US treasury secretary issues warning on debt ceiling

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US Treasury Secretary Janet Yellen has warned that the government has reached its debt ceiling, requiring accounting manoeuvres to continue paying its bills. It sets the stage for a political conflict in Congress over lifting the debt ceiling that could severely impact the stability of the US dollar and the financial system.

In a letter to Congress last week, Yellen said that as of this Thursday the outstanding debt of the US was projected to reach the statutory limit of just under $31.4 trillion. The Treasury would "need to start taking certain extraordinary measures to prevent the United States from defaulting on its obligations."

She said such measures only allowed the government to meet its obligations for a limited period.

"It is therefore crucial that Congress act in a timely manner to increase or suspend the debt limit. Failure to meet the government's obligations would cause irreparable harm to the US economy, the livelihoods of all Americans, and global financial stability."

Yellen said it was not possible to provide an exact estimate of how long the Treasury could continue to operate with extraordinary measures, but it was unlikely actual cash would run out before June.

However, financial markets would be impacted well before then because "in the past even threats that the US government might fail to meet its obligations have caused real harms, including the only credit rating downgrade in the history of our nation in 2011."

In 2011, opposition by so-called "Tea Party" Republicans to raising the debt ceiling under the Obama administration without massive cuts in social spending meant the US came close to a default. A deal was reached, but not before Standard & Poor's had downgraded US debt from its top rating, a change that remains in place.

The deal, brokered by then Vice President Joe Biden, involved significant cuts in government spending.

Twelve years on, the dynamics of debt ceiling politics are potentially even more explosive because of the further shift to the right in the Republican party, as revealed by the critical role of its leading members in the Trump coup attempt of January 6, 2021, and the inordinate power of a fascistic cabal that forced 15 votes in the election of House Speaker Kevin McCarthy.

McCarthy was only elected after the so-called House Freedom Caucus extracted major concessions, giving it significant power to determine procedures and the legislative agenda.

Among the measures agreed to by McCarthy was a change in procedural rules so that just one member of the House can move a vote of no confidence in the Speaker. This means that in any negotiations between the Republicans and the administration on the debt ceiling, McCarthy will face the prospect of being removed if he does not come up with a deal that meets demands for sweeping cuts in spending.

At this stage, both sides are staking out their positions. The Biden administration claims it will not make budget cuts as part of any deal because lifting the debt ceiling does not involve new spending measures, but is needed to honour commitments made in legislation previously passed by Congress.

Nor will it take executive action outside of Congress to avoid a default. In line with Biden's commitment to work with the Republicans as they careen further to the right and outright fascist elements acquire ever greater powers, White House press secretary Karine Jean-Pierre said the administration was not considering any measures that went around Congress.

The debt ceiling should be lifted without conditions and "there's going to be no negotiation over it," she

said. But as the experience of 2011 shows, such reassurances are worthless.

White House spokesman Andrew Bates has said "the president and the country" would not stand for cuts to Medicare, Social Security, Medicaid or other core social programs as part of a deal on the debt ceiling.

But McCarthy believes those issues are very much on the table. Action on the debt ceiling was part of his campaign to secure the speakership—a position he repeated on Thursday, saying, "spending is out of control" and "we cannot continue around the same process."

He clearly thinks, with good reason, that the administration, headed by the man who brokered the 2011 deal, will move. He said he had a "very good conversation with the president when he called me and I told him I'd like to sit down with him and work through these challenges."

The release of the Yellen letter and the prospect of a crisis going beyond that of 2011 have sparked expressions of concern because both political and financial conditions are even more toxic than they were then.

According to Nancy Vanden Houten of the think tank Oxford Economics: "Most policymakers would prefer to limit a debt crisis, but the leverage given to the hardline Republicans in the House raises the odds that one will occur."

The *Financial Times* reported that business groups are "getting nervous," and cited comments from Suzanne Clark, president of the US Chamber of Commerce, the largest business lobby group. Clark said she had heard from members a "clear, emphatic emotion not to default on our debt, to not play chicken with the full faith and credit of the United States."

The economic and financial situation is more precarious than it was in 2011. At that time, the US Federal Reserve was pumping money into the financial system under its "quantitative easing" program. Today, it is imposing a tightening monetary regime to batter down the wage demands of workers in the face of the highest inflation in 40 years, leading to turbulence in financial markets.

Even the threat of a default will raise questions about the stability of the US financial system and the role of the dollar as the world's reserve currency, in a situation where there is increased nervousness, expressed in the increase of gold purchases in recent months.

As the *Wall Street Journal* commented, the standoff over the debt limit "comes at a fragile time" for the US economy, amid concerns that the Fed's interest rate increases could tip the US economy into recession, under conditions where global growth is slowing.

"Uncertainty over the reliability of Treasurys—a safe-haven asset around the world that underpins much of the financial system—could further cloud the economic outlook," it said.

In March 2020, at the start of the pandemic, the $24 trillion US Treasury bond market froze, when, for several days, no buyers could be found for US government debt, supposedly the safest financial asset in the world.

This crisis was alleviated only though a massive intervention by the Fed, which pumped a further $4 trillion into financial markets and provided dollars to other central banks.

None of the issues that caused the freeze has been resolved, and there have been reports since then of a lack of liquidity in the US debt market. An outright default, or even the threat of one, could have major consequences for both the US and the global financial system.