Testimony of

Frank Keating

On behalf of the

American Bankers Association

for the hearing

Impact of a Default on Financial Stability and Economic Growth

before the

Committee on Banking, Housing, and Urban Affairs

United States Senate

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Chairman Johnson and Ranking Member Crapo, my name is Frank Keating, President and Chief Executive Officer of the American Bankers Association (ABA).The ABA is a 135 year old association that represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees. I also served as governor of Oklahoma for two terms and as a member of the Bipartisan Policy Center's Debt Reduction Task Force.

I appreciate the opportunity to be here to represent the ABA regarding the need to raise the debt ceiling and the consequences of failing to do so.

Let me be very clear: we need to meet our obligations and not create any uncertainty that we will do so—on-time, every time. In this country, our word is our bond. The respect and admiration that the United States and its institutions inspire around the world are based on the certainty that when our nation makes a promise, we keep it.

Ordinary Americans will bear the brunt of the damage if our leaders do not prevent the United States from defaulting on its debt for the first time in history. We are much closer to disaster this year than we were just over two years ago when the debt-ceiling standoff caused economic uncertainty to spike, consumer confidence to plummet and stock prices to spiral downward — all because of the perceived risk of the United States defaulting on its domestic and international debt obligations. The Bipartisan Policy Center (of which I am a board member) estimated the 2011 debt standoff cost taxpayers close to $20 billion as nervous investors demanded higher interest on U.S. Treasury bonds to account for the risk of government default. If our nation defaults on its nearly $17 trillion in debt, the harm is likely to be measured in hundreds of billions of dollars.

Even the slightest uptick in Treasury interest rates would cascade through the economy. It would raise the costs for taxpayers to service our country's debt and would raise the cost of borrowing for businesses, meaning job losses and price increases. Default would be a blow to retirement funds, leaving fewer resources available for retirees. For banks, which hold $3 trillion in Treasury, agency and mortgage-backed securities, the sharp decline in value of those securities would translate into fewer resources available for mortgages, business, auto, credit card and student loans.

If Congress fails to act and we hit the debt ceiling we will set off a chain of events that will cover our entire economy and impact all Americans. These impacts would not be easily reversible. The repercussions could linger for years, providing a constant drag on our economy.

Default would also put the United States in the category of reckless debtor nations that have broken their word in the markets, including Argentina, Venezuela and Cameroon. Defaults left those countries financial pariahs and debilitated their economies.

No one takes our national debt more seriously than I do. As a Republican governor, I balanced my state's budget eight years running and worked with colleagues from both sides of the aisle to ensure that Oklahoma honored its debts and expanded its economy. Later, I joined the Bipartisan Policy Center's Debt Reduction Task Force (also known as the Domenici-Rivlin commission), which endorsed painful but necessary measures to put the country's fiscal house in order. Rather than inflict damage upon ourselves by failing to pay our existing obligations, we should instead focus on reducing our future spending and bringing our debt to a sustainable path.

Honoring U.S. fiscal obligations is not a Republican or Democratic issue — it's the American thing to do. As George Washington said, "No pecuniary consideration is more urgent than the regular redemption and discharge of the public debt; on none can delay be more injurious, or an economy of the time more valuable."

Since May, the Treasury has used extraordinary measures to keep us from hitting the debt limit. We have been lucky to avoid it thus far, but time is up. With the U.S. economy and our nation's honor on the brink, our leaders must — in the spirit of patriotic compromise — do what it takes to make a deal.

If confidence is lost in our country's willingness to pay its bills on time, we will have lost something that may be impossible to regain — the world's trust.

The Debt Ceiling Must Be Raised To Pay What Our Country Has Already Spent

It is essential that Congress act to raise the debt ceiling and pay the debts it has already incurred to maintain our nation's credibility. U.S. Treasuries are the world's risk-free assets and lifeblood of global financial markets. When times are tough, it is Treasuries that are the world's safe financial harbor. This is only possible because governments, businesses and investors around the world have unparalleled confidence in both our ability and willingness to pay out debts. Our country has been a huge beneficiary of this and we should never take it for granted. We need to manage carefully our debt levels, but we cannot inject doubt as to our willingness to meet our obligations.

By raising the debt ceiling, Congress does not authorize any new spending, it simply commits to paying the bills it has already approved and money already spent. Paying our debts should not be confused with controlling future spending. Both must be done. At over 70 percent of GDP, there is no denying our overall

debt level is too high. We need as a country to find a path forward that makes the most effective use out of the hard-earned tax dollars our citizens entrust to the government to manage.

Default Will Have Severe Long-term Consequences

Failing to raise the debt ceiling in time would be an unprecedented mistake that would have dire consequences for our economy. Even the ***prospect*** of a default has shown to be massively disruptive to our economy. The debt ceiling standoff in 2011 gave a clue to the potential damage. As I mentioned above, that event alone cost U.S. taxpayers nearly $20 billion in increased interest costs, all of which could and should have been avoided. The market today is already pushing short-term Treasury rates up and credit default insurance spreads on Treasuries have widened.

If the U.S. were to fail to pay its debts, even for a few days, the consequences would be many times worse. In the first two weeks of November alone $345 billion in U.S. government bonds will come due. If we have not raised the debt ceiling by this point, the ability to roll over that debt and pay bond holders could be impaired. Interest rates would spike, as investors demand a higher premium for the risk they now take by holding our government's debt.

The inevitable increase in Treasury interest rates would cascade through the economy, directly impacting the lives of every American. Taxpayers will have to pay the higher government interest costs. Stocks would plummet, dealing a sharp blow to retirement funds. Borrowing costs for companies – both large and small – would rise, making businesses less willing and able to invest in new plants, buy equipment and hire additional workers. Because banks hold large portfolios of Treasury, agency and mortgage-backed securities, any rise in rates would create unrealized losses that would end up reducing capital ratios and limiting the supply of funds that could be lent to individuals wanting to buy a home, finance a new car or go to college.

The short-term impacts will certainly knock the current economic recovery back on its heels. These consequences are not easily reversible and are likely to linger for years, providing a constant drag on our economy. While the failure to pay our country's bills on-time would have the biggest cascading impact, failure to raise the ceiling would also reduce the available funds to pay salaries to our armed forces, retirees on Social Security, and thousands of other commitments we have already made.

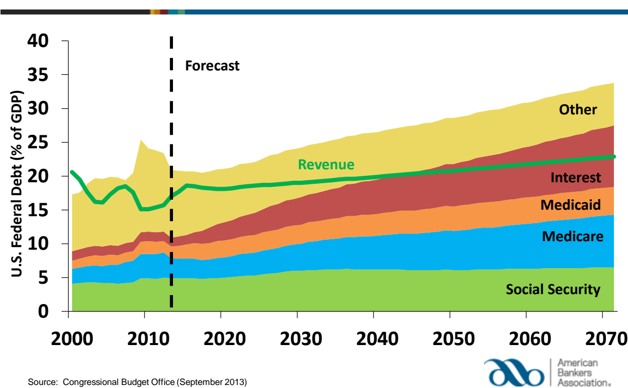
A Sustainable Solution to Our Long-term Debt is Needed

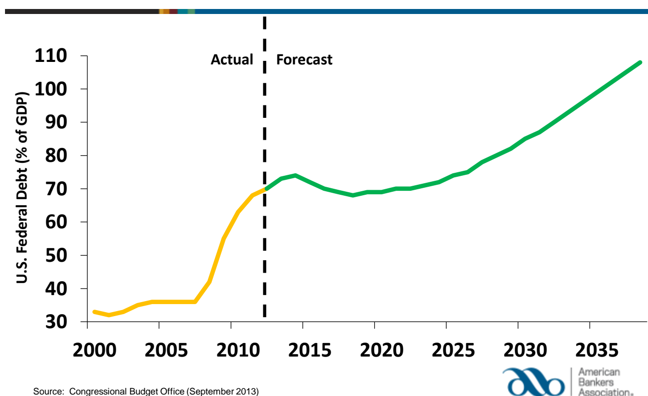
There should be a wholesome debate about how taxpayer dollars are spent in the future. We need to be sure that those precious tax dollars from hardworking American's are used in the most productive way. But we should not confuse the need to pay our bills for things that Congress has already approved and spent with the management of spending that is appropriate for the future. To use a credit card analogy, the decision

about what to buy on credit tomorrow must take into account the debt we already owe, but that is never an excuse for not paying the current bill on time and in full.

Markets, not Congress, truly determine our government's ability to borrow. Our debt is already 70 percent of our GDP. While the sequester is expected to reduce debt-to-GDP for a few years, even it fails to arrest the longer-term upward trajectory. According to the Congressional Budget Office (CBO), by the year 2043 entitlement programs and debt service payments alone are projected to outstrip revenues. This means that there will be no funds at all for any discretionary spending. It is impossible to address the long-term sustainability of our debt without addressing the growing costs associated with our entitlement programs.

The CBO predicts that in the next 25 years our debt will surpass 100 percent of our GDP. This would put us in the same league as the fiscally unstable countries that led Europe into crisis. Already, the U.S. debt amounts to nearly $54,000 per person, and $148,000 per taxpayer. The interest payments alone on our debt will cost over $8,000 per U.S. citizen in 2013.





Addressing future spending and bringing our debt down to sustainable levels must be done in a bipartisan way. My experience serving on the Domenici-Rivlin commission gives me hope that tough decisions can be made for the good of our country.

Conclusion

The answer to managing our debt is not to simply stop making our payments on money already spent. We should never inject uncertainty into the markets that we as a country will not keep our word and pay the debts that we owe. We must pay our bills on-time and in full; then we must carefully manage our future spending so that we can begin to pay down our accumulated debt. I urge members of this committee and the full Senate and House to engage in a bipartisan way to find long-term solutions to our growing debt levels.

Our role in the global economy is too important to flirt with danger of a default. Once trust is lost, it is difficult, if not impossible, to regain.