The Washington Post

Back to previous page

Debt-ceiling breach would push economy into free fall, without a government safety net

By Zachary A. Goldfarb and Jim Tankersley, Published: October 13

The Obama administration will have to decide whether to delay — or possibly suspend — tens of billions of dollars in Social Security checks, food stamps and unemployment benefits if negotiations to raise the federal debt ceiling are not resolved this week, experts say, one of the many difficult choices officials will have to make at a time when the government will essentially be running on fumes.

The government will begin Monday with about $30 billion cash in the bank and a little more room to borrow as a result of extraordinary measures launched in the wake of the debt-ceiling crisis. By Thursday, administration officials say they will exhaust all borrowing authority and have only that cash on hand.

Experts on federal finances say that money might be enough to make payments for a few days, but certainly not for more than two weeks. In any event, they say, President Obama will have to make untested decisions about who and what to pay because daily tax receipts will make up only about 70 cents of every dollar of necessary spending.

Economists roundly agree that no matter which course Obama chooses, a drop in federal spending that large would exert a huge drag on economic growth. And in contrast to what happens during a traditional downturn — the safety net expands to help the vulnerable — assistance to seniors and low-income people could be delayed or reduced if Congress doesn't raise the debt ceiling.

Officials may also have insufficient funds to operate major parts of the government that are open during the shutdown, such as the Federal Aviation Administration and the FBI.

Senior Treasury Department officials convened Sunday evening to discuss the financial market's reaction to the continuing fiscal stalemate. Although the stock market jumped late last week amid optimism about a deal, bond markets remain deeply nervous about a potential breach of the debt-ceiling deadline Thursday.

Market reactions could be the first direct way that Americans witness the impact of a breach, but the consequences are likely to be felt in numerous other ways.

According to the Bipartisan Policy Center, which has done the most detailed analysis of federal finances in a debt-ceiling breach, administration officials would have to consider delaying or suspending tens of billions of dollars in critical payments to low-income people and seniors.

Under the most alarming scenario, as soon as Friday, payments to Medicare and Medicaid providers, unemployment benefits, Social Security checks and tax refunds would be postponed for one to four days.

Food stamps due to be distributed Oct. 25 could be held until Oct. 30. The same would happen to payments to defense contractors.

With huge payments due in early November, the situation would become grimmer. Nearly $60 billion in Social Security checks, veterans benefits and pay for active-duty troops is due Nov. 1. Those could be delayed nearly two weeks, according to the Bipartisan Policy Center's analysis.

"Right now, Grandma is getting a Social Security check. In a few weeks, unless we solve this, she won't," said Steve Bell, a former top Republican Senate staff member and a senior vice president at the policy center.

The exact timing of such delays isn't knowable because, officials say, the flow of federal tax receipts, which would be the sole source of revenue, is not entirely predictable. Greater uncertainty is being caused by the government shutdown and the start of the fiscal year Oct. 1.

By all accounts, the Treasury would strive to make interest payments on U.S. bonds if Congress failed to raise the debt ceiling on time. That would avoid a technical "default," as defined by credit-rating firms Standard & Poor's and Moody's, but financial markets could still respond with great worry.

A major test of investor reactions would come Thursday, when the Treasury Department is slated to refinance more than $100 billion in debt. If investors uncertain about U.S. finances refuse to refinance the debt or demand higher interest rates, markets could go into a tailspin.

But delayed safety-net payments are one of the biggest worries because of their outsize economic impact.

Americans who rely on those programs to buy groceries or pay rent would suddenly be without that aid. According to Moody's Analytics, food stamps and unemployment benefits have significant ripple effects, given that needy families tend to spend the money immediately. Moody's estimates that every $1 spent on food stamps or unemployment benefits tends to drive about $1.70 in economic growth.

The loss of that spending would hurt the economy, and those hurt by the economy wouldn't have any government help to fall back on, forming a vicious cycle.

Economists at Citi Research ran a simulation recently that included a worst-case scenario in which lawmakers don't raise the debt limit for an extended period of time. The model predicted that unemployment could shoot back to 10 percent and the economy would dive into recession.

But the results "could have been worse than that," said William Lee, a global economist at Citi, because the model assumes that in the case of recession, government spending picks up as more people qualify for unemployment benefits and food stamps.

It's likely, according to experts, that in a debt-ceiling breach, officials would strive to minimize the impact on vulnerable populations. But that would force officials to prioritize some payments over others — a move that they say is impractical and potentially illegal.

If the government were able to preserve much of the safety net and the military pay in the month following a debt-ceiling breach, it would have to forgo other spending, according to the Bipartisan Policy Center.

For example, it might have to suspend all federal salaries and benefits and veterans benefits, as well as operations of the Justice Department, the Energy Department, the FAA, the Environmental Protection Agency and other agencies.

Those would just be the direct effects of a hard cap on federal spending. There could also be broader effects in the financial markets.

In such a situation, short-term-borrowing markets, which play a critical role as a safe place for cash, could dry up. That could lead to liquidity problems for financial firms, which would have trouble raising the daily funding they need to maintain their operations — and that probably would have spillover effects elsewhere, such as the stock market.

And from Oct. 18 to Nov. 15, the Treasury Department must refinance $370 billion in debt. In that process, the Treasury borrows money to pay back investors and then borrows the same amount from investors. If investors are growing nervous about a default, they could demand much higher interest rates to offset the risks of lending to the government.

Given that Treasury bonds are the benchmark interest rate for much lending in the economy, all sorts of loans could get expensive — mortgages, corporate loans, auto loans — which would crimp home buying, corporate investment and auto purchases.

The Organization for Economic Cooperation and Development, which tracks growth across the developed world, has calculated that the effects would compound economically and ripple globally.

“We’re not necessarily trying to cause alarm,” Angel Gurría, the OECD’s secretary general, said in an interview. “But there is cause for alarm.”