Insight

Debt Ceiling Inaction Will Tax Americans

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The vote counters on Capitol Hill are singing in scary unison – no one can find the 218 House votes needed for a debt ceiling increase package right now. There's an emerging view that maybe the only way to get enough votes is to first suffer a massive market drop after failing to meet the Aug 2nd deadline – that a day of market chaos might be the only fuel that can push that bill across the finish line.

Political commentators cite as a precedent the TARP vote in September of 2008. With credit markets frozen and banks suffering a massive crisis of confidence, the Administration requested TARP legislation to keep the problem from getting worse – to stop the spiral of bank failures that were going to take their toll on Main Street. But that Main Street effect wasn't obvious yet, and Congressmen on both sides of the aisle simply didn't believe that "Wall Street's problem" would ricochet through the whole economy, drying up credit and costing millions of jobs. Because the pain wasn't yet apparent back in their districts, House members voted down the TARP legislation the first time it came to the floor. When the Dow-Jones Industrial Average dropped more than 700 points (over 7 percent) in response to the failed vote, members finally saw the cost of not acting and passed the bill a few days later.

In the wake of that first failed vote the market drop destroyed $1.2 trillion in wealth- from pension funds, 401(k) accounts, college savings funds and other nest eggs American families depend on. Americans paid for Congress' failure to act.

This time will be worse. Markets today are assuming there will be a deal to raise the debt ceiling. If there isn't, we should expect a significant negative reaction, immediately impacting Americans' savings.

That failure to act could have a permanent impact on the price we pay to finance our debt going forward. Investors may never again have the same confidence that US debt is nearly risk-free. Today we benefit from that confidence, paying lower interest rates on the debt we issue. If a short-term failure to raise the debt limit leads investors to demand even a tiny risk premium, taxpayers will bear an even greater burden in paying the interest on our debt. A back of the envelope calculation, ignoring compounding, suggests that just an additional single basis point (one one-hundredth of a percentage point) on the interest rate we pay on our debt translates into $1.4 billion a year in additional interest payments taxpayers must pay.

We're already struggling to get our economy back on track. Americans are nervous about jobs and have watched their homes plunge in value. Does Congress need to force Americans to take yet another painful hit on their savings as the price of this debt ceiling vote? Republicans rightly oppose raising taxes in conjunction with raising the debt ceiling, but failing to raise it will exact a tax of its own as markets react to Washington's dysfunction.