 2 (May 2010), pp. 573–578, http://www.ycsg.yale.edu/center/forms/growth-debt.pdf (accessed July 12, 2012).
[12]Stephen Cecchetti, Madhusudan Mohanty, and Fabrizio Zampolli, "The Real Effects of debt," Bank for International Settlements *Working Paper* No. 352, September 2011, http://www.bis.org/publ/work352.pdf (accessed July 12, 2012).
[13]See U.S. Office of Management and Budget, "Budget of the United States Government, Fiscal Year 2013: Mid-Session Review."

perception of greater policymaking uncertainty."[14] Reaching the debt limit provides the critical moment to force the necessary action to reduce spending and borrowing, slowing and eventually halting the rise in the public debt.

The Source of the Debt Limit

Section 8 of Article 1 of the Constitution of the United States vests Congress with "Power…To borrow money on the credit of the United States." Congress then, by law, delegates the exercise of this power to the Treasury Department. The borrowing power is a natural extension of the related authorities vested in Congress to raise revenues and appropriate funds. In exercising these related fiscal powers, Congress limits the amount of federal debt the government may issue at any one time to borrow money.

The level of publicly held debt at any one time reflects the extent to which the federal government has engaged in deficit financing. The level of debt summarizes the financial consequences of past fiscal policy. In contrast, the need to raise the debt limit reflects an intention to continue deficit financing, effectively distilling the financial implications of current policy and forcing debate, discussion, possibly reform, and ultimately affirmation of current policy if the limit is increased. Thus, contrary to a popular refrain, raising the debt limit reflects current decisions, not past policy.

Congress could dispense with the periodic ritual of raising the debt limit. It could simply give Treasury the authority to borrow such funds as are needed to carry out the deficit consequences of current law. This would be the easier course politically and highly popular with the current and every future President, but Congress has wisely chosen not to take it. The nation is far better served when Congress and the President are forced to acknowledge the net effects of their policies by raising the debt limit to maintain that course. Whereas individual policies are typically enacted and extended piecemeal, the debt limit provides a unique opportunity to assess the overall course of fiscal policy. The discomfort of legislators facing a debt ceiling increase validates the importance of the ceiling and creates a climactic opportunity for Congress to make crucial policy course corrections that both distant and recent history demonstrate are often too difficult in the course of the regular annual budget and appropriations processes.

Once the limit is effectively reached, Treasury has a small, limited toolbox of financial management measures it then uses to maintain current spending levels pending congressional action before actual spending becomes strictly limited by incoming receipts. For example, Treasury can abstain from refinancing certain cash management bills allocated to the Supplementary Financing Program (SFP).[15] The Treasury may also delay making deposits to certain accounts and to redeem securities in the Thrift Savings Plan's G Fund, the Civil Service Retirement and Disability Fund, and the Exchange

[14]See Standard & Poors, "United States of America Long-Term Rating Lowered to "AA+" Due to Political Risks, Rising Debt Burden; Outlook Negative," August 5, 2011, at http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245316529563.
[15]The SFP is an account at the Treasury created to assist the Federal Reserve in its operations in support of the financial system. See Federal Reserve Bank of New York, "Statement Regarding Supplementary Financing Program," September 17, 2010, at *http://www.ny.frb.org/markets/statement_091708.html*.

Stabilization Fund.[16] According to Treasury Secretary Geithner, at this time these measures would be expected to "create approximately $200 billion in headroom under the debt limit."[17]

In years past, budget deficits typically on the order of 2 or 3 percent of the economy allowed Treasury to use these tools to continue federal spending unabated for some months.[18] With a deficit on the order of 8 percent of the economy, these tools may only bridge the government's cash flow into late February 2013.

Managing Government's Finances with No Headroom

The amount of debt the federal government is allowed to issue is set by statute. Federal spending is similarly established by law.[19] Treasury is at once prohibited by law from issuing additional debt above the limit and obligated by law to spend certain amounts for designated purposes. If the federal government exhausted its financial management tools having already reached the debt limit, then government spending would be limited to incoming receipts. At that point, the law setting a debt limit and the laws in place directing government spending would conflict. Something would have to give.

The legal prohibition on selling additional debt because government borrowing has reached the statutory limit does not translate into an inability to spend (because tax money is still coming in), but rather an inability to spend all the law requires. Thus, the consequences of reaching the debt limit are quite different from a "government shutdown" resulting from the inability of Congress and the President to agree on spending.

Very simply, reaching the debt limit means spending is limited by revenue arriving at the Treasury and is guided by some method of prioritization among the government's obligations. Certainly, vast inflows of federal tax receipts—inflows that far exceed amounts needed to pay monthly interest costs on debt—would continue.[20] To be sure, how the government would decide to meet these obligations with the limited resources is a matter of some conjecture, yet the government clearly would never be forced to default on its debt because of a lack of income. Whether the Treasury is required as a matter of law to prioritize incoming receipts to pay interest costs first is an open question, but there appears to be little doubt the Treasury would do so.[21] Therefore, there is no real question

[16]See Congressional Research Service memorandum, "Reaching the Debt Limit," December 28, 2010.
[17]See correspondence from Treasury Secretary Timothy F. Geithner to Senate Majority Leader Harry Reid (D-NV) dated December 26, 2013, at http://www.treasury.gov/connect/blog/Pages/Secretary-Geithner-Sends-Debt-Limit-Letter-to-Congress-12-26.aspx.
[18]While federal spending is generally fairly well distributed over the course of the year, federal receipts demonstrate a very uneven monthly pattern. Whereas receipt levels in February and March are traditionally relatively low, receipts are traditionally exceptionally high in April with the tax filing season and again in June with quarterly tax filings. Thus, the timing of when the debt limit is reached is very important to policy.
[19]Section 9 of Article I of the Constitution provides that "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law…."
[20]See U.S. General Accounting Office, *A New Approach to the Public Debt Legislation Should be Considered*, September 1979, at *http://www.archive.gao.gov/f0302/110373.pdf.*
[21]See Section 3123 of Title 31 of the United States Code, which says that "[t]he Secretary of the Treasury shall pay interest due or accrued on the public debt." Section 3123 does not provide guidance, however, on

that Treasury would take the actions necessary to preserve the full faith and credit of the U.S. government and avoid defaulting on debt and interest due. Suggestions that the United States would default on its public obligations are irresponsible and wrong.

The issue is less clear-cut with all of other government spending obligations. With insufficient funds on hand to make all expenditures required by law, the Treasury would be forced to prioritize what is spent now and what is postponed or never spent—a de facto recission by executive fiat. If spending must be funded out of receipt levels that are insufficient to meet all obligations, it appears an ever-growing backlog of unmet bills, excluding net interest, would ensue until Congress took action one way or another. In 2013, the federal government is expected to run an average monthly deficit of around $80 billion.

Some may argue Treasury has an implicit authority to prioritize spending on programs that have dedicated revenue sources. For example, the Social Security payroll tax provides a dedicated revenue source. Whether such sufficient authority exists or not, the fact remains that benefits have been paid on time during past episodes when the debt limit was reached. In some cases, Congress legislated specifically to ensure Social Security benefits would be paid, thus eliminating any doubt.

The Treasury would face a difficult question once all funding headroom is exhausted:

1. The Treasury would not have enough money to pay out all of the appropriations made;
2. Congress has, by law, said that the Treasury must carry out all appropriations laws and cannot refuse to carry out a portion of them (an action called "impoundment" that was prohibited years ago by law); and
3. Congress has, by law (the debt limit statute), said that the Treasury cannot borrow to supplement income tax receipts to pay the government's bills.

In short, the Treasury would not have enough money to go around. Although the law generally does not appear to tell the President what he must do in that situation, some may argue that, as a practical matter, he would have to "just do it" and set priorities for which lawfully owed bills to pay and which not to pay until the Treasury again has the money to pay everything that the laws require.

One question raised is whether Treasury has the administrative tools to prioritize spending. To be sure, it is unlikely Treasury's payment systems were designed to sift through the various spending demands according to some priority list. It is equally likely Treasury would take whatever actions were necessary to continue making the highest priority payments, such as interest on the debt, Social Security payments, and so forth because these obligations all flow from discrete payment systems.

A related question is how long Treasury could operate such a prioritization system and how long the nation would tolerate the federal government operating in this fashion. The

how to implement Section 3123 and other statutes directing expenditures when there is not enough cash on hand at the Treasury to cover all of the directed expenditures.

answers are unknown, but the likely upshot is somewhere between days and weeks, certainly not months or years because no doubt certain proper functions of the federal government and certain higher congressional priorities would go unmet. Moreover, a President acting alone, without statutory authority, to decide which government bills to pay and which not to pay is anathema in a government based on the rule of law. Clearly, that is something best avoided.

A helpful step would be for Congress to pass legislation similar to the Full Faith and Credit Act, introduced in 2011 by Senator Pat Toomey (R–PA), establishing explicit guidelines and clear authorities for the Administration to prioritize spending after-the-fact if it were to prove necessary.[22] For example, legislation could clearly indicate that net interest on publicly traded federal debt would receive the first claim on income tax receipts, thus eliminating any remaining shred of substance from the question of defaulting on outstanding debt. The legislation could also clarify the high priority that should be accorded national security spending and perhaps other clearly high-priority spending programs such as Social Security, Medicare, and Medicaid. Funding each of these would leave roughly $22 billion a month available to cover the remaining $92 billion in obligated spending.

How Would Credit Markets React?

A key consideration for any course of action is how credit markets would react to a particular outcome. If credit markets react badly, the repercussions for the economy could be harsh and prove expensive for future government finance at all levels of government. For this it is important to recognize which measures of debt are relevant. Two measures of government debt are common to the debt limit discussion: debt that is sold in the credit markets, typically called "publicly held debt," "gross debt," or "public debt," which includes publicly held debt plus debt the federal government has issued internally to record certain intergovernmental transfers such as transfers from the general fund to the Social Security trust fund.

Credit markets are concerned with the publicly held debt, its growth over time, and on-time net interest payments.[23] Publicly held debt approached $12 trillion at the end of 2012.[24] While publicly held debt is the relevant measure of the debt for credit markets, the debt limit applies to the gross debt.

If the federal government were forced to operate indefinitely at the current debt limit, the initial reaction in credit markets would surely be unfavorable. Credit markets value certainty and carefully evaluate and exact a price for uncertainty. Despite the recent run-up in federal debt and the tremendous financial difficulties facing the federal government due to past promises made in major entitlement programs, U.S. government debt is still

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[22]See "A New, Extra-Extraordinary Debt Ceiling Tool," by J.D. Foster, Ph.D., Heritage Foundation Issue Brief No. 3814, January 3, 2013, at http://www.heritage.org/research/reports/2013/01/debt-ceiling-and-extraordinary-measures-to-fund-budget-shortfall.
[23]For a discussion of why publicly held debt is the meaningful quantity, see Alex Brill, "Reform, Don't Raise, the Debt Limit," American Enterprise Institute, January 20, 2011, at *http://www.aei.org/article/103031*.
[24]See Monthly Treasury Statement, U.S. Department of the Treasury, November, 2012, at *http://www.fms.treas.gov/mts/mts1112.pdf* .

the global benchmark for safety. The uncertainty surrounding how the federal government would operate if it could not fund all obligated spending would rattle markets initially, likely leading to adverse movements in interest rates and the dollar exchange rate.

However, not all of the news would be grim, as the passage of time would soon make clear. As noted, the Treasury Department would surely affirm that it would make all interest payments on government debt, thus reassuring bond holders and allaying all concerns over defaulting on the debt. While spending cuts required to align total spending with revenues would be deep, credit markets ultimately might see the forced austerity as beneficial because the U.S. government would be running an enforced balanced budget. Once the novelty wore off—how long this would take is unclear—markets ultimately might see the forced austerity as beneficial, especially if they concluded that the result would be congressional action to put the government on a sound financial footing after decades of rising spending and borrowing.

Following recent events, including the previous debt ceiling debate and the fiscal cliff fiasco, credit markets are also rightly concerned about whether the U.S. government can function to address fundamental issues at least at a minimum level. After passing laws obligating a certain level of spending, if Congress then denied the Administration the funding for that spending it would raise reasonable and serious questions in the minds of credit market participants about the institutional soundness of U.S. government. In its August 2011 publication explaining the cut in the U.S. government's credit rating, Standard & Poors specifically referred to concerns regarding "America's governance and policymaking becoming less stable, less effective, and less predictable than what we previously believed."[25] Credit markets assess both the quality of the creditor as well as the quality of the credit.

Finally, policymakers need to be equally concerned with the possible credit market reaction if the President and Congress were to fail to make significant progress on credibly reducing federal spending. Market participants are fully aware of how policymakers have failed in every recent opportunity to constrain spending growth. They are fully aware that entitlement spending is projected to soar in the very near future. Market participants also are aware that the particulars of the American political calendar strongly imply that this debate triggered by the debt ceiling may be the last, best opportunity to enact credible, significant fiscal reforms.

Three Options on the Debt Limit: Two Drastic, One Sound

Congress and the President broadly face three options on the debt limit.

Drastic Option #1: Hold the line.

One option is to hold the debt limit in place, thereby forcing an immediate almost $1 trillion reduction in non-interest spending for the year (about $80 billion a month). If Congress and the President choose this option, then the legislative guidance described

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[25]See Standard & Poors, "United States of America Long-Term Rating Lowered to "AA+" Due to Political Risks, Rising Debt Burden; Outlook Negative," August 5, 2011, at http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245316529563.

above and enacted in advance would be consequential.

This option is equivalent to forcing the federal government to operate with a balanced budget henceforth, and Congress would need to act quickly to amend the law adjusting spending for 2013 downward by about $1 trillion. In rough terms, federal spending in 2013 is projected to be about 23 percent of the economy compared with the norm of about 20 percent, while revenues are projected to be about 17 percent of the economy, compared with the norm of about 18.5 percent. If the debt ceiling is held in place, Congress will need to slash spending substantially below the postwar norm for spending and even below the postwar norm for revenues.

Drastic Option #2: Raise the debt limit without cutting.

A second option is for President Obama and Congress to raise the debt ceiling and do nothing more, once again missing their opportunity to restrain the growth in federal spending, enact some basic reforms to major entitlements, and thereby put the federal government's finances on a path to balance. This option is drastic because it means once again federal policymakers would have ignored the imperative of restraining spending. Worse, there are few apparent opportunities remaining in the near future for substantive action. Simply raising the debt ceiling may appear to some as the most natural path of least political resistance, but circumstances created by the rapid growth in debt, projected deficits, and soaring entitlement spending dictate otherwise.

Both options 1 and 2 -- holding the debt limit in place and raising the debt ceiling without entitlement reforms and spending cuts – represent extreme choices in terms of fiscal policy and as expressions of the federal government's ability to function. Congress should seek a more sensible approach addressing both the immediate concerns surrounding the debt limit, and also addressing the federal government's irresponsible near-term and long-term fiscal paths.

The Sound Option: Credibly control spending and then raise the debt limit.

Congress should not authorize the government to borrow any more money without first setting the government firmly and credibly on the path to balancing the budget.[26] The immediate difficulty is Congress may lack the time to agree to complicated, comprehensive budgetary solutions. It spent many months in fruitless conflict over the fiscal cliff. The sequester is looming at the end of February. The continuing resolution allowing domestic discretionary or "day-to-day" spending expires at the end of March, and the Treasury has only a few weeks of headroom to continue to pay the federal government's bills,

Of course, Congress could pass a small increase or a series of small increases in the debt ceiling to gain time for more comprehensive solutions. The danger is that passing small increases to gain time could become a habit en route to the drastic solution of simply raising the debt ceiling by a large amount without the necessary entitlement reforms and

[26]See David S. Addington, "Don't Raise the Debt Limit Without Getting Spending Under Control," Heritage Foundation Background Paper No. 2549, April 21, 2011 at *http://www.heritage.org/research/reports/2011/04/dont-raise-the-debt-limit-without-getting-spending-under-control.*

spending reductions.

Fortunately, with the sequester in place, Congress has already taken a big first step in restraining discretionary spending. Regrettably, the sequester makes deep and ill-considered cuts to national security spending, so Congress needs to reconfigure the composition of spending cuts in the sequester to preserve sufficient national security spending. Additional cuts to domestic discretionary spending beyond the sequester amounts will be needed to reach a balanced budget.[27]

While cutting discretionary spending is important, the greater fiscal issues involve the nation's entitlements, especially Social Security, Medicare, and Medicaid. In recent years analysts have developed and Congress has already considered a handful of meaningful, yet simple reforms to Social Security and Medicare that meet the test of real reform and enjoy broad, bipartisan support. These reforms would substantially restrain the growth of government spending in the near term, but especially in the long term where the fiscal threat is greatest.[28]

To be sure, these reforms will not resolve either Social Security's or Medicare's key structural flaws. They constitute a start of the reform journey, not the conclusion, but they would be a powerful start that would markedly alter the nation's fiscal trajectory.

At a minimum, Congress should consider:

1. **Raising the Social Security eligibility age to match increases in longevity.** Americans are living longer and so they are receiving benefits longer compared with the number of years that they are paying into Social Security. As the President's own Simpson-Bowles Commission observed, it is important for the program's sustainability to increase the eligibility age in line with longevity.[29] Originally set at 65, the normal eligibility age is rising two months every year until 2022, when it will reach 67. According to the Social Security actuaries, continuing to increase the eligibility age to 69 by the year 2034 and allowing it to rise more slowly thereafter to reflect gains in longevity could go a long way toward reducing Social Security's funding shortfall.[30] While this would not reduce today's budget deficit, it would strengthen Social Security's finances and

[27]See "$150 Billion in Spending Cuts to Replace the Sequester" by Patrick Louis Knudsen, Heritage Foundation Background Paper No. 2744, November 15, 2012, at *http://www.heritage.org/research/reports/2012/11/150-billion-in-spending-cuts-to-offset-defense-sequestration.*

[28]See "Six Bipartisan Entitlement Reforms to Solve the Real Fiscal Crisis: Only Presidential Leadership is Needed," by J.D. Foster, Ph.D., and Alison Acosta Fraser, Heritage Foundation Background Paper No. 2748, November 30, 2012, at *http://www.heritage.org/research/reports/2012/11/six-bipartisan-entitlement-reforms-to-solve-the-real-fiscal-crisis-only-presidential-leadership-is-needed.*

[29]See "The National Commission on Fiscal Responsibility and Reform," The White House, December 2010, at *http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf*

[30]Social Security Administration, Office of the Chief Actuary, "Individual Changes Modifying Social Security," Actuarial Publications, December 21, 2011, http://www.socialsecurity.gov/OACT/solvency/provisions/index.html (accessed November 27, 2012).

dissipate far more important long-term budget pressures.[31]

2. **Correcting the cost-of-living adjustment (COLA).** The annual COLA benefit adjustment is determined today by the Bureau of Labor Statistics' Consumer Price Index (CPI). However, the CPI, an antiquated measure, generally overstates inflation, meaning that benefits are increased a little too much each year to offset inflation. The effect on benefits in a given year of switching to a more accurate inflation measure is minute, but Social Security spans generations. Again, according to the Social Security actuaries, using a more modern inflation measure would substantially reduce Social Security's shortfall over time.[32]
3. **Raising the Medicare eligibility age to agree with Social Security.** As with Social Security, Medicare has an eligibility age problem in that Americans are living longer and so they are receiving benefits longer, but unlike Social Security the Medicare eligibility age remains stuck at 65. An obvious solution is to wait a few years and then slowly raise the eligibility age to align eventually with the Social Security eligibility age. While the short-term budgetary savings would be modest, the critical issue for fiscal policy is the long-run trajectory and the long-term savings in Medicare from raising the eligibility age would be profound.
4. **Reducing the Medicare subsidy for upper-income beneficiaries.** In 2012, the average Medicare beneficiary received a subsidy of about $5,000. Subsidizing Medicare benefits for low-income seniors—and perhaps for some middle-income seniors—makes sense. But retired millionaires do not need and should not receive a $5,000 subsidy to buy Medicare health insurance. The Medicare subsidy was first cut for the wealthiest seniors in legislation signed by President George W. Bush in 2004. Obamacare cut it further, and President Obama proposed paring it back further yet in his budget proposals in February 2012.

   Medicare has many programmatic problems demanding attention and the sooner the better, but the foremost fiscal problem is the subsidy. The total cost of the Medicare subsidy, about $230 billion in 2012, will soar over time as health care costs rise and the baby boomers retire.[33] Paring back the subsidy for wealthy retirees is an obvious step toward reducing the budget deficit today and shoring up Medicare for the long run.

These four proposals for Social Security and Medicare reform meet the test of simplicity, being relatively easy to communicate to the American people, having been thoroughly

[31]See David C. John, "Three Social Security Fixes to Solve the Real Fiscal Crisis," Heritage Foundation Issue Brief No. 3807, December 19, 2012, at *http://www.heritage.org/research/reports/2012/12/3-social-security-fixes-to-solve-the-real-fiscal-crisis*.
[32]See "Restoring America's Future," by Senator Pete Domenici and Alice Rivlin, Bipartisan Policy Center, November 2010, at *http://bipartisanpolicy.org/sites/default/files/BPC%20FINAL%20REPORT%20FOR%20PRINTER%2002%2028%2011.pdf*.
[33]Centers for Medicare and Medicaid Services, *2012 Annual Report of the Board of Trustees of the Federal Health Insurance and Federal Supplementary Medical Insurance Trust Funds*, April 23, 2012, p. 10, Table II.B.1, http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Downloads/TR2012.pdf (accessed November 27, 2012).

vetted, and enjoying widespread support. Together, they would dramatically improve America's fiscal future for the better.

Two additional proposals Congress should consider immediately meet the tests of simplicity and effectiveness, but have not been considered as intensively**:**

5. **Phasing out Social Security benefits for upper-income retirees.** Everyone who has ever paid into Social Security is entitled to the benefits prescribed by law. However, as a nation we need to ask whether today's working families should pay payroll taxes so that upper-income retirees can continue to receive their checks. We need to ask why phasing out the Medicare subsidy to upper-income seniors would make sense while continuing to send them their full Social Security check. In short, Social Security should be reformed as social insurance against poverty rather than a government-run pension scheme.

   Some might charge that this is redistributionism, but would anyone suggest millionaires should receive food stamps? Food stamps and other welfare programs are specifically intended to operate as part of the social safety net, yet their existence constitutes a form of redistributionism that most Americans accept. Social Security (and Medicare) should become true social insurance, meaning only those seniors who need help should receive help. On the other hand, if Social Security remains a government-run pension, then it remains a vastly larger program built on an entirely different redistributionist principle—in many cases from workers to the wealthy.

6. **Consolidating Medicare's elements and collect a higher, single premium.** Medicare is actually three distinct components, referred to generally as Parts A, B, and D, reflecting the fact that Medicare coverage has expanded over the years in distinct phases. This antiquated structure is confusing to seniors and administratively inefficient. An obvious reform is to consolidate the three distinct parts into a unified Medicare program.

   Medicare Parts B and D each require beneficiaries to pay a premium covering 25 percent of the costs of the program. As the Medicare Parts are consolidated, the premium should also be consolidated and then raised to cover 35 percent of the relevant costs.[34] This, again, is a long-standing bipartisan proposal that was included, for example, in the so-called Domenici–Rivlin plan named after former Senator Pete Domenici (R–NM) and Alice Rivlin, former Director of the Office and Management and Budget in the Clinton Administration.[35]

Charting a Sustainable Course

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[34]See Robert E. Moffit, "The First Stage of Medicare Reform: Fixing the Current Program," Heritage Foundation Backgrounder No. 2611, October 17, 2011, *at http://www.heritage.org/research/reports/2011/10/the-first-stage-of-medicare-reform-fixing-the-current-program.*

[35]See "Restoring America's Future," by Senator Pete Domenici and Alice Rivlin, Bipartisan Policy Center, November 2010, at *http://bipartisanpolicy.org/sites/default/files/BPC%20FINAL%20REPORT%20FOR%20PRINTER%2002%2028%2011.pdf.*

The federal budget deficit is unsustainable today because of out-of-control spending. Even as the economy strengthens and revenues recover, spending in years to come is slated to rise to even more unsustainable levels. The debate over the debt ceiling is an appropriate, indeed may be the last prime opportunity for a course correction to putting the government on a credible path to balancing the budget in 10 years.

The silver lining in this otherwise dark cloud is Congress has already enacted a substantial down payment in cutting discretionary spending through the sequester. While more can and should be done to reduce discretionary spending while fully funding national security, Congress should next focus particularly on the entitlement programs. Fortunately, the Administration, Congress, and outside analysts have already vetted a number of sound reforms to Social Security and Medicare.

Congress faces two roughly equally drastic options: keeping the debt ceiling in place or raising the debt ceiling without any other actions to slow the growth in spending. Alternatively, if Congress ultimately inclines toward raising the debt limit, then in the same legislation it should enact substantial entitlement reforms and other spending reductions with the clear goal of putting the nation on a credible path to balance in 10 years. Fortunately, there are well-vetted options available that would not only move the budget toward balance, but also help to keep the budget in balance while preserving the major entitlement programs for future generations.

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Mr. JOHNSON OF TEXAS. Thank you, Dr. Foster.

Professor Johnson, you are recognized for 5 minutes. Please proceed.

STATEMENT OF SIMON JOHNSON, PH.D., RONALD A. KURTZ PROFESSOR OF ENTREPRENEURSHIP, MASSACHUSETTS INSTITUTE OF TECHNOLOGY SLOAN SCHOOL OF MANAGEMENT, BOSTON, MA

Mr. JOHNSON. Thank you very much, Mr. Chairman.

I find it frightening and also hard to believe that we are having this conversation in general and that you are having a hearing on this matter.

Among other things, I am the former Chief Economist of the International Monetary Fund, and I would remind you that the United States is not just the center of the world's economy; our financial assets, our government debt serves as a linchpin of the world's financial system.

From 1948 to 1968, foreigners held as reserves U.S. Government debt worth about 2 percent of our GDP. Their reserves now, their rainy-day funds, the basis of their financial calculations, are now at least 15 percent of our GDP. These are assets they hold willingly. They hold them because this has in the past been regarded as the world's safest asset. You are calling this into question when you raise the issue of not increasing the debt ceiling. This, to the world, to the world's investors, is just unbelievable, that you would even have this conversation.

Could I show, please, the first slide?

I testified before this Committee and I made these exact same points in the summer of 2011. And the point I tried to communicate to you then was that if you continued to have a confrontation around the debt ceiling, you would create an unprecedented level of uncertainty regarding economic policy in the United States.

This chart is taken from the work of Professors Baker, Bloom, and Davis. The full reference is in my written testimony. And they have measured policy uncertainty since 1985—not, I would say, at my behest or particularly focusing on the debt ceiling. But what do they find? What do you see in this chart?

Matching exactly with what Mr. Levin said at the beginning, August 2011 stands out as the moment since 1985 when we had the greatest uncertainty, the most lack of clarity for everyone—not just for the government, everyone in the private sector. Consumers, businesses cannot make decisions if they don't know what is going to happen to the government debt.

And listening to the testimony just now, I was further frightened by the extent to which leading experts disagree or vary in opinion with regard to exactly what may happen if we are to breach or come up against or somehow play with this debt ceiling.

The United States has never threatened to default, not since the 1780s. That has been the key element of U.S. fiscal policy since the Constitutional Convention in Philadelphia. That is actually a lesson that President Madison learned the hard way in and after the War of 1812, the importance of being very careful with your public debt and very careful with all communications around your public debt management.

If you don't raise the debt ceiling now or if you postpone this conversation, if you say, every 60, 90, or 100 days we are going to again have the same kind of conversation about the debt ceiling, you will continue to have this sort of spike in policy uncertainty, you will continue to undermine the private sector, you will continue to delay investment and to reduce employment relative to what it would be otherwise.

I urge you—I understand you have many difficult fiscal conversations to come. I appreciate that. I realize there is a range of reasonable opinion here. But I urge you, as I urged you in the summer of 2011: Take the debt ceiling off the table. Do it for our sakes. Do it for the world economy. Do it for the global financial system, which has still not recovered from the problems of 2007–2008.

If you want to destabilize the European economy, if you want to put pressure on all those sovereigns in Europe who are right now struggling fiscally, then you should have exactly this confrontation, pushing up the yield on risky assets around the world. But you don't want to do that. You don't want to destabilize Europe. You don't want another downgrade of U.S. debt. You don't want another spike in policy uncertainty.

Please, take the debt ceiling, once and for all, completely off the table.

Thank you.

[The prepared statement of Mr. Johnson follows:]

Testimony submitted to the House Ways and Means Committee, hearing on statutory debt limit, January 22, 2013 (embargoed until 1:30pm).

Submitted by Simon Johnson, Ronald Kurtz Professor of Entrepreneurship, MIT Sloan School of Management; Senior Fellow, Peterson Institute for International Economics; co-founder of http://BaselineScenario.com; member of the CBO's Panel of Economic Advisers; member of the FDIC's Systemic Resolution Advisory Committee; and member of the Systemic Risk Council.[1]

A. Main Points

1) This is a difficult time for the U.S. and global economy. Financial markets can easily become unsettled. A serious sovereign debt crisis remains unresolved in Europe's euro area. There are serious potential risks on the horizon in countries such as Japan, China, and Brazil. IMF Managing Director Christine Lagarde warns about a potential "relapse" in the world economy.

2) In this context, continuing uncertainty around the U.S. federal budget in general and the debt ceiling in particular is not helpful – and may prove destabilizing both at home and around the world.

3) Even a partial shutdown of federal government in the United States would have a significant negative effect on the economy. The private sector – particularly small business – would be greatly damaged by any lack of clarity about when and how the government will pay for goods and services purchased or make the transfer payments promised to citizens.

4) In addition, we have seen repeatedly over the past few years that congressional deadlock over fiscal issues worsens uncertainty and makes it harder for the private sector to make sensible decisions – including regarding the consumption of durables and all kinds of business investment.

5) Empirical research by Scott Baker (Stanford), Nick Bloom (Stanford), and Steve Davis (Chicago) finds that over the period 1985-2012, policy uncertainty reached its highest peak with the debt ceiling crisis in the summer of 2011.[2] (See Figure 1 below; this is reproduced from Baker, Bloom, and Davis, "Measuring Economic Policy Uncertainty," with permission.)

6) This kind of uncertainty makes it harder for employment to recover fully. Repeating a showdown over the debt ceiling every 3-6 months is sure to prolong the agony of the economic recovery. In fact, this would be one of the worst possible economic policies imaginable.

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[1] This testimony draws on *White House Burning: The Founding Fathers, Our National Debt, and Why It Matters to You*, co-authored with James Kwak. Underlined text indicates links to supplementary material; to see this, please access an electronic version of this document, e.g., at http://BaselineScenario.com, where we also provide updates and links to columns and other analysis with detailed policy assessments for the global economy. The Systemic Risk Council is a private group founded and chaired by Sheila Bair. All views expressed here are personal.

[2] See their website www.policyuncertainty.com.

7) Five years after the financial crisis intensified, we remain substantially below full employment levels. This in turn keeps more pressure on monetary policy than is desirable, leading the Fed to engage in ever more experimental measures.

8) Relatively low employment depresses tax revenue. This is the major reason our current deficits are so large. We need the economy to recover fully, with jobs for all Americans who want to work. This is the best way to address our short-term fiscal issues.

9) In the worst case, a failure to increase the U.S. debt ceiling would seriously and permanently undermine our standing in credit markets, increase interest rates, and worsen the budget deficit. The stock market would also likely fall sharply (and this could well happen, even if interest rates do not spike up.) Any or all of these developments would have an immediate negative effect on all parts of the private sector.

10) The debt ceiling impasse in summer 2011 created a degree of uncertainty that was not helpful to job creation. The "fiscal cliff" stand-off at the end of 2012 was another instance of policy induced uncertainty – if the same deal had been reached six months earlier, this would have been much better for the economy than what actually transpired.

11) Standard solvency analysis – including, for example, the tools used by the International Monetary Fund – confirms there is no prospect of an immediate fiscal crisis in the United States. We currently have "fiscal space", in the sense here is strong global demand for Treasury obligations in the foreseeable future.[3]

12) Long-term interest rates are low and remarkably stable. Partly this is due to actions by the Fed through various forms of "quantitative easing", but U.S. government securities are also seen as a safe haven for international investors. However, this safe haven status will be jeopardized if markets perceive a significant probability that we will not pay our debts as contracted – or if create the perception that our economy will be thrown into repeated turmoil through regular showdowns over the debt ceiling.

13) Over the CBO's 10-year forecast window, with the partial expiration of the Bush-era tax cuts, there is no insurmountable budget problem.[4] There is no fiscal emergency over this time horizon.

14) Our most important budget problems come *after* the ten-year horizon, because Medicare spending accelerates due to an aging population and increasing health care costs. The real issue here is containing healthcare costs – i.e., cutting Medicare in such a way as to shift healthcare costs onto families is not an appealing solution, particularly as this would likely raise healthcare spending as a percent of GDP.[5]

15) We should aim to find a way to control healthcare costs as soon as possible – every year of high healthcare cost inflation makes the problem worse. Our competitors are controlling healthcare costs much more effectively than we are; with the set of advanced countries, the

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[3] Comparative cross-country estimates are provided in Jonathan D. Ostry, Atish R. Ghosh, Jun I. Kim, Mahvash S. Quereshi, "Fiscal Space," IMF Staff Position Note, September 1, 2010, SPN/10/11.
[4] See James Kwak, "The Weirdness of 10-Year Deficit Reduction," http://baselinescenario.com/2011/07/21/the-weirdness-of-10-year-deficit-reduction/.
[5] For more detail, see the CBO assessment of the budget proposal put forward by Congressman Paul Ryan: http://cbo.gov/sites/default/files/cbofiles/ftpdocs/121xx/doc12128/04-05-ryan_letter.pdf.

US stands out as having the worst (highest) projects for rising healthcare costs through 2030 or 2050.[6]

16) The United States is in the midst of a significant demographic transition, with the population ageing. We need to invest in education and ensure access to affordable healthcare to everyone if we are to increase productivity as the population ages. Ultimately, this is the only way to ensure that older, retired workers can receive a sustainable level of reasonable benefits (including pensions and healthcare).

17) In this context and over the coming decades, the United States needs to make a longer-term fiscal adjustment. Part of that should include additional tax revenues.[7] The Bush-era tax cuts reduced revenue to an excessive degree, given the ageing of society. We are still struggling to recover from that flawed way of thinking about our public finances.

18) It is striking the extent to which income inequality has increased dramatically since the last tax reform in 1986.[8] From 1986 to 2006, there was little change in average income for the bottom 90 percent of wage earners while the top 1 percent experienced a gain of around 50 percent. The gains for the top one-tenth of one percent were even higher.

19) The returns to higher education have greatly increased over this time period and there are not good income prospects for anyone with only a high school education (or less). If anything, the tax system should lean towards becoming more progressive – and investing the proceeds in public goods that are not sufficiently provided by the private sector, like early childhood education and the kind of preventive healthcare that helps prevent disruption to education (e.g., due to asthma).

20) At the same time, we must not lose sight of the very large fiscal risks posed by the nature and structure of our financial system. Our worsening budget picture since 2000 is due to a combination of factors – including large tax cuts, two foreign wars, and the introduction of Medicare Part D. The recent increase in government spending is due almost entirely to the way the financial sector imploded and damaged the rest of the private sector in 2007-08.[9] (See Figure 2 below for the CBO's assessment of what caused the relative swing in budget projections.)

21) To see the fiscal impact of the last finance-induced recession, look at changes in the CBO's baseline projections over time. In January 2008, the CBO projected that total government debt in private hands—the best measure of what the government owes—would fall to $5.1 trillion by 2018 (23% of GDP). As of January 2010, the CBO projected that over the next eight years debt will rise to $13.7 trillion (over 65% of GDP)—a difference of $8.6 trillion. (For a vivid graphical representation, see Figure 3 below.)

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[6] See the IMF's Fiscal Monitor (October 2012), Statistical Table 12a, columns 3 and 4.
[7] For more details on the viable options, see *White House Burning*, Pantheon, 2012, by Simon Johnson and James Kwak.
[8] For more details and discussion of what accounts for the increase in inequality, see David Autor and Daron Acemoglu, "Skills, Tasks and Technologies: Implications for Employment and Earnings," http://econ-www.mit.edu/files/5571.
[9] Over the past decade, foreign wars also contributed to increased government spending. But the negative fiscal effect of the financial crisis was much larger than the cost of the Iraq and Afghanistan wars combined.

22) Most of this fiscal impact is not due to the Troubled Assets Relief Program – and definitely not due to the part of that program which injected capital into failing banks. Of the change in CBO baseline, 57% is due to decreased tax revenues resulting from the financial crisis and recession; 17% is due to increases in discretionary spending, some of it the stimulus package necessitated by the financial crisis (and because the "automatic stabilizers" in the United States are relatively weak); and another 14% is due to increased interest payments on the debt – because we now have more debt.[10]

23) We should be attempting to strengthen the safeguards in the Dodd-Frank financial reform legislation. Repealing or rolling back that legislation poses a major fiscal risk.[11] The fact that this is not currently scored by the Congressional Budget Office does not reduce this risk or make it any smaller.

24) In effect, a financial system with dangerously low capital levels – hence prone to major collapses – creates a nontransparent contingent liability for the federal budget in the United States.[12] This can only lead to further instability, deep recessions, and damage to our fiscal balance sheet, in a version of what senior officials at the Bank of England refer to as a "doom loop".

25) The remainder of this testimony reviews in more detail: the catastrophic outcomes likely if there is any kind of default on US government debt; why spending cuts – either from a government shutdown or from some other form of immediate austerity – will be contractionary in the current US context; and why the US fiscal balance sheet and efficient provision of public goods remains threatened by a dangerous financial system.

B. Effects of Defaulting on US Government Debt

The consequences of any default on the US debt would, ironically, actually increase the size of government relative to the US economy.

The reason is simple: If the government defaults, this will destroy the private credit system as we know it. The fundamental benchmark interest rates in modern financial markets are the so-called "risk-free" rates on government bonds. Removing this from the picture – or creating a high degree of risk around US Treasuries – would disrupt many private contracts and all kinds of transactions.

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[10] See also the May 2010 edition of the IMF's cross-country fiscal monitor for comparable data from other industrialized countries, http://www.imf.org/external/pubs/ft/fm/2010/fm1001.pdf. The box on debt dynamics shows that mostly these are due to the recession; fiscal stimulus only accounts for 1/10 of the increase in debt in advanced G20 countries. Table 4 in that report compares support by the government for the financial sector across leading countries; the US provided more capital injection (as a percent of GDP) but lower guarantees relative to Europe.

[11] See Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and The Next Financial Meltdown*, Pantheon, 2010.

[12] See Anat Admati, Peter DeMarzo, Martin Hellwig, and Paul Pfleiderer, "Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is *Not* Expensive," Stanford University, March 2011 (revised), https://gsbapps.stanford.edu/researchpapers/library/RP2065R1&86.pdf. See also Anat Admati and Martin Hellwig, *The Banker's New Clothes: What's Wrong with Banking and What to Do about it*, Princeton University Press, 2013, forthcoming.

In addition, many people and firms hold their "rainy day money" in the form of US Treasuries. The safest money market funds, for example, are those that hold only US government debt. At least, these are the funds perceived as safe – if the US government defaults, all these funds will "break the buck", meaning that they will be unable to maintain the principal value of money that has been placed with them.

The result would be a flight of capital – but to where? Banks will have a similar problem; many of their balance sheets will be destroyed by the collapse in US Treasury prices (the counterpart of an increase in interest rates on such debt, as bond prices and interest rates move in opposite directions).

There is no company in the United States that would be unaffected by a government default – and no bank or other financial institution that could provide a safe haven for savings.

There would be a massive run into cash, with everyone withdrawing as much as possible from their banks. Imagine the lines at ATM machines and teller windows – something we have not seen on a grand system since the Great Depression.

And private credit would disappear from our economic system, which then gives the Federal Reserve an unpleasant choice. Either it can step in and provide an enormous amount of credit directly to households and firms – very much as the central bank, Gosbank, did in the Soviet Union. Or the Fed can stand idly by while GDP falls 20-30 percent, the kinds of decline we have seen in modern economies when credit suddenly dries up.

With the private economy in free fall, consumption and investment would decline sharply. Our ability to export would also be down – foreign markets would likely be affected also and, in any case, if firms trying to export cannot get credit then most likely they cannot produce.

Government spending would contract in real terms, without a doubt. But what would fall more – government spending or the size of the private sector? Almost certainly the answer is the private sector, because this is so dependent on credit to buy its inputs. Think about the contraction that happened in fall 2008 but multiply by 10.

The government, on the other hand, in the last resort has access to the Federal Reserve and can therefore get its hands on cash money to pay wages. With the debt ceiling not increased, this would require some legal sleight of hand. But the alternative would clearly be a collapse of US national security – the military and the border guards have to be paid; the transportation system needs to operate, and so on.

Issuing money in this situation would almost certainly be inflationary but, the Fed would reason, perhaps not – because we have never been in this situation before, credit is now imploding, and the desperate credit expansion measures in fall 2008 proved not to be as bad as the critics feared.

This is what a US debt default would look like. The private sector would collapse, unemployment would quickly exceed 20 percent and, while the government would shrink, it would also remain the employer of last resort.

Anyone who does not want to raise the debt ceiling is playing with fire. Some people expressing this position are also advocating a policy that would have dire effects – and do the exact opposite of what they want to the structure of our economy. The government would become more important, not less important.

C. Spending Cuts Would Be Contractionary

Immediate spending cuts would, by themselves, likely slow the economy. The IMF's comprehensive recent review of cross-country evidence concludes: "A budget cut equal to 1 percent of GDP typically reduces domestic demand by about 1 percent and raises the unemployment rate by 0.3 percentage point."[13]

The contractionary effects of spending cuts can sometimes be offset by other changes in economic policy or conditions, but these are unlikely to apply in the United States today

If there is high perceived sovereign default risk, fiscal contraction can potentially lower long-term interest rates. But the US is currently perceived as one of the lowest risk countries in the world – hence the widespread use of the US dollar as a reserve asset. To the extent there is pressure on long-term interest rates in the US today due to fiscal concerns, these are mostly about the longer-term issues involving healthcare spending; if this spending were to be credibly constrained (e.g., in plausible projections for 2030 or 2050), long rates should fall. In contrast, cutting discretionary spending would have little impact on the market assessment of our longer-term fiscal stability.

It is also highly unlikely that short-term spending cuts would directly boost confidence among households or firms in the current US situation, particularly with employment still around 3 percent below its pre-crisis level. The US still has a significant "output gap" between actual and potential GDP, so unemployment is significantly above the achievable rate. Fiscal contractions rarely inspire confidence in such a situation.

If monetary policy becomes more expansionary while fiscal policy contracts, this can offset to some degree the negative short-run effects of spending cuts on the economy. But in the US today, short-term interest rates are as low as they can be and the Federal Reserve has already engaged in a substantial amount of "quantitative easing" to bring down interest rates on longer-term debt. It is unclear that much more monetary policy expansion would be advisable or possible in the view of the Fed, even if unemployment increases again – for example because fiscal contraction involves laying off government workers.

Tighter fiscal policy and easier monetary policy can, in small open economies with flexible exchange rates, push down (depreciate) the relative value of the currency – thus increasing exports and making it easier for domestic producers to compete against imports. But this is unlikely to happen in the United States, in part because other industrialized countries are also undertaking fiscal policy contraction. Also, the preeminent reserve currency status of the dollar means that it rises and falls in response to world events outside our control – and at present political and economic instabilities elsewhere seem likely to keep the dollar relatively strong.

The available evidence, including international experience, suggests it is very unlikely that the United States could experience an "expansionary fiscal contraction" as a result of short-term cuts in discretionary federal government spending.

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[13] *World Economic Outlook*, October 2010, Chapter 3, "Will It Hurt? Macroeconomic Effects of Fiscal Consolidation," p.113. This study has important methodological advantages, in particular because it focuses on policy intentions and attempts to implement spending cuts and revenue increases.

D. The Real Dangers and Costs of Fiscal Crisis

The advisable debt limit, relative to GDP, for the United States is subject to considerable debate and is not knowable with a high degree of precision. There is no precise debt-GDP level at which a crisis is triggered, but with net debt relative to GDP in or above the range of 90-100 percent, a country becomes much more vulnerable to external shocks – particularly if it is relying on foreign investors to buy a substantial part of its debt.

If any shock throws the economy into recession, fiscal policy in most industrialized countries will to some degree automatically counteract the effect – as spending increases (on unemployment benefits and other forms of social support) and taxation declines (as GDP falls). Such automatic stabilizers are generally helpful as they prevent the recession from becoming more serious – or even some form of prolonged collapse, which was the pre-1945 experience of many countries.

It is important not to oversimply fiscal concerns into precise cut-offs for "dangerous" debt levels. Recent European experience provides ample illustration that countries can run into trouble refinancing their debts at a wide range of debt-to-GDP values.

Greece ran into trouble in 2010 with gross debt relative to GDP of 142 percent; its debt levels in 2006 and 2007 were around 105 percent. This is a classic case of too much debt by any measure – although the full extent of the debt and underlying deficits were not completely clear until market perceptions shifted against Greece.

Portugal faced a fiscal crisis with gross debt at 90.6 percent of GDP in 2011, but its debt was only 62.7 percent in 2007. The issue for Portugal is low achieved and expected growth relative to fiscal deficits – the markets have become unwilling to support debt that continues to increase as a percent of GDP.

Ireland, another eurozone country that currently has an IMF program, is a different kind of fiscal disaster. In this case, the on-balance sheet government debt was low (25 percent of GDP in 2006-07 for gross debt) but there was a big build up in off-balance sheet obligations – in the form of implicit support available to a banking system that was taking on large risks. Bailing out the banks in fall 2008 and supporting the economy during severe recession has pushed up gross debt to 114 percent of GDP in 2011 and debt levels will reach at least 125 percent (in our estimates, even higher) before stabilizing.

Compared with other industrialized countries, Japan stands out as an extreme. Government debt-relative to GDP is expected to reach 229.1 percent in 2011 (on a gross basis) and rise to 250.5 percent in 2016. On a net basis – taking out government debt held by other parts of the public sector – the equivalent figures are 127.8 percent in 2011 and 163.9 percent for 2016. But nearly 95 percent of Japanese government debt is held by residents – and, at least for the time being, Japanese household and business savings remain high.

Countries with greater reliance on foreign savers, such as the US (where nonresidents held over 30 percent of general government debt in 2010) and the UK (nonresidents held 26.7 percent of general government debt in 2010) need to be much more careful. Within the eurozone, as a result of greater financial integration combined with the mispricing of risk, foreigners typically hold 40-90 percent of all outstanding government debt (mostly held by other eurozone financial institutions).

The increase in debt relative to GDP in industrialized countries from 2007 to 2011 was about 28 percent (of GDP; unweighted average across countries, as calculated by the IMF) – most of which was due to automatic stabilizers, i.e., the increase in spending and fall in taxation that occurs whenever a country goes into recession.

Seen in that context, the increase in the US gross debt – from 62.5 percent of GDP in 2006 to 98.6 percent at the end of 2010 and 107.2 percent at the end of 2012 – was very much in line with experience in other countries.[14] But the current trajectory of debt now, rising to 114.2 percent in 2016, is on the high end (the average debt-GDP for industrialized countries is projected to rise by about 7 percent over this period.)

In terms of net general government debt held by the private sector, at the end of 2012, the US was around 83.8 percent of GDP – up from 48.2 in 2007. This is not yet at a dangerous level but the future projections are not encouraging – this number will rise to 89.6 percent in 2016 and 89.4 percent in 2017, according to the IMF. And in the Congressional Budget Office's longer-term projections, the future costs of healthcare cause a rise in debt to Japanese levels or beyond by 2030 or 2050.

The role of the US dollar as the world's preeminent reserve currency means there is a strong demand for our government securities in the foreseeable future. In 1948 and in 1968, world holdings of US dollar assets in the form of reserves were worth about 2 percent of GDP. Now world reserve holdings of dollar assets are worth at least 15 percent of GDP – and some would put this as high as 30 percent of GDP.

But it is not clear how far this will carry us – particularly as alternative reserve assets typically develop in a diverse world economy with competing national interests. It would be wise to undertake medium-term fiscal consolidation. Rising healthcare costs and a weak tax base could well undermine our long-term potential growth.

In addition, the United States continues to face very large implicit liabilities in the form of implicit support available to the financial sector, both directly – if "too big to fail" global banks get into trouble – and indirectly, in the form of automatic stabilizers that will always kick in when the economy declines sharply due to a banking crisis.

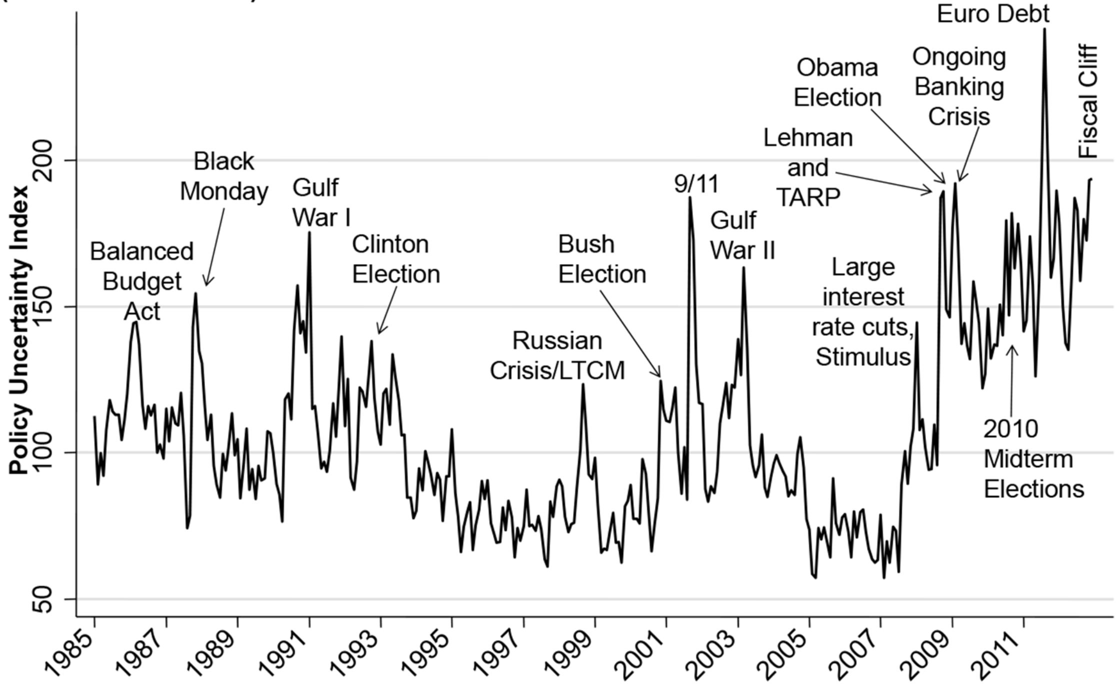
If a financial crisis due to the mispricing of risk causes a fiscal crisis, including immediate spending cuts and tax increases, this has major distributional consequences. The financial sector executives and traders who do well during a financial boom are highly paid; typically this is on a return-on-equity basis without appropriate adjustment for risk, so they take on too much debt. When the downside risks materialize, the costs of the crisis are borne by those who lose jobs and suffer other collateral damage. If sharp spending cuts follow that reduce public services (e.g., government-funded education), this effectively transfers the costs of dangerous compensation schemes for the financial elite onto the middle class and relatively poor people.

There is nothing pro-market or pro-private sector about an inefficient redistribution scheme that allows a few people to become richer due to implicit government subsidies for "too big to fail" global financial institutions. Such firms are likely to damage themselves with some regularity – their executives have little incentive to be sufficiently cautious. If the consequent crises

[14] These gross and net debt numbers are taken from the IMF's Fiscal Monitor, October 2012, Statistical Table 4. The 2012 data are a forecast.

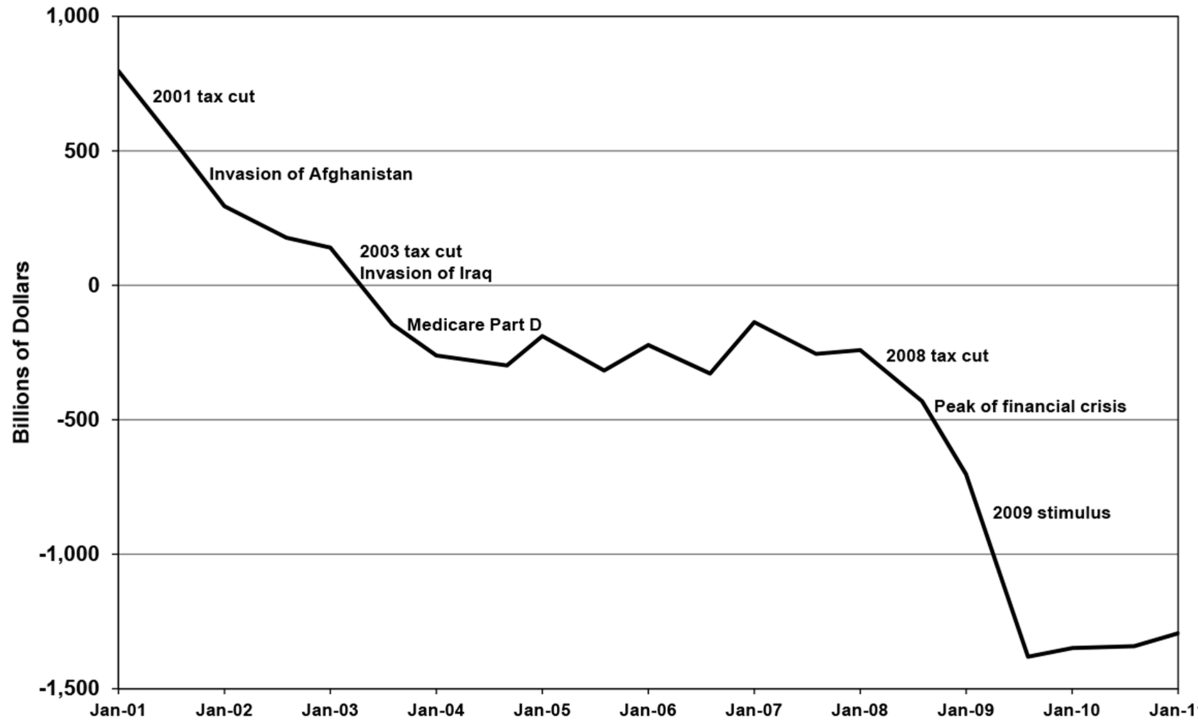
undermine public goods, such as access to effective education and quality healthcare, this is likely to permanently lower growth rates through undermining the human capital of the US workforce.

Figure 1: Index of Economic Policy Uncertainty
(Jan 1985 – Dec 2012)



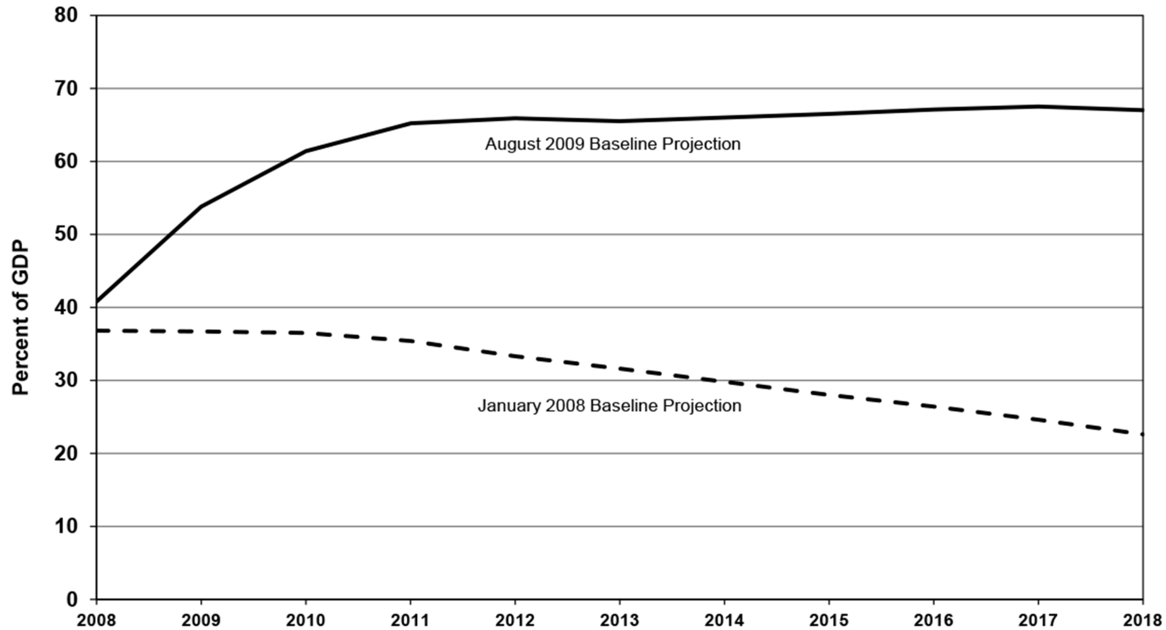
Notes: Index of Policy-Related Economic Uncertainty composed of 4 series: monthly news articles containing uncertain or uncertainty, economic or economy, and policy relevant terms (scaled by the smoothed number of articles containing 'today'); the number of tax laws expiring in coming years, and a composite of IQ ranges for quarterly forecasts of federal, state, and local government expenditures and 1-year CPI from the Phil. Fed Survey of Forecasters. Weights: 1/2 News-based, 1/6 tax expirations, 1/6 CPI disagreement, 1/6 expenditures disagreement after each index normalized to have a standard-deviation of 1. Data from Jan 1985-Dec 2012. Index normalized mean 100 from 1985-2009. Data at www.policyuncertainty.com

Figure 2: Change in Projected 2010 Budget Balance, 2001–2011



Source: CBO, *Budget and Economic Outlook* and *Budget and Economic Outlook: An Update*, 2001–2011.

Figure 3: Increase in National Debt Due to Financial Crisis



Source: CBO, *Budget and Economic Outlook*, January 2008; *Budget and Economic Outlook: An Update*, August 2009.

Mr. JOHNSON OF TEXAS. Thank you, sir.

We have a vote going on right now, and it appears to me that we are not going to be able to continue as we are. So I think we will recess until the vote is over, which will be about half an hour, they say, and return. So the meeting stands in recess——

Mr. LEVIN. Mr. Chairman, let me just mention, there is going to be a Rules Committee meeting on the bill, so I may not be here for the questioning. I think my colleagues will be pressing the issue of a 3-month delay and the potential harm it can do.

We went through this once, Dr. Johnson. I remember your testimony so well. And to think of going through it again, my hope is that there will be questions that can elicit your view as to why we should not be playing with fire once again.

Thank you.

Mr. JOHNSON OF TEXAS. The Committee stands in recess.

[Recess.]

Chairman CAMP [presiding]. The Committee will come back to order.

I want to thank our witnesses for being here today.

And I think we will move into the question and answer period. I am going to reserve my question time for a minute, and I will go to Mr. Brady.

You are recognized for 5 minutes.

Mr. BRADY. Thank you, Mr. Chairman.

And thank you to all those who were here for the testimony today. It was very helpful.

First, clearly, America will pay its debts. That has been made clear by Republicans and Democrats in Congress. We always have. And I hope that those who choose to be melodramatic about it these days to gain political advantage, if you could please stop, that would be helpful.

Second, there is absolutely no chance that the President's request to have a permanent unlimited debt ceiling will occur. This is the constitutional prerogative of the House and the Senate. As we have seen in the past, it has also been a helpful tool, not only on checks and balances, but to enact spending reforms and restraints that can be helpful, although, in my view, have not been as helpful as they have in the past.

And a third point is that the claim we heard earlier today, that a short-term extension of the debt limit may raise our U.S. Government debt service cost, that is highly speculative. The 2011 GAO study showed mixed results, with no significant impacts in 40 percent of the extensions. So three out of every five had no impact. The 2012 report was based on only one event, so it is statistically inconclusive. The Bipartisan Policy Center estimates are based upon both of these questionable GAO studies, and they miss the point.

The fact of the matter is, unsustained spending over time, without doubt, will raise the cost of our borrowing in America. That is why we are all here today to deal with this issue or attempt to give our best insight.

I would like to ask Dr. Foster a question because it relates to the debt ceiling. Many of us see the other side of that coin as a credit downgrade, a second one, which has serious consequences not just for our borrowing but for borrowing of small businesses and consumers at home.

My question to you—and I know there are different opinions, but what do you think Congress has to do? What steps should we take to create not just medium-term fiscal consolidation addressing that issue, but long term, dealing with our long-term drivers of debt and spending? What do we need to do to avoid a second downgrade, or a downgrade by a second credit rating, to be accurate?

Mr. FOSTER. To avoid another downgrade, which on our current path is almost assured, we really need to do two things. And they are pointed out in the letter expressing the first downgrade.

One, don't raise any question about not raising the debt ceiling; ultimately, we have to do that. And the second is we have to get our long-term fiscal house in order. That means we have to get the entitlement programs under control, achieving two goals: One, the reforms necessary to make sure they achieve the result intended, which is protecting at-risk populations, while spending moneys that we can afford to spend and no more.

There are simple entitlement reforms—straightforward, and well-vetted—that this Congress could adopt, I believe, fairly quickly. They are not even legislatively complex. And these are the kinds of reforms that have received bipartisan support in the past. They are sort of commonsense changes.

It is frustrating, in fact, that we don't take these reforms more seriously and move on them because they would have profound impacts in the long run, where the fiscal problem really lies. Yes, we have a serious problem with a trillion-dollar budget deficit today, but, really, as large as that is, that problem is dwarfed by our long-run fiscal problems from the entitlement programs.

We know some of the basic reforms, bipartisan reforms that can be enacted that will go a long way to getting Medicare and Social Security, in particular, on a more sustainable path. And that is where the Congress should be looking as we debate fiscal policy this year, beginning with the debt ceiling.

Mr. BRADY. Do you think investors look beyond that debt-ceiling issue to those fundamentals you talked about, answering the question, is America serious about getting its financial house in order over the long term? Do you think that really creates the most uncertainty going forward over the long term?

Mr. FOSTER. It is certainly a tremendous source of uncertainty. There are others, but that is a major source of uncertainty that credit markets most assuredly look at, as indicated by the letter transmitting the credit rating downgrade the last time.

Mr. BRADY. All right.

Thank you, Mr. Chairman. I yield back.

Chairman CAMP. Thank you.

Mr. Rangel is recognized for 5 minutes.

Mr. RANGEL. Thank you. And welcome back, Mr. Chairman.

Chairman CAMP. Thank you.

Mr. RANGEL. I am under the impression that the debt ceiling is to give the authority to the President to assure our creditors that each and every nickel that we would borrow will be paid back. I also believe that we have to have some guidelines on the spending in order to share with creditors and Americans alike the fact that we are going to reduce unnecessary spending. Having said that, there are some people who believe that we have to have to be involved, this debt ceiling, and with the deficit. And, of course, that is controversial.

Under the system of prioritizing payments, as some people are pushing forward, they would believe that we can determine just who we were going to pay out interest to while we get a better handle on the spending part of this dilemma. And I just want to ask Dr. Johnson some questions.

These programs, I think you pay your interest on your debt as the number-one priority. I think every family would like to pay off interest; Social Security; and then third, somewhere active duty military. And I think that is patriotic as well as political.

But under this scenario, Dr. Johnson, will we be paying the people that we borrowed from in China, the debt that we owe China, the biggest creditor, or one of the largest, before we would pay our American military that got caught, like I did, in Korea, fighting the Chinese? Does this work out, that in terms of avoiding the payment of our debt, that we would pay off our debtors before we pay off our military? Is that part of this plan?

Mr. JOHNSON. Well, Mr. Rangel, it is hard to know. I mean, I don't think these plans are very detailed, worked-out, credible plans. They are vague notions, the ones I have seen.

But, yes, I have seen the notion expressed that the United States would pay its debts in the form of interest and principal on bonds, a substantial fraction of which are held by the Chinese Government, for example, ahead of payments that it would make of other kinds, which would include, presumably, the way that is framed, payments to active service military personnel, for example.

Now, that just seems like a very strange notion——

Mr. RANGEL. It seems to me, if you owed anybody any money, no matter whether it was the country or your company, and you were not giving the executive director the authority to pay what has already been borrowed, that that shouldn't make our lenders feel comfortable.

But about the question of reducing spending, is there a vehicle that the Congress can exercise its ability without jeopardizing the reputation of credit? I mean, we have to deal with it, but you say and I think most people believe, don't attack the debt ceiling and integrity of the United States of America, but use the constitutional vehicles you have. What can the Congress do to express America's concern about spending?

Mr. JOHNSON. Well, Congressman, as you know far better than I do, you have a wide range of tools, and, in fact, you have more than 200 years of fiscal history in which the Congress did exactly that. Congress exerted for many, many years both a reasonable tax base that was consistent with the spending that they wanted, and nobody ever put the debt ceiling or the U.S. willingness to pay its obligations on the table in the way that it was placed in the summer of 2011 and the way that I fear it is now being placed on the table again.

It was a big mistake in 2011 to create this degree of uncertainty and fear in the United States and around the world, and it is a big mistake to do it again today.

Mr. RANGEL. Why would any good-thinking, patriotic American who loves the country as well as we all do want to use the debt ceiling as a vehicle to reduce spending rather than the other legislative opportunities we would have? What would their reasoning be? Certainly not to embarrass the United States of America.

Mr. JOHNSON. I have no idea, Mr. Rangel. But I can tell you that——

Mr. RANGEL. Well, if you don't have any, then maybe it is to defeat the objectives of this President at whatever cost, as some leaders or so-called leaders have said: That they want to stop this President, and they were unsuccessful in that measure. So maybe, maybe they have decided to change tactics. And maybe this discussion is unnecessary and we find some other way to get a handle on the deficit.

Let me thank you for your contributions to this hearing, as you have contributed so many times before.

Mr. Chairman, I yield back the balance of my time.

Chairman CAMP. Thank you.

Mr. Johnson is recognized.

Mr. JOHNSON OF TEXAS. Thank you, Mr. Chairman.

Mr. Foster, in his famous farewell address, President Eisenhower said, "We cannot mortgage the material assets of our grandchildren without risking the loss also of their political and spiritual heritage. We want democracy to survive for all generations to come, not to become the insolvent phantom of tomorrow."

In your testimony, you say that with respect to our fiscal future, "a change of course is inevitable." The question is, what kind of change? You warn that one such change may be brought by credit markets increasingly intolerant of Washington's fiscal imprudence.

In essence, you are saying, if we don't do anything, it is only a matter of time that financial markets will, so to speak, blow the whistle on Washington and say, "The game is over." In other words, we are on borrowed time here, aren't we?

Mr. FOSTER. Yes, sir, I am afraid we are.

And this is rather an unusual posture for Americans to be in. We are not used to thinking in these terms because, traditionally, even though we have had a fair amount of government debt, it has ranged in the order of 40 percent of our economy, which is completely manageable. It has since shot up dramatically and is going to continue to shoot up under current policies.

And the evidence is very clear in the academic literature; it is very clear in international observation. There comes a point where your debt, as a share of your economy, reaches levels at which credit markets become noticeably disturbed. They become very worried. And it is expressed, in part, as rising interest rates, which then spread throughout the economy. We are not just talking about Treasury interest rates but mortgage rates and consumer rates and so forth.

Mr. JOHNSON OF TEXAS. Well——

Mr. FOSTER. This is a certainty. And it is a path that we are on that will have extreme consequences that we are not used to thinking about in this country.

Mr. JOHNSON OF TEXAS. Well, I ask the question, how much time do we really have? You know, with the U.S. per-person debt now 35 percent higher than that of Greece, when do you think we face our Greek moment if we fail to take meaningful action to get our fiscal house in order?

Mr. FOSTER. Well, right now we are having a good news/bad news situation. The good news is that, despite all that we have done wrong, we are still one of the safest places in the world to invest. And there are a lot of places around the world that capital wants to avoid. So it keeps coming into this country, driving down our interest rates, even as we are raising debt rapidly.

Well, at some point that is going to reverse, and that capital will flow out again, and interest rates will rise rapidly. When that will happen I cannot say because I don't know when, for example, Europe is finally going to get its fiscal house and monetary houses in order. But once they do, this process will reverse and we will see the consequences of what we have done.

Mr. JOHNSON OF TEXAS. Yeah, Germany is making moves now.

Mr. Hoagland, would you care to comment?

Mr. HOAGLAND. I agree with Dr. Foster that we are probably the best-looking horse in the glue factory today. That may not last.

I would also say that I am very worried about, as I said in my opening statement, the fact that we are looking at debt-to-GDP that is close to 77 percent. And while in the past we have had debt-to-GDP after World War II at that level, we didn't have 50 percent of it being owned by foreign investors. And that is what scares me in terms of our sovereignty. We think we have to deal with this going forward.

I agree also that the real issue here is mandatory spending and putting in procedures, processes, and building upon a regular-order process up here of getting budget resolutions adopted, conference agreements, a reconciliation bill, and working it through the regular order. And that is why I would say that while this is not the perfect solution in terms of the 3-month extension, it puts you back closer to what would normally have been a regular-order process. And I think that is positive.

Mr. JOHNSON OF TEXAS. Well, I would like to know what both of you think, if we don't get it in order, you know, to our small-business owners, to our young families, to our aspiring college students, what kind of future are we looking at for these folks? Either one of you.

Mr. HOAGLAND. I think the standard of living that we experienced and enjoyed, we have to be honest with ourselves that we are lessening that standard of living for future generations, our children and our grandchildren. I don't think there is any question that this level of debt would lower that standard of living that we enjoyed.

Mr. JOHNSON OF TEXAS. Yeah, and people will stop wanting to come here, won't they?

Thank you, Mr. Chairman. I yield back.

Chairman CAMP. Thank you.

Mr. McDermott, you are recognized for 5 minutes.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

I have to tell you, listening to this hearing is like we are living in "*Alice in Wonderland*." Here we are hearing from witnesses telling us how to use default creatively or use it to get some leverage or something. And simply talking about it here is destructive. The whole world is watching this hearing. It is the first hearing on this issue.

And the whole point of a society is to create and run a government in order to make order for people. People don't like chaos. And this hearing is about how to create chaos to get what you can't get politically with votes. Businesses and workers in my district think this kind of talk is crazy.

Today we are talking about a crisis manufactured by the Republicans, a crisis they have manufactured to achieve policies that the voters wouldn't vote for at the ballot box. The Republicans are taking the economy hostage every single time they get a chance. There are threats for workers and businesses, investors, retirees. And job growth stops every time the Republicans have a crisis; the economy falters. This is the Republican governance and economic policy at work—or not working, really.

The biggest problem with the Republican arguments that are before us—and we just heard it again—is that spending and debt are problems. And this is a misdirection. Republican Congresses and Republican Presidents were happy to run up huge deficits to wage wars they didn't pay for, or take tax cuts for individuals and industry and give billions to oil companies.

Now, deficits aren't what the Republicans care about. What Republicans want to do is end the guarantees on Medicare and Social Security. We just heard somebody say it is the entitlement payments that are the problem. I disagree. I think this country can have a social safety net that covers people and pay for it.

And that ought to be happening, but what is happening on the other side of the aisle here is that they want everybody who is lucky and doing well to just do well, and if you aren't doing well, well, you have to deal with it. It is your problem. It is social Darwinism; it is survival of the fittest put into public policy in this Committee.

That is the Republican policy. And I respect that they want a different policy than I do, but we ought to be honest about the debate. Instead, we just watch people say "spending" in the TV cameras again and again and again. "Spending" is just a term that the polls like. Republicans won't say what they want to cut because the public doesn't want their policies. But the word "spending" polls very well, so we hear a lot of it. But we don't hear debate because the Republicans want crisis but no solution.

If we were serious about having a debate here, we would start talking about what in Medicare should be cut, or how are we going to change it, or how are we going to finance physicians. All those things would be on the table. But we don't hear that. What we say is, "Let's just cut." And when you start talking across the board, you are talking about medical research, and you are talking about NASA, and you are talking about NOAA, and you are talking about all these government agencies as though they don't do anything that add anything to this society.

So when we are spending our time here talking about this deficit stuff and raising the debt limit, we are simply saying to the world, for the first time, America is not going to pay its debts.

Now, my question to you, Mr. Johnson, is this: If this was such a good idea, why haven't we done it before? We could have saved a lot of money by not paying our debts. Why have we suddenly decided that this is the time to do it?

Give me some understanding so the American people can understand why, after all these years since the First World War, we have paid our debts under Republicans and Democrats. I voted under George Bush—both of them—to raise the debt limit. But now we are going to stop paying. Please tell me why they are doing it.

Mr. JOHNSON. Well, Congressman, it is not a good idea, and it is not the way fiscal policy was run not just since World War I, but going back to 1789, after the initial assumption of debt at the Federal level and the restructuring of debt with which Alexander Hamilton began fiscal policy in this country; policy has absolutely been to always pay your debts and your other obligations. And it took a long time to convince the world that the United States was the safest place to put your reserve assets or your rainy-day money. And it was a great achievement. And now it is being squandered and thrown away for, I presume, some negotiating purpose. It makes no sense from a broader economic perspective.

Chairman CAMP. Thank you. Time has expired. I would ask unanimous consent to place in the record a Statement of Administration Policy on H.R. 325, the temporary suspension of the debt ceiling, where the Administration says, "For these reasons, the Administration would not oppose a short-term solution to the debt limit and looks forward to continuing to work with both the House and the Senate to increase certainty in the stability for the economy."

Without objection, so ordered.

[The submission of The Honorable Dave Camp follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

January 22, 2013
(House Rules)

STATEMENT OF ADMINISTRATION POLICY

H.R. 325 – Temporary Suspension of Debt Ceiling
(Rep. Camp, R-MI, and Rep. Miller, R-MI)

The Administration supports a long-term increase in the debt limit that would increase certainty and economic stability. Although H.R. 325 is a short-term measure and introduces unnecessary complications, needlessly perpetuating uncertainty in the Nation's fiscal system, the Administration is encouraged that H.R. 325 lifts the immediate threat of default and indicates that congressional Republicans have backed off an insistence on holding the Nation's economy hostage to extract drastic cuts in Medicare, education, and other programs that middle-class families depend on. For these reasons, the Administration would not oppose a short-term solution to the debt limit and looks forward to continuing to work with both the House and the Senate to increase certainty and stability for the economy.

Instead of short-term management of self-inflicted fiscal crises, the President believes there is now an opportunity to strengthen the economy by putting the Nation on a sounder fiscal path. Progress has already been made towards that goal. In 2011, the President signed into law $1.4 trillion in spending reductions, not counting additional savings from winding down the wars in Iraq and Afghanistan. The fiscal agreement the President signed at the beginning of January increased revenue from high-income households by over $600 billion. Together with interest savings, these two steps will cut the deficit by more than $2.5 trillion over the next decade. The President has made clear that he remains willing to work with both parties in the Congress to budget responsibly and to achieve additional deficit reduction consistent with the principles of balance, shared growth, and shared opportunity.

The President has also made clear that he will not have another debate with the Congress over whether or not they should pay the bills that they have already racked up through the laws that they passed. The President has made clear that the Congress has only two options – pay their bills, or fail to do so and put the Nation into default.

H.R. 325 would temporarily allow the Congress to fund commitments to which it has already agreed. A temporary solution is not enough to remove the threat of default that Republicans in the Congress have held over the economy. The Congress should commit to paying its bills and pass a long-term clean debt limit increase that lifts self-inflicted and unnecessary uncertainty from the Nation's economy.

* * * * * * *

Mr. Tiberi, you are recognized for 5 minutes.

Mr. TIBERI. Thank you, Mr. Chairman.

Thank you, gentlemen, for coming and testifying.

Let me expand a little bit on Mr. McDermott's line of questioning and just get a quick response from the four of you. Back in 2006, speaking on the Senate floor, then Senator Obama announced that he intended to vote no on the debt-ceiling increase. He went on to say, and I quote, to oppose the effort—"I oppose the effort to increase America's debt limit. We now depend on ongoing financial assistance from foreign countries to finance our Government's reckless fiscal policies. Over the past 5 years, our Federal debt has increased by $3.5 trillion dollars to $8.6 trillion." Oh, to have those numbers today. Since then, we now have a $16.4 trillion debt, nearly doubled in 6 years. In fact, since this President has become President in 2009, he has added more than four times, more than—more debt in 4 years, excuse me, than the previous President did in 8.

So, to the four of you, a quick question. Was the President right, is this a failure of leadership? And is there a better direction?

Mr. Casey.

Mr. CASEY. Well, I certainly think he was right that we oughtn't to continue to run the store based on borrowing. There is a lot of ways you can pay your debts, and they don't all include incurring——

Mr. TIBERI. But since he made that speech, it has gotten worse; we have done nothing to change the trajectory.

Mr. CASEY. I agree.

Mr. TIBERI. It has gotten worse. So is the President right, it is a leadership failure?

Mr. CASEY. Yeah, I would agree with that, it is.

Mr. HOAGLAND. Congressman, it didn't say that he was right to say what he said. I would be careful to point out that some of that increase in that debt that took place was a result of obligations that were incurred long before he was ever President of the United States or he——

Mr. TIBERI. Oh, right.

Mr. HOAGLAND. Or wherever. And I just would make that very clear.

Mr. TIBERI. Oh, sure.

Mr. HOAGLAND. Also, I would simply say, the House-passed budget resolution last year under Congressman Ryan, which was going in the right direction of controlling spending, still had a debt for the end of this year at $17.1 trillion.

Mr. TIBERI. Right. It is getting worse.

Mr. HOAGLAND. It is—and getting worse. It is built into the pipeline.

Mr. TIBERI. Thank you. Agreed.

Mr. Foster.

Mr. FOSTER. Yes, sir, thank you. There is no question that allowing debt to continue to build more rapidly as a share of GDP is reckless; it is irresponsible. Under some circumstances, it is inevitable. Those circumstances are not what we have today. We should be getting it under control and doing so quickly.

Mr. TIBERI. Mr. Johnson.

Mr. JOHNSON. Congressman, figures 2 and 3 in my written testimony address this issue directly; where did the debt come from? These are the Congressional Budget Office numbers. This is figure 2, and you can see the impact of the tax cuts; the two foreign wars; Medicare Part D, which was not paid for; the 2008 Bush tax cut; and then, of course, the financial crisis. The largest swing, if you move to figure 3, this shows you the swing in medium-term debt projected by the CBO before and after they realized the severity of the financial crisis.

Mr. TIBERI. Let me ask you a quick question.

Mr. JOHNSON. That is a 50 percent of GDP increase in debt.

Mr. TIBERI. Was the President right, yes or no?

Mr. JOHNSON. The President was right when he spoke of the reckless fiscal policies at the moment. What he didn't realize was how bad it was going to get as a result of reckless financial policies——

Mr. TIBERI. And so the President is right today, then, you are saying as well. Even though the debt has nearly doubled and we had a deficit actually that was on the decline with what you talked about, two wars, prescription drug benefits, tax cuts, it was actually less than $200 billion the year that Rob Portman, now Senator, was budget director and has now since gone over a trillion dollars 4 years in a row.

Mr. JOHNSON. Congressman, we had the largest financial crisis since the Great Depression.

Mr. TIBERI. I have heard this before.

Mr. JOHNSON. We lost a huge amount of revenue, according to the Congressional Budget Office that is 70 to 80 percent of the swing in debt. These are the CBO's numbers.

Mr. TIBERI. We are not going to solve it. I have another question for Mr. Hoagland.

Mr. Hoagland, I notice that you have some experience on budget issues in the Senate. How many years did you work in the Senate, and when you worked in the Senate on budget issues, did they pass budgets when you were there? How many times? Or did they fail to pass a budget 1 year, 2 years, or maybe 3 years?

Mr. HOAGLAND. I was with the Senate Budget starting with the CBO in 1975, with the Budget Committee since 1982, and left the Senate after Majority Leader's Office in 2007. Over the 33 years that we have had budget resolutions, beginning in 1979, seven times have we failed to get a conference agreement on a budget resolution. Unfortunately, over that 33 years, three of those times have been in the last 3 years. There is one time when I was staff director of the Senate Budget Committee with Chairman Pete Domenici that we did not get a concurrent resolution on the budget, and that had to do in 1998 when John Kasich was Chairman of the House Budget Committee, and we had just finished the 19—but one time.

Mr. TIBERI. One time.

Mr. HOAGLAND. The Senate not——

Chairman CAMP. Time has expired. Thank you.

Mr. TIBERI. Thank you.

Chairman CAMP. Mr. Doggett.

Mr. DOGGETT. Thank you very much, Mr. Chairman.

I know opinions clearly differ about where we are headed in the future, but I think as Mr. Johnson's chart demonstrates, when we concluded the Clinton Administration, we had a surplus for the first time in recent memory, and a huge tax cut, where Alan Greenspan sat where you are sitting, Mr. Johnson, and told us that the justification for this tax cut in part was that we were reducing the debt too fast, that we would create some uncertainties in the bond market because we were moving so quickly, but an unpaid tax cut, unpaid prescription benefits, two unpaid wars. Now we are told we can no longer afford, by some of our Republican colleagues, to provide health security for people at 65 or 66 that you just—you would like to do it, but we just can't afford to do it anymore.

And as it relates specifically to the proposal we just heard the Administration's statement on, I gather your opinion, Mr. Johnson, is, you know, better than have a Valentine's Day cliff to at least have some additional time to help resolve this, but if we keep moving in 3-month or 1-month or 6-month spurts, the effect on economic growth will be very damaging.

Mr. JOHNSON. Absolutely, Congressman. If we could pull up figure 1 from my written testimony——

Mr. DOGGETT. Please.

Mr. JOHNSON [continuing]. What you would get is the spike, this is the spike from August 2011, you are going to have that every 3 months. That was a disastrous month for hiring because who wants to hire when you don't know if there are going to be payments made by the government or if various other disruptions are going to take place? These are big numbers for the U.S. economy. You are going to do this every 3 months, for how long? Until you have another election? That is far too long for the health and sanity of the American people.

Mr. DOGGETT. And at the same time we had that phenomenon, I believe the General Accountability Office has estimated that the direct cost of Republicans taking us right up to the brink on the debt, on the full faith and credit of the United States last time was over a billion dollars in increased interest costs. We could also expect to see an increase in borrowing costs for taxpayers if we don't get this debt ceiling resolved.

Mr. JOHNSON. That is a definite possibility, Congressman. To the extent we disrupt debt markets, if we worry investors, if we create risk, and we are hurting not just the Federal Government; this has implications for State governments and for local governments that, of course, do not generally borrow at the low interest rate the Federal Government borrows at, so they have a risk premium in there. You are driving up risk premia around the world when you generate this kind of uncertainty.

Mr. DOGGETT. Your written testimony indicates that, for a decade, actually for a couple of decades, we have seen income inequality increase dramatically with little change in income for 90 percent of wage earners and a 50 percent increase for those at the top. What are the policies that you think we most need to address other than getting stability on this full faith and credit of the United States to change that and to ensure that there is a more equitable share in the success of the American economy?

Mr. JOHNSON. Well, the evidence is completely compelling that education, human capital, the ability of people to work with information technology, these are huge determinants of what has happened to income inequality. And many people in American society today cannot afford by themselves to get that kind of education. To the extent that you can make resources available to support younger people, support families in the pursuit of high productivity human capital, that is good for them, that is good for the economy, and that is good for the tax base, so over the medium term, that is absolutely going to strengthen the budget.

Mr. DOGGETT. And in terms of competitiveness worldwide, building a stronger workforce from, as you mentioned, early childhood education to access to a college education is really vital to American competitiveness, isn't it?

Mr. JOHNSON. It is the number one determinant of both our competitiveness, the extent to which we can compete with other countries, and our productivity, how much do we actually produce per person in this economy. The number one determinant looking forward is human capital; that is about education. It is about ability to innovate, ability to work with those new technologies.

Mr. DOGGETT. And over the short run, what is the effect of across-the-board cuts on early childhood education, on Pell grants, on research funding for medical research and other basic scientific research?

Mr. JOHNSON. It is all going to be negative for growth and for human capital, and it is going to impact equality, and to the extent that you don't have a progressive tax system, it is also going to give you negative impact on the budget.

Mr. DOGGETT. While the most immediate concern, I know, and the main focus of your testimony is upholding the full faith and credit of the United States, is it your feeling that at this time in our economy, we need to see a contraction of government spending?

Chairman CAMP. All right, time has expired, I am sorry.

Mr. Reichert.

Mr. REICHERT. Thank you, Mr. Chairman.

My first question is to all the panelists. Thank you for being here. There are a lot of—there is a lot of talk across the aisle about raising revenue to solve our debt problem. Is it possible to raise taxes enough to permanently sustain programs such as Social Security and Medicare without reforming the programs themselves? And what sort of tax increase would this be on the middle class, and what would this sort of tax increase do to our broader economy?

Mr. CASEY. I would ask the Committee if I may pass on that since it goes beyond my legal expertise. I will defer to the economists.

Mr. HOAGLAND. I believe that it would require a balance between both spending, controlling entitlement spending, mandatory spending, and revenue increases to lower the debt-to-GDP figure to a goal of about 60 percent. I believe the last proposal that was on the table before the fiscal cliff discussion was that the House Republican leader's proposal was $800 billion in tax increases; the President's was $960 billion. You get $600 billion; there is $200 billion there that you are still looking at for this next 10-year window, but I think that has to be coupled with changes to mandatory spending programs.

To Mr. McDermott's position, there are specific proposals as it relates to changing the Medicare program that does not harm current recipients of Medicare but protects the program for the future beneficiaries out there.

Mr. FOSTER. There is an illusion that you can solve all these problems with tax increases without getting into the question of whether or not you should, or that you could. The answer is you can't. The costs in these programs are rising so rapidly over the next decades, not 2014 or 2015, but over the near future, that you can't solve them with tax increases. We would not have much of an economy left if we tried that.

So you must understand, the starting point for getting our fiscal house in order is reducing the growth in the entitlement spending, just as Mr. Hoagland suggested. Then it is a political point, a debatable point, as to whether or not you want to mix in tax increases as part of that solution. That is a political decision at that point, not an economic decision, understanding that the tax increases we tend to enact tend to be those most harmful to the economy, thereby slowing the growth of the economy as well as the tax base. But you have to start with the entitlement reform, slowing the growth of that spending. That is a necessary and unavoidable component of getting our fiscal house in order.

Mr. JOHNSON. Congressman, I actually wrote a book on this topic, which I would be happy to send you.

Mr. REICHERT. Congratulations.

Mr. JOHNSON. Thank you. And the bottom line is that Social Security you could rebalance relatively easily with new revenue, and some relatively minor——

Mr. REICHERT. What kind of impact would that have on the middle class, just using revenue, just taxing people?

Mr. JOHNSON. The impact on the middle class would be relatively small, and again, I can send you the numbers. The key issue there is that they are raising the cap on earnings subject to Social Security, which was not indexed last time that was changed by this Congress in the mid 1980s.

The big problem is healthcare spending, Congressman, but it is not Medicare, per se, it is healthcare spending. If you shift that, the responsibility of health care from Medicare on to families, individuals, and companies, you will raise healthcare spending as a percent of GDP, that is the CBO scoring of that issue. And that is not going to help American families. You need to find a way to control, limit healthcare spending as a percent of GDP. That is the key variable to focus on, how the healthcare system functions, how it delivers, and what it costs.

Mr. REICHERT. If tax increases were the only solution that you are talking about here, you are just relating the tax increase to Social Security. Medicare, Medicaid, what is the impact there? What is the impact of just raising taxes on the broader economy totally?

Mr. JOHNSON. The problem, Congressman, is the healthcare spending. If healthcare spending increases, you can either pay that out of the budget, in which case it would be very high cost, or you can shift that on to individuals, in which case it ruins them. Either way, it doesn't make much difference. It is the healthcare costs that you have to focus on.

Mr. REICHERT. I want to go to some of the discussion that was occurring earlier. Why are we focusing on spending today, now? Why now? I may not have enough time to get to that question. I see the yellow light is on. So, Mr. Chairman, I will yield back before. It is a long question.

Chairman CAMP. All right. Okay.

Mr. Larson, you are—I am sorry, Mr. Neal has come back in.

Mr. Neal is recognized for 5 minutes.

Mr. NEAL. Thank you, Mr. Chairman.

As we debate increasing the debt ceiling this afternoon, I think a bit of history is important as we acknowledge the current fiscal situation. In January 2001, CBO estimated that the total budget surplus for 2002 to 2011 would be $5.6 trillion, surplus. Instead, after years of reckless spending and tax cuts, the Federal Government ran deficits from 2002 until 2011. The total deficit over that 10-year period amounted to $6.1 trillion, a swing of $11.7 trillion from January 2001 and its projections.

We began down this path by enacting tax cuts that cost the government $2.3 trillion. The other major expenditure during those years that contributed mightily to these deficits is the engagement in two wars. By the time we got to January of 2009, the debt was $10.6 trillion, setting a record for debt for any Administration. Pursuing two wars and massive tax cuts was the reason, and Mr. Johnson, while he was temporarily holding the chair for Mr. Camp, indicated that we were all responsible for many of those positions. Having voted against the war in Iraq and having voted against the Bush tax cuts in 2001 and 2003, I think I have earned an element of credibility on these questions.

So today we are debating another increase in the debt limit. I don't understand how anyone who voted for the Iraq war could now vote against raising the debt ceiling. In reality, arguing over the debt ceiling is essentially an argument over whether or not we should pay our bills. We should pay our bills.

This debt is about the past, not about the future. If you voted for the war in Iraq and the Bush tax cuts, the bill is here. Remind our colleagues and friends: 1.7 million new veterans, 45,000 of whom have served us honorably, as the other 1.7 million have, but they have been wounded. Half of the 45,000 have claimed disability.

So we hear from some of our friends, the default deniers, that they think hitting the debt ceiling is no big deal, that we could raise the debt ceiling only if we cut government spending as well. But where were they during those years, those very difficult years? And incidentally, I have compiled the voting records on the debt limit increases that President Bush requested during those years.

And I hope, Mr. Chairman, I could insert that into the record.

Chairman CAMP. Without objection.

[The submission of The Honorable Richard Neal follows:]

Ways and Means Committee Members on Previous Debt Ceiling Votes

P.L. 107-199 (June 28, 2002) - New Debt limit $6.4 trillion

Rep. Dave Camp - Yes
Rep. Sam Johnson - Yes
Rep. Kevin Brady - Yes
Rep. Paul Ryan - Yes

Rep. John Boehner - Yes
Rep. Eric Cantor - Yes

P.L. 108-24 (May 27, 2003) - New Debt limit $7.384 trillion - Passed House pursuant to rule XXVII and H.Con.Res. 95. Vote summary of H.Con.Res.95:

Rep. Dave Camp - Yes
Rep. Sam Johnson - Yes
Rep. Kevin Brady - Yes
Rep. Paul Ryan - Yes

Rep. John Boehner - Not voting
Rep. Eric Cantor - Yes

P.L. 108-415 (November 19, 2004) - New Debt limit $8.184 trillion

Rep. Dave Camp - Yes
Rep. Sam Johnson - Yes
Rep. Kevin Brady - Yes
Rep. Paul Ryan - Yes

Rep. John Boehner - Yes
Rep. Eric Cantor - Yes

P.L. 109-182 (March 20, 2006) - New Debt limit $8.965 trillion - Passed House pursuant to rule XXVII and H. Con. Res. 95. Vote summary of H.Con.Res.95:

Rep. Dave Camp - Yes
Rep. Sam Johnson - Yes
Rep. Kevin Brady - Yes
Rep. Paul Ryan - Yes

Rep. John Boehner - Yes
Rep. Eric Cantor - Yes

Mr. NEAL. Thank you, Mr. Chairman.

Many of the most senior Members of this Committee routinely voted to raise the debt ceiling during those years, even though the money for the tax cuts and the wars was put on emergency basis for the purpose of hiding the costs. So I am pleased that we are coming around to a more reasonable position today, and I hope that we are going to find a common path forward on many of these issues.

Mr. Johnson, you state in your testimony that low—unemployment depresses tax revenue, and this is the major reason for our current deficits and why they are so large. Once the economy recovers fully and the unemployment rate is lowered, it certainly will take some of the pressure off of these discussions, acknowledging there are long-term challenges that we have to address. I have been making this point inside of my own caucus, not to overreact to the situation in which we find ourselves, and if we could only find that common path forward that I referenced, we would find that you could have a conversation that would be worthwhile past the political talking points.

Now, getting Americans back to work should be the number one priority, and as we address this fiscal situation, toying with the debt, considering that American companies are estimated to be sitting on $1 trillion domestically and more than $1.8 trillion offshore. If we offered a picture of stability, and again a conversation worth having, we might be able to ameliorate some of the tension that surrounds this issue.

Would you comment, Mr. Johnson?

Chairman CAMP. You have 8 seconds. You can follow up with a letter, but we are going to stay on time here.

Mr. JOHNSON. We should pay our bills. That is the number one priority. If we don't pay our bills as a government, we will disrupt the economic recovery and push unemployment higher.

Mr. NEAL. Thank you.

Chairman CAMP. Thank you.

Mr. Boustany, Dr. Boustany is recognized.

Mr. BOUSTANY. Thank you, Mr. Chairman.

I want to put this in perspective for a moment. The former Chairman of the Joint Chiefs of Staff, Admiral Mullen, was quoted as saying the debt of the United States is a threat to our national security, and while it might not rise to that level acutely immediately, it certainly is a serious strategic restraint on the ability of the United States to operate in an international environment. And it is clearly a threat to our economic prosperity.

I want to make it clear, nobody on this side of the aisle is talking about default, none of us are talking about default. We are talking about a serious solution going forward with a big problem, which is widely acknowledged to be a spending problem.

Now, several of you made a number of points. Mr. Casey, you talked about Congress having the power of the purse and using it wisely, with discretion, to enact spending reforms which are desperately needed.

Mr. Hoagland talked about going back to regular order, something we all believe needs to happen. You also mentioned temporary extraordinary measures that are currently being used and talked a little bit about prioritization, and I want to bring that up again in a moment.

Mr. Foster, you spoke about process not being a substitute for real policy reforms. We all agree with that, I think both sides could agree with that.

But the bottom line is this: We have a spending problem, and we have to also recognize that in the context of how it plays out in the economy, it is not just spending, but it is also a need for growth. This is why we want to do tax reform, real tax reform, fundamental tax reform that puts our Tax Code on a 21st century basis that promotes American competitiveness and growth.

Now, historically, and I went back and I read a CRS report, short-term debt limit increases have been used just to buy time in order to get to a point where you couple it with real spending reforms. This has happened historically. Am I correct?

Mr. HOAGLAND. Yes, sir.

Mr. BOUSTANY. So we are not talking about something out of the ordinary as we talk about this current proposal on the table.

But I want to go back, Mr. Hoagland, to prioritization because we know there are extraordinary measures already being done by Treasury, and prioritization, we wouldn't have to be in this crisis if the President had come forward with a real plan. He has had opportunities with four budgets and hasn't done that and has continued to perpetuate the problem.

Now we are caught in a situation where we are waiting with the budget and the timing, but the bottom line is this: We don't need to be in this. We didn't need to be in this crisis, but we find ourselves in it. Now if prioritization is going to be used as one of these extraordinary measures, talk a little bit more, elaborate a little more on the fact that we have uneven receipts coming in and how this plays out. I want this to be real clear for the public that might be paying attention to this.

Mr. HOAGLAND. The Treasury has estimated that the cash flows in are very unprecise. Even in a 1-week forecast out, the estimate is that varies on statistically plus or minus $18 billion, just 1 week out, just estimating the receipts coming in. Two weeks out, the estimates are a $30 billion variation plus or minus. When you combine that with the requirements, in terms of statute, the payments going out, you create a tremendous level of difficulty in terms of being able to set the timeframe in which you should pay those when you don't know exactly, when you are doing prioritization, paying with income coming in with the degree of variation that exists in the receipts coming in. It is just very, very difficult.

Mr. BOUSTANY. For the interest payments, there is a different computer system, right, than what is used for the other payments?

Mr. HOAGLAND. Correct. The interest payments is a separate computer system. It is possible that you could just prioritize those interest payments, but I think the Fitch report last week said that you could avoid an actual default, default being defined as paying the interest, but then those other noninterest obligations will be looked at as another form of default, which would also affect Fitch's rating.

Mr. BOUSTANY. I see. How much time do you think we would have with prioritization? How much time could be bought?

Mr. HOAGLAND. Congressman, I mentioned in my report that we are talking about the pay-fors, the Prompt Payment Act, the Impoundment Act; I think you have a long time in terms of you determining prioritization.

Chairman CAMP. Time has expired.

Mr. Larson, you are recognized.

Mr. LARSON. Thank you very much, Mr. Chairman, and it's always good to see you back here and in good health. Let me start by saying thank you to our panelists for their testimony and thank you for your service to your institutions and the country and I thank the Chairman for this hearing.

I think it is a good news/bad news story. On one hand, the good news is that we have avoided yet another immediate crisis. The bad news is that we are just kicking the can down the road for 3 months and, in essence, then are dealing with default and not paying on our bills just 3 months later. That creates an enormous problem and one I think that—I would hope that this Committee, above all others, could solve because I do believe in this Committee and its bipartisan membership in our ability to address this issue. We know that what we have to do is both stabilize this economy, invest in this economy, reform this economy, and grow it in terms of what everyone has testified and what the people on this Committee believe in.

No less than Speaker Gingrich said on "*Face the Nation*" that, look, take the debt ceiling off the table, at least provide the American people with a modicum of security that they know we are not going to hold this hostage, too. We ought to be adults about it, as the former Speaker said, and take that off the table. That doesn't mean to desert the issue or back away from the issue of dealing with debt. And there are still appropriate opportunities, as he pointed out, whether through sequester or continuing resolution to do it, but we owe it to the American people to make sure we take this uncertainty away from them. We saw what that uncertainty does in terms of impacting their pensions and their 401(k)s, and they look to this Congress, and frankly, I think the Congress looks to this body to return to regular order. And I know we have the leadership on this body to do that, and by returning to regular order, we can go after the difficult things.

Mr. Johnson pointed out that the issue is healthcare costs. That is true. Mr. Ryan, who serves on the Budget Committee and this Committee, has pointed out the issue is healthcare costs. How do we go after those costs? It just simply isn't entitlements, aka insurance that people have paid. They have paid for that; that is their insurance. What are the actuarial assumptions around that? What do we have to do to change and alter that? We ought to be able to carry that out in regular order, not in meetings in the White House, not in meetings in the Senate, where they won't do a budget and where they will wait to do some kind of bill themselves. We ought to be doing it in this Committee.

Mr. Johnson, I was confronted in my hometown by our CFO, who said, "Listen, if you guys don't provide us some certainty again, we have to go out to the bond market again in this very difficult time, and what happens to us is we end up in a situation where we have to raise people's property taxes because Congress twiddles and diddles and plays hostage politics." What is your experience with respect to the impact that this will have on local municipalities, our cities, and our communities?

Mr. JOHNSON. Well, Congressman, the impact is going to be bad, and it could be dramatically bad, depending on what happens in 3 months. I don't agree with Mr. Gingrich on many fiscal issues, but I think on this one, he is right. Take the debt ceiling off the table permanently. Investors around the world are watching this hearing. They are looking at your words. They are trying to understand, what does prioritization mean? How does this not involve default? The degree of uncertainty that is being multiplied by this conversation is extraordinary, the impact on municipalities is going to be tough. They will face higher borrowing costs to the extent that risk premia rise in the United States and around the world and that means either they are going to fire people or they are going to raise property taxes or they are going to face some other problems. So this is a very bad route to go down from that perspective.

Mr. LARSON. I have great respect for Dr. Boustany, but we are talking about default. And whether we are talking about immediate default or default 3 months from now, that is a policy issue.

Mr. Hoagland, you also talked about bringing balance to this issue. I thought that was an excellent point, and you said that it ought to be done through regular order. How do you see that proceeding?

Mr. HOAGLAND. I see that proceeding by the President submitting a budget. I see that proceeding by the Budget Committee passing budget resolutions. I see that by a conference agreement between the House and Senate on a budget resolution. I see that by including a reconciliation instruction to achieve the savings over the time period, and I see that working through the normal course.

Mr. LARSON. I have been in Congress 14 years; we have not completed that once since I have been here in full complete order.

That is why I think it is incumbent upon our Committee, and I know the great integrity that our Chairman and Members of this Committee have. I think that we can achieve those goals. I know my time is up.

Chairman CAMP. Thank you. Thank you very much.

Mr. Paulsen is recognized for 5 minutes.

Mr. PAULSEN. Thank you, Mr. Chairman, also for holding the hearing.

I want to thank each of the witnesses for being here. You know, it is pretty clear to me that there is actually broad bipartisan consensus that our country is on a fiscally unsustainable path right now. The 2010 report by the Bipartisan Policy Center's Debt Reduction Task Force—Mr. Hoagland, I believe you were a member of that Task Force—included the very sobering warning that the Federal budget is on a dangerous, unsustainable path. Federal spending is projected to rise substantially faster than revenues, and the government will be forced to borrow ever-increasing amounts. Federal debt will rise to unmanageable levels, which will push interest rates up, endanger our prosperity, and make us increasingly vulnerable to the dictates of our creditors, including nations whose interests may differ from ours. We have talked a little bit about that earlier from some of the other questions.

My constituents are, quite honestly, very perplexed that Washington continues to borrow 40 some cents of every dollar it spends. They can't get their arms around that. And there is a recognition now that without significant changes to our fiscal policy, the national debt itself is going to become an existential threat. I would like each of the panelists, if you could, just comment what are the implications of current debt levels? What are the consequences of increased levels? And what really is the turning point where our debt becomes unmanageable, where it becomes an unmanageable situation?

Mr. Casey.

Mr. CASEY. Well, I think on most of that question, I will defer to the economists, but I will say that one thing I think we need to keep in mind is that we are not—we fling around the term debt ceiling. What we are talking about here is Congress' power to borrow money and how we should be paying our bills based on that or based on some other method of raising revenue, so I think it is very important to keep that clearly in mind.

Mr. PAULSEN. Mr. Hoagland, you were a member of that Task Force as well.

Mr. HOAGLAND. Yes, and in fairness, Congressman, that Task Force also recommended a balanced plan that included tax increases as well as spending cuts going forward, more on the spending side than on reduction of the rate of growth. The implications of the debt level, that we are headed at 77 percent going into the future, I think has a major—will jeopardize, quite frankly, our standing in the world. When we have about 40, 50 percent of this debt owned by investors outside of the United States, we are questioning, we are raising questions about the sovereignty of this country going forward.

In terms of, where is the turning point, I think that is the problem; most economists would say they can't answer that question. Who knows when that last drop into the test tube turns the water blue? But it will turn at some point, and that is the problem. When it turns, it will turn fast. That is why I think you have to have a plan going forward to avoid that date coming. I don't know. There is a book out on this called, "*This Time is Different*." This time is not different. Something will happen. We just want you to control that so it has some process behind it.

Mr. PAULSEN. Now, knowing that the United States is still a safe haven in terms of money flocking here, based on what is happening in Europe, I mean, can we learn anything of what is happening in Europe basically on how capital——

Mr. HOAGLAND. We are not Greece. We are not Italy. We are not Spain, but I think when you look at the level of spending there relative to their assets, I think you end up with a situation where you do create social disorder which is very dangerous.

Mr. PAULSEN. Mr. Foster.

Mr. FOSTER. There are three basic things. The first is that with all that debt, you are going to see in the future a lot more of government's resources, the Federal Government's resources being used just to pay off the interest on the debt from the past. As I said in my testimony, Americans expect services from the taxes they pay; they don't expect just that you service the debt from previous deficits.

Second, interest rates are going to rise. We have now increased the debt sufficiently that all previous debates about whether deficits matter for interest rates can be set aside. It has now risen enough that it will matter, and it will matter a lot. Interest rates will rise and they will rise a lot faster and further than they ever would have otherwise.

Third, as my colleague was just saying, it is like a family or any business, if you take on far too much debt, you lose control of your own future. You lose control of your path forward. Somebody else is going to be able to dictate the terms to you as to what you are going to do. The dictator in this case will be the bondholders and the credit markets. We lose control of our future as a Nation. Ask these countries in Europe, Mr. Hoagland knows, we are not Spain or Italy or Greece, but we will have one thing in common if we keep this path: We will lose control of our future as they have lost control of theirs.

Mr. PAULSEN. Can you comment in terms of if there is even a 1 percent or a 2 percent increase in interest rates what the effect is going to be on interest payments, on a dollar amount?

Mr. FOSTER. Well, if you think about it, 1 percent payment, and you have $15 trillion out there, that's $150 billion——

Chairman CAMP. All right, thank you, time has expired.

Mr. Kind is recognized for 5 minutes.

Mr. KIND. Thank you, Mr. Chairman.

I want to thank you for holding this hearing and thank the panelists for your input and your discussion today, which is important. I think we all understand what the ultimate solution is of the debt ceiling: We need a long-term, bipartisan deficit reduction agreement in this place that is comprehensive and that will get our fiscal house in order, especially dealing with the demographics and the aging population. That is the answer. I equate this to the Middle East peace plan. We all know where we need to end up; it is just finding the political process and the will to get there. Every bipartisan commission that has met and been tasked to come up with a solution has reached the same conclusion, there is going to have to be some additional revenue and some major spending reforms in the budget for this to make sense in a balanced and a fair fashion.

Mr. Foster, I appreciated your testimony here today where you said there is some additional room on the revenue side, even given where we ended up with the fiscal cliff, a little over $600 billion over 10 years in new revenue, but that was short of where things stood during the previous conversations.

But, Mr. Johnson, in your written testimony and also your oral testimony here today, I think you have been fairly clear that the greatest if not the chief contributor to the deficits and the fiscal shortfall today has been the underperforming economy and the high unemployment rate, so I would assume then that one of the responses if not the response to help with the fiscal situation is to get the economy back fully functioning with good-paying jobs and lowering the unemployment rate. Is that right?

Mr. JOHNSON. Absolutely, Congressman, and it would be, in that context, disastrous if you were either not to extend the debt ceiling or create a lot of uncertainty about who is getting paid and how they are getting paid because of the debt ceiling or because of the sequester or because of some sort of government shutdown. All of those things are bad for the recovery. They are bad for revenue, and all those things would tend to push up interest rates, which has the adverse consequences that my colleague just described.

Mr. KIND. So I really don't understand the argument for holding the debt ceiling hostage and jeopardizing the full faith and credit and possibly defaulting on our financial obligations for the first time in our Nation's history, given the safe haven that we have enjoyed. In fact, the great irony in this recession is the fact that people have been willing to pay us to take their money, which is, in effect, what has been going on. It has been a lifesaver for us economically, and all that, I assume, would be in jeopardy overnight if we do default on our financial obligations. Would you agree?

Mr. JOHNSON. Absolutely. The most obvious risk we face is that we will, through our own deliberate irresponsibility, undermine the safe haven status of the United States. The world is a complicated, dangerous place; people look to the United States as a safe place to keep their reserves, keep their money, but we can throw that out the window very, very quickly if irresponsible actions are taken around the debt ceiling.

Mr. KIND. I would also submit that, you know, both sides, both political parties need to be a little more realistic in our approach to this whole discussion, and not to sound too partisan, but we have just come off two national campaigns where my colleagues on the other side accused Democrats of taking $700 billion out of Medicare and promising to restore that money while at the same time promising to increase defense spending by $2 trillion over the next 10 years. Those are the two largest spending programs we have in the Federal deficit, and that is a $2.7 trillion proposition of new spending that they were offering in two national campaigns, and now they want to sit back and criticize the President for not being realistic in his budget choices? They lose me on that argument.

But, Mr. Hoagland, you have had a lot of experience and especially with Dr. Frist, and we do understand that the largest and fastest growing area of spending is rising healthcare costs. I think there is a solution to getting enhanced quality of care but at a better price. We need to change the way we pay for health care in this country, so it is value- and outcome-based and no longer volume-based, which fee-for-service brings. Would that help improve the fiscal outlook if we can make that conversion to a different payment system?

Mr. HOAGLAND. Yes, Congressman. I don't want to scoop my bosses. Senator Frist, Senator Daschle, Senator Domenici, and Alice Rivlin will be coming out with a report here in the middle of March, where we are looking specifically at this question, and one of the areas where we are focusing, we have to move away from the fee-for-service payment system to a more orderly system and move it away, and we believe that in the long run will help control costs overall in the Medicare area, but that also some 50 percent of health care is——

Mr. KIND. Well, I knew you guys were involved in that work because the Institute of Medicine is doing a comparable report coming out in a couple months. I also appreciated Mr. Brady's comment, he is going to be the new Chair of the Health Subcommittee, about getting away from SGR and moving to a quality-based physician reimbursement system, too. I think that is going to be key to the fiscal outlook as well, but there is a lot here we can follow up on.

But, Mr. Chairman, thanks again for this hearing and the feedback here today. Thank you all.

Chairman CAMP. Mr. Reed is recognized for 5 minutes.

Mr. REED. Thank you, Mr. Chairman.

I have been listening to this testimony all afternoon, and I just have to say, I am embarrassed to hear some of the comments that have been made today about what I believe to be the biggest threat to the future security of our country, the security of our country, when it comes to our kids and our grandkids, and that is the debt. So I am going to ask you, point blank, each and every member of this panel, is the present debt path sustainable? Does anybody think that it is?

Mr. HOAGLAND. No.

Mr. REED. Mr. Casey.

Mr. CASEY. No.

Mr. REED. Mr. Foster.

Mr. FOSTER. No, sir.

Mr. REED. Mr. Johnson. It is a yes or no question.

Mr. JOHNSON. No, sir, not over the long term, Congressman.

Mr. REED. Thank you. Why is it not sustainable? Can each of you briefly answer that question?

Mr. Casey, starting with you.

Mr. CASEY. Well, frankly, as a layman, there comes a point when they start cutting up your credit cards, and we will reach it.

Mr. REED. Mr. Hoagland.

Mr. HOAGLAND. And when the rate of growth in terms of payment on the interest of that debt is faster than the rate of growth of the economy, then you are, the country is defaulting.

Mr. REED. Mr. Foster.

Mr. FOSTER. That is the heart of it, sir, when your interest expenses are growing faster than your income, you are in trouble.

Mr. REED. Mr. Johnson.

Mr. JOHNSON. Healthcare costs, Congressman, it is the failure to control healthcare costs, as just discussed.

Mr. REED. So that is the debt, but the debt crisis, why it is not sustainable, is eventually the interest on the debt becomes so large that you can't pay that payment, correct?

Okay, because I have done some calculations on that point, and I have looked at, what is our—if our present debt at $16 trillion, just close to 3 percent, what is the debt service payment on that for our interest costs? Do you guys know that off the top of your head? Well, it is $492 billion. Let's say it goes to 6 percent. Does anybody know what that is?

Mr. FOSTER. Twice.

Mr. REED. That is $985 billion. Do you know what that means? What are we presently paying on our debt service payment? Do any of you know that number off the top of your head?

Mr. FOSTER. It is about $250 billion I believe.

Mr. REED. Yeah, so if you take the difference between the two, it goes up to 6 percent, you have $765 billion of additional need for cash payments to service the debt. What do we pay on our national defense budgets in an annual year?

Mr. HOAGLAND. We pay about $700 billion.

Mr. REED. So overnight, because that is an annual number, we are going to have to find the amount that we pay on our national defense lines in our Federal budget, an equivalent amount of dollars to service our debt. Is my understanding correct? Does anyone disagree with that math?

Mr. JOHNSON. You are right, Congressman, but if you have a big fight over the debt ceiling, that is going to push up interest rates and cause exactly the effect you are worried about.

Mr. REED. So if we just take care of the debt ceiling, put our head in the sand and say, we are never going to worry about the debt ceiling, at what point in time does the debt become so large that our creditors say, you know what, we are going to charge you a little bit more interest, and that interest then goes up to 6 percent on the $16 trillion. Don't we just get to the same problem that you are concerned about in the short term on a long-term approach by not dealing with the underlying problem at all?

Mr. JOHNSON. Congressman, I am totally in favor of dealing with the budget, that is the point of the book we wrote called "*White House Burning*," a dramatic enough title I hope, but the point is you need a balanced approach, as Mr. Levin said at the beginning, and you have the forces to do it——

Mr. REED. Mr. Johnson, if I could, it is my time, it is my time. And I have heard the balanced approach now for a year and a half, and I heard it today from the panel. There has been $600 billion of additional revenue that—as a result of the fiscal cliff negotiations. A balanced approach to me was if you gave revenue, you got spending reforms. Has the President offered any spending reforms as of yet in regard to that $600 billion of additional revenue?

Mr. FOSTER. We are hoping to see some in the budget, sir.

Mr. HOAGLAND. When he, when the President put—when Secretary Geithner put forth his proposal on November 29th, he had spending reductions of like $400 billion.

Mr. REED. So $400 billion in relationship to $600 billion of new tax revenue, and the President offered $400 billion in spending cuts.

Mr. HOAGLAND. In fairness, the President proposed $1.6 trillion in revenues for $400 billion in spending cuts.

Mr. REED. That doesn't sound too balanced to me, in my opinion. So I will just end with this. It is clear that Admiral Mullen had it right; this debt—and I could care less about all the people here in Washington, D.C.—I am really concerned about the people back at home, my constituents, my kids, my grandkids. This isn't sustainable, and to have this bickering over these issues without putting a real concrete proposal in front of the American people to say these are the visions of how we deal with this problem, that is why I wholeheartedly support this 3-month extension, and I am glad to hear the White House supports it also because at least now we will put in black and white hopefully in the Senate and in the House a vision to deal with this number one threat to our national security. Thank you.

With that, I yield back.

Chairman CAMP. Thank you.

Mr. Pascrell is recognized for 5 minutes.

Mr. PASCRELL. Three-quarters of the deficit reduction to date has been spending cuts, and I would rather err on the side of what Roosevelt said in his second inaugural, and that was, "The test of our progress is not whether we add more to the abundance of those who have much; it is whether we provide enough for those who have too little." He said that in 1937 in the second inaugural.

I am more concerned about one-fifth of our children living in poverty, and I am more concerned about the guys who are working out there—male income compared from 1969 to the present, and what do we have? We have people making, males making $1,000 more back in 1969. That is what I am concerned about. We have had a redistribution of wealth, all right, in this country. It was all upward. It was all upward. Let's get our facts straight here.

This storied Committee, Mr. Chairman, is even discussing the idea that America will not pay our bills, that we will be a deadbeat Nation, as the President said, and that is unbelievable to me. Certain things are unbelievable to you. That is unbelievable to me because if you read Article XIV and Section 4, questioning whether or not to pay the public debt may be unconstitutional from this body. It is not a long section. It is the public debt. It is right there.

And about the public debt, it also says—Mr. Foster, you didn't read the whole section. It says, if the House—if the Congress doesn't do it, the Executive must do it. It says that right in the bill. Am I not correct?

Mr. FOSTER. I will leave that to the constitutional scholars.

Mr. PASCRELL. I will read it to you.

Mr. FOSTER. Go ahead.

Mr. CASEY. No, sir, it doesn't say that, but please read it.

Mr. PASCRELL. I will. If Congress won't pay them, then the Executive must.

Mr. CASEY. In Section 4 of the 14th Amendment.

Mr. PASCRELL. Well, I am talking about the interpretation of Section 4 of Article XIV.

Mr. CASEY. Okay.

Mr. PASCRELL. You disagree with that?

Mr. CASEY. I disagree most wholeheartedly.

Mr. PASCRELL. So the Executive has nothing to say about the debt?

Mr. CASEY. Well, the Executive has no power to raise the debt, certainly. He has an obligation to pay the public debt, which is to say pay the amounts of money that have been loaned.

Mr. PASCRELL. And how is he going to do that if the Congress does not give him the ability to do that? That is a little problem, isn't it?

Mr. CASEY. It is obviously a problem.

Mr. PASCRELL. Okay. Well, let me go on here. We are not going to default on our obligations and not just to our bondholders, because another thing that we are talking about, which is questionable, is whether we can prioritize the payments to make everybody happy. I have heard that here. Go ahead.

Mr. HOAGLAND. I just want to be clear that I was not proposing prioritization. I was just pointing out the difficulties of prioritization.

Mr. PASCRELL. So you understand it is questionable under the Constitution?

Mr. HOAGLAND. Yes, sir.

Mr. PASCRELL. We all saw the economic impact that the last debt ceiling had on the economy. The Dow dropped 2,000 points. We added $18.9 billion to our deficit just in that time, and for the first time in our history, we were downgraded for our credit rating. That was all when we didn't default, either. The mere threat of default and irresponsible discussions of default is what I am talking about right now, like the one we are having today, were enough to do significant damage to our economy, just the discussion of it. And we saw that.

So let's give the American people some certainty. We have been saying that for the last 2 years. You have heard that. When are we going to solve that problem? When we solve this problem. How are people going to invest if they don't really know what is coming toward them? So let's end the talk of default, the irresponsible discussion. Responsibly default, could we responsibly default? Let's get an end to that discussion. Let's pass a long-term increase in the debt ceiling so that the phrase "backed by the full faith and credit of the United States of America" continues to mean something, and I believe it does mean something to all of you, and thank you for coming today.

Chairman CAMP. Thank you. I would just note for the record that this discussion may not be as harmful as we think as the Dow S&P 500 just hit a 5-year high today. With that, I will——

Mr. PASCRELL. I am sure it is because of our discussion, Mr. Chairman.

Chairman CAMP. Yes, I am sure it will be.

With that, I would recognize Mr. Young for 5 minutes.

Mr. YOUNG. Thank you so much, Mr. Chairman.

I thank all our panelists for being here today.

It is clear, based on all your testimony, that really the big issue here, I think Mr. Hoagland put it most succinctly, the real issue is mandatory spending, and, you know, we are entering budget season, what ought to be budget season here in Washington, D.C., and I am just curious. First, Dr. Foster, I will start with you. As the President submits his budget for fiscal year 2014, what do you anticipate the likelihood is that his request will include any reforms of significance to make sustainable Medicare and Social Security in that budget request?

Mr. FOSTER. Well, sir, despite being an economist, I am also an optimist, so I am going to say I think he may take the opportunity and really choose to lead on this, and until he proves otherwise, that is what I am going to believe.

Mr. YOUNG. Well, good. I share your hope. I spent a couple of years on the Budget Committee before being on this Committee and was hopeful then, too, so I think that is the most important thing that certainly could be done because it is important that we act quickly. There is a cost to waiting, and perhaps, Mr. Hoagland, you could discuss the important benefits of acting quickly here, coming up with a clear, specific, comprehensible, and comprehensive plan to make these largest unsustainable programs of government sustainable.

Mr. HOAGLAND. Congressman, I think it is necessary that a plan be put together that shows a path toward regaining sustainability in the Medicare program long term and in the Social Security program. The President back in November had proposed about $400 billion in spending reductions. I am, like Dr. Foster, I am optimistic he will come forth with that. The proposal here by the Republican leadership was $600 billion. This is over a 10-year period. The only comment I would have, Mr. Young, would be that the issue of controlling healthcare costs in a 10-year window is difficult. What we really should be looking at is a much longer window because some of the fundamental changes we have to make in the healthcare delivery system will take time to implement, such as Mr. Ryan's proposal last year.

Mr. YOUNG. Well, fair enough, and I supported Mr. Ryan's proposal last year. I was encouraged that it received some bipartisan support. I would hope in the future it might get a bit more.

But, Mr. Hoagland, to continue with you, the road map, if you will, in order to arrive at a spot where we can get concrete ideas from Democrat leadership, from the President of the United States about how to make these largest programs of government sustainable is through regular order. Could you bring us through that regular order as we have articulated it?

Mr. HOAGLAND. I am a regular order guy. I have spent my career up here. I believe the power of making legislative decisions lies with committees such as this very powerful Committee here, and I think it is better that the decisions in terms of what legislation could flow forward come out of the committees. Therefore, that is why I believe a budget resolution that is put together that sets the broad parameters for how much you are trying to achieve in the way of deficit reduction worked through the committees of jurisdiction is the most salient way of achieving a goal and expressing to the American public we really are serious about a fiscal blueprint that puts us on a path of sustainability, and we are lowering that level of debt to GDP in the future.

Mr. YOUNG. It strikes me as an orderly approach, a collaborative approach, one that ought to receive bipartisan support, and one that by design is set up to come together with some degree of consensus about what our Nation's priorities are, and then give the markets a degree of certainty about what is going to happen in the future, allowing us to create more jobs, et cetera.

Incidentally, this is exactly the approach that the House Republican Conference has taken with respect to the debt limit increase. We have tied increasing this debt limit contingent upon the Senate finally producing a budget for the first time in several years. It strikes me as eminently reasonable. It happens to also be very popular among the American people. So I do agree that talk about default is irresponsible to characterize this hearing as about something other than an effort to bring us back into balance and to try to get a budget out of the U.S. Senate and a clear budget out of the President of the United States. I think it is irresponsible to characterize it otherwise.

And I would just say to Mr. Johnson, I will give you a brief opportunity to respond, sir, that you spoke a great deal about policy uncertainty, but really it strikes me the greatest uncertainty longer term exists when you have Medicare, Medicaid, and Social Security unsustainable and no plan to make them sustainable.

Chairman CAMP. All right. Mr. Johnson will have to respond to that question in writing as time has expired.

Mr. Davis is recognized for 5 minutes.

Mr. DAVIS. Thank you very much, Mr. Chairman.

I certainly want to thank our witnesses for coming. You know, it appears to me that as we continue to raise the specter of possible default, that we undermine the confidence of our citizenry, and we certainly do a disservice to our country. You know, if you are living every day with the idea wondering, are we going to be able to make it until next week, or are we going to be able to make it for the next 3 months, I am not sure that that is the most effective way of convincing our citizenry that we are a stable, viable government, able to solve its problems, to meet its needs, and bring resolution to whatever crisis there might be facing us.

Dr. Johnson, let me ask you, after the 2011 crisis, we had the worst job creation month in 27 months. Why? Why did that occur?

Mr. JOHNSON. That occurred because of the additional uncertainty created for everyone, including companies that make the hiring decisions about what is going to happen next week or next month. This is a classic problem many countries have, but those are usually countries much poorer and less well organized than the United States. It was in 2001, extraordinary and unbelievable to people that we would come so close to default, and it is extraordinary again today that you would put the debt ceiling on the table in these negotiations when the last thing you surely want to do is get into any of these complicated games about prioritization, nonpayment or this or that creditor or potential default.

Mr. DAVIS. Let me ask, how do business interests, how does a company respond to this short-term kick the can down the road, when they have to make decisions about their company, people they must hire, or products they must develop? How does the business community respond to that?

Mr. JOHNSON. They delay decisions; they wait. That is the finding, overwhelming finding, for example, by Baker Bloom and Davis but also other people who studied uncertainty, the effects of uncertainty. We don't know what is going to happen; therefore, we hesitate to make commitments. We are not going to buy that new equipment. We are not going to expand. We are not going to hire people. Let's wait and see. And while uncertainty remains elevated as it is today, there will be hesitation in hiring and hesitation for the overall macroeconomic recovery.

Mr. DAVIS. It is my position that one of the great needs that we have to get out of the economic crisis that we have been facing and creating and wondering about is to create jobs. I mean, it seems to me that if more people were working, that that means more people would be paying taxes; they would be putting more money into the Treasury. And if jobs are not being created, then I don't think we can just keep dallying around and dallying around and still there is no bottom line. How does this impact job creation and really provide the kind of assurance that people are going to be able to work and contribute significantly to further development of our economy?

Mr. JOHNSON. Job creation is going to be impacted negatively by the uncertainty around fiscal policy, particularly any discussion of the debt ceiling, any of the debt-ceiling-related points that have come up today. Those are negative in terms of increasing uncertainty. Those are going to cause more hesitation in hiring. Those are going to slow employment growth below what it would otherwise be. And those are not helpful to the economic recovery or, as you say, Congressman, to the budget.

Mr. DAVIS. So, in essence, we are kind of kidding ourselves about being able, without creating jobs, to solve economic problems; that just making decisions to shift thoughts and ideas and processes, and at the end of the day, there are still no more people working.

Mr. JOHNSON. You need an economic recovery, Congressman, for everything else that you want to do. And that requires jobs to come back to where they were. We are still at least 3 percent below peak employment pre-financial crisis. This is the longest, worst recession in American history since the 1930s.

Mr. DAVIS. Thank you very much.

And thank you, Mr. Chairman.

Chairman CAMP. Thank you, Mr. Davis.

Mr. Griffin is recognized for 5 minutes.

Mr. GRIFFIN. Thank you, Mr. Chairman.

Thank you all for testifying today. I want to be really clear as well. I haven't heard any talk on this side of the aisle about default, wanting to default, using default as leverage. That is a straw man. The only people I have really heard a lot about default from are on the other side of the aisle. So I just want to make that abundantly clear.

And it reminds me of what now Majority Leader Reid said back in 2006. He is the one that was talking about default. He said, "Americans know that increasing debt is the last thing we should be doing. After all, I repeat, the Baby Boomers are about to retire. Under the circumstances, any credible economist would tell you we should be reducing debt, not increasing it. Democrats won't be making argument to support this legislation, which will weaken our country, weaken our country. We are being asked to do what shouldn't be asked of us, to increase the debt to almost $9 trillion."

So there is a lot of politics going on here. And what I would like to do—and most of the questions I had to ask have been asked. So I would like to just go over a couple of things to clarify. We have heard a lot of talk about the Bush tax cuts and the wars adding to our debt. And I was looking here at revenue as a percentage of GDP. And it is interesting that in the mid-1990s, when taxes were higher—1995, for example—revenue as a percentage of GDP was

18.4 percent. During the Bush years, in 2007, after the economy recovered from 9/11, it was 18.5 percent. So the idea that revenue dipped significantly during the Bush years because of tax cuts is just not true. Sure, it went down after 9/11.

I didn't see 9/11 labeled on this chart, Mr. Johnson.

But I think that that is a critical part of the equation.

The other thing that I would point out, a key change—and Majority Leader Reid referred to it—the key change has been demographics. We all agree we have spent too much in Congress, a lot of it long before I got here. But the issue now is not who spent too much. The issue now is, who is willing to fix the problem and who is not? That is ultimately the issue.

And we have heard a lot about a balanced approach, and we just had an agreement here in the House, in the Congress, that raised taxes.

Now, from my calculations, before the taxes that were raised on the American people recently—a few weeks ago—we had a deficit of about $1 trillion. After those tax increases, we have a deficit of about $1 trillion. Does anyone disagree with that?

Mr. Casey, do you agree that it had no significant impact on our deficit?

Mr. CASEY. I agree.

Mr. GRIFFIN. Mr. Hoagland.

Mr. HOAGLAND. I agree that the deficit for fiscal year 2013 will still be about $1 trillion.

Mr. GRIFFIN. Even after the tax increases?

Mr. HOAGLAND. Yes. But of course those tax increases phase in over a longer period of time.

Mr. GRIFFIN. If you take $60 billion a year and subtract it from a little over $1 trillion, you are still right at $1 trillion. Correct, Mr. Foster?

Mr. FOSTER. That is the simple math, sir.

Mr. GRIFFIN. And Mr. Johnson.

Mr. JOHNSON. No, Congressman. Look, the way that you have discussed the budget and the way you argue about the budget is over a 10-year timeframe. Those were insufficient, I agree, to completely address the budget issue. I supported larger, stronger strengthening of revenue—not immediately, though. Phasing it in over time is the right way to do it. You don't want to shock the economy too much. Phasing it in over 10, 15 years.

Mr. GRIFFIN. I am running out of time. The bottom line is, I understand you look at things over 10 years. And we all know that in 10 years, there is no control over what is going to be spent and what is going to be coming in. But the bottom line is, the tax increases we got with no cuts did nothing to impact the deficit of any significance—it is still about $1 trillion. You could say it is $910 billion. Okay. It is still about $1 trillion. The bottom line is, we still are about $1 trillion in the red every single year. And I will be waiting with optimism to see the President's budget.

Again, thank you all for coming today. And I yield back.

Chairman CAMP. Mr. Hoagland, in your 33-plus years of dealing with budget issues in the Senate on the Senate Budget Committee and in other areas, have you ever known in the history of our country of four successive years of trillion-dollar deficits?

Mr. HOAGLAND. No, sir.

Chairman CAMP. So it is an unprecedented position we are in, in terms of the annual deficits?

Mr. HOAGLAND. I never thought I would see trillion-dollar deficits.

Chairman CAMP. And the debt—and I tend to use gross debt as a percentage of GDP.

Have you ever seen the gross debt as a percentage of GDP at the level that we are seeing right now?

Mr. HOAGLAND. Only after World War II. But then we owed it to ourselves, and we brought it down rather substantially there.

Chairman CAMP. So since World War II, the level of GDP——

Mr. HOAGLAND. Has averaged about 40 percent.

Chairman CAMP. Okay. And I was on the President's fiscal commission. And at that time, it was about 90 percent. Now it is over 100 if you look at gross debt. And we had a presentation there by doctors—it was by Drs. Carmen Reinhart and Kenneth Rogoth—who indicated that a country's economic growth would—and I am using their words—deteriorate markedly when its debt-to-GDP ratio was above 90. And obviously, we are at that point now.

Mr. HOAGLAND. Correct.

Chairman CAMP. What impact do you believe that will have on the economic growth and job creation in the United States in the future?

Mr. HOAGLAND. I believe, again, that has a very negative impact upon the growth of this country going forward in terms of our credit rating around the world, in terms of our economic growth pattern will be negatively affected by that level of debt to GDP. While it is not a good example, all we have to do is look at what is happening in Europe and see the consequences that that has had over there.

Chairman CAMP. We recently got a Fitch ratings report. And I am quoting from their report that said, "In the absence of an agreed and credible medium-term deficit reduction plan that would be consistent with sustaining the economic recovery and restoring confidence in the long-run sustainability of the U.S. public finances, the current negative outlook on the AAA rating is likely to be resolved with a downgrade later this year, even if another debt-ceiling crisis is averted."

How do you think the financial markets and the broader economy would react if Congress simply increased the debt limit and there was no credible commitment to addressing the current fiscal situation, as we have just discussed?

Mr. HOAGLAND. Mr. Chairman, I think that the debt limit bill does not control or limit the ability of the Federal Government to run deficits or incur obligations. But I do believe there is a limit on our ability to pay obligations. So I think that while this is not the perfect solution, at least you do have the opportunity here by—if you simply raised it without some form of a process, which I hope would come about through going back to regular order, I think that would be looked upon very favorably. But if you simply raised it with no process involved, I think that would be looked upon negatively by the market.

Chairman CAMP. All right.

Dr. Foster, any comment on that?

Mr. FOSTER. I think that is exactly right. The markets are looking. They understand something of Washington and how Washington works. They understand there are only a few moments in a given year or 2- or 4-year period in which we have a forcing moment, a time when Congress must actually do something. And the critical value of the debt limit and the debate around the debt limit that is a simple enough issue that the American people can understand it. The budget is complicated. They don't understand the budget. They do understand debt. They have debt. They understand. They don't understand trillions. But the concept, they get.

The second value is that it is a forcing moment. It forces Congress to act when the regular order of the budget process has failed. Mr. Hoagland talked about this—and I completely agree with him regarding the importance of the regular order. But Congress has a regular habit of ignoring the regular order. This is a forcing moment, and it is a critical time to take action.

Chairman CAMP. And Mr. Hoagland, again, given your experience on budget, we have had other short-term extensions of the debt limit in the history of this country, have we not?

Mr. HOAGLAND. Yes, we have a number of times. Looking it up, I think it was at least—in my career up here, we have had it at least seven or eight times, we have had a short-term limited increase.

Chairman CAMP. And we have also had extensions of the debt limit that have had policy reforms attached to them as well, have we not?

Mr. HOAGLAND. Oh, I think the most important one—I said my first experience here was with the 1985 Gramm-Rudman-Hollings Act, which was tied to debt limit increase because we were going over $2 trillion.

Chairman CAMP. So when the President and many Democrats call for a so-called clean increase in the debt ceiling, which they mean has no other reforms or other proposals attached to that or changes in spending behavior, how do you see the path forward? And what should advocates of lower spending expect from the Administration? Or other budget reforms that might be attached with it? You mentioned Gramm-Rudman-Hollings. And I would like you to comment and then Dr. Foster.

Mr. HOAGLAND. As I say, I don't think the debt limit bill, per se, it controls spending. It controls—it is a limit. But I do think that there are other tools. And they are not pretty. But you do have a sequester. I would certainly argue—and this is just myself speaking, not BPC—that you would look at the sequester as something that really does reduce spending. And I would also argue that one thing to do there would be to modify the sequester so that it actually does affect more than just the discretionary portion of the budget and maybe, and with some trepidation, also tax expenditures.

Chairman CAMP. All right. Dr. Foster.

Mr. FOSTER. Yes, sir. As I mentioned, the debt limit is a forcing moment. And one of the things it can force is a shift in budget processes to make them more effective, to get Congress to take actions that it might not otherwise take under the regular order as it then stands, Gramm-Rudman-Hollings being the great example.

One of the things we should be looking for in this current debate is, how do we tighten up, make more rigorous the budget process regular order so Congress takes it seriously and then puts forward the kinds of resolutions and reconciliation bills that Mr. Hoagland was talking about?

Chairman CAMP. Thank you.

And Mr. Casey, I just want to clarify this point before we adjourn. The Constitution grants Congress the sole authority over fiscal powers to tax, spend, and borrow; is that correct?

Mr. CASEY. Absolutely correct.

Chairman CAMP. And because the power resides in Congress, the debt limit is not actually a limitation on the Executive's power to borrow; is that correct? It is the statute that contains the debt ceiling is actually a grant of authority to the President.

Mr. CASEY. It certainly can be read that way. I mean, it is a limit on the amount that Congress is permitting the Executive to borrow.

Chairman CAMP. But it would be authority he would not otherwise have——

Mr. CASEY. Absolutely. Absolutely. Without it, he cannot borrow a nickel.

Chairman CAMP. So when that authority runs out, it is actually the Constitution of the United States that is preventing the President from attempting to borrow on the credit of the United States?

Mr. CASEY. Yes.

Chairman CAMP. All right. Thank you.

I want to thank all of our witnesses and certainly the Members for participating in this hearing today.

And with that, this hearing is now adjourned.

[Whereupon, at 4:36 p.m., the Committee was adjourned.]

[Submission for the Record follows:]

22 January 2013
Committee on Ways and Means
Hearing on Debt Limit

Distuinguised Representatives,

Hello, and thank you for taking the time to listen to what I have to say. I urge you not to give up the constitutional right granted solely to the House of Representatives for controlling the nations purse strings. I also urge you to not raise the debt limit. My reasoning for this statement is that if we take the hit now and deal with the repercussions it will be easier for us than if we continue to foolishly put off the fiscal problem facing our nation. If we continue to act irresponsibly it will be much more difficult for the nation when the bill, so to speak, comes due. I would urge you make cuts in Defense Department spending before cutting anything else. As a soldier I am not afraid of this but rather I welcome such cuts. I urge you not to think of gaining or losing the votes of the ever fickle people but to think of your solemn responsibility entrusted to you by those same people and by God.

Thank You

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