May 9, 2023

The Honorable Janet Yellen
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Madam Secretary:

As current and former Chairs and Vice Chairs of the Treasury Borrowing Advisory Committee over the past 25 years, we are deeply concerned about the lack of resolution of the statutory debt limit. The U.S. Treasury began to employ extraordinary measures to avoid breaching the debt limit on January 19th. Since then, markets have become increasingly concerned that the U.S. Government will default on its debt. This has already increased the debt burden to the American taxpayer.

Auctions of U.S. Treasury Bills have weakened, as investors demand an increasing premium to compensate for this risk. Investor interest in 1m Treasury Bill auctions has dropped to a local low, with primary dealers needing to buy nearly half of recent issuance. Secondary U.S. Treasury markets are also reflecting signs of stress with investors demanding nearly 120bps more for Treasury Bills maturing in early June than at the end of May.

Rating agencies have begun publishing analysis regarding the possibility of a U.S. government downgrade, and associated increase in credit risk for municipal, government sponsored entities (GSE) and corporate issuers. There will be a direct impact on any issuer whose credit relies on backing from the U.S. government: examples include GSEs like Fannie Mae or Freddie Mac, central counterparty clearing houses like DTCC, and essential infrastructure like Amtrak or TVA. A broader range of issuers would be indirectly impacted, due to their reliance on U.S. government funding, payments, or investments. These include hospitals relying on Medicare disbursements, universities with significant federal funding, and Public Housing Authorities. This is only a partial listing. A U.S. government downgrade or default would surge broadly throughout the real economy.

This current stalemate runs the risk of undermining the foundation of the U.S. Treasury bond market: the full faith and credit of the U.S. government. A protracted standoff over the debt limit will dramatically increase taxpayer costs and exacerbate market stress. Further, any delay in making an interest or principal payment by Treasury would be an event of seismic proportions, not only for financial markets but also the real economy.

The role of the Treasury market as backbone of the entire financial system cannot be overstated. As evidenced in March-2020, Treasury market dysfunction will rapidly propagate into other markets, harming American consumers, businesses, and municipalities alike. Trading in and financing of U.S. Treasury securities would be called into question, leaving the market without a benchmark pricing curve and causing investors to pull back from fixed income and equity markets. Market intermediaries would reduce liquidity provision amidst increasing volatility, heightened operational risks, and concerns about credit worthiness and collateral eligibility. The validity of Treasuries as eligible collateral for margin would be called into question, with devastating consequences for interest rate derivative, commodity, and mortgage markets.

In addition to these explicit costs, market participants are already undertaking significant preparations to reduce exposure in case of a possible default. The costs of the standoff extend well beyond what is seen in markets, as default preparations require operational, liquidity and solvency plans. This is time taken away from already extensive risk management and is particularly pernicious amid an evolving banking crisis.

Indeed, the financial market and banking system stress which began in March 2023 reinforces how integral a well-functioning U.S. Treasury market is to the real economy. The total economic impact of the failure of SVB and others is yet to be seen, but reduction in credit availability has already begun, making loans more difficult for individuals and small business to secure. With financial markets on edge, continuing to debate raising the debt limit is reckless and irresponsible.

The short-term impacts of a protracted negotiation are costly; the long-term implications of a default are unthinkable. We are at the peak of the nation's debt needs and expect those needs to only increase further. Our country relies on $32T in debt financing; anything that damages investor confidence at a minimum elevates the cost of that financing, and at worst could jeopardize US borrowing access entirely. The magnitude of adverse consequences from a prolonged negotiation, or a default, is unquantifiable, with both the American taxpayer and the U.S. economy bearing the burden.

It is imperative that the debt limit be increased with all due haste, but a more permanent fix is also required. Since 1941 when the Public Debt Act was passed setting a single limit on the amount of Treasury debt obligations that could be outstanding at any one time, Congress has passed and the President has signed more than 80 debt limit increases, and several suspensions. It is time to introduce an alternative method of enforcing fiscal responsibility, by either requiring the limits to be raised simultaneously with appropriations or by repealing the debt limit altogether.

Respectfully,

Treasury Borrowing Advisory Committee Chairs and Vice Chairs, 1998 – present

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