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Congress creates uncertainty yet again

There's always a resolution, but there's also a cost - human and financial - to budget bickering



By Mark Zandi, September 29th, 2013

Lawmakers are at it again: They are waging another battle over the federal budget that threatens to shut down the government and breach the nation's debt limit.

We have seen this movie too many times before in the past several years. But while it has always ended with a last minute agreement that averts a calamity, each time the movie runs it does significant economic damage. The political brinkmanship creates significant uncertainty and anxiety among consumers, businesses and investors, weighing on their willingness to spend, hire and invest.

Congress' most immediate order of business is appropriating funds to keep the government operating after Monday. If lawmakers fail to act and there is a shutdown that lasts only a few days, it would be a nuisance, particularly to the roughly 800,000 federal employees who can't go to work, but the economic fallout would be no big deal. Federal workers would quickly get paid, and other impacted government functions would ramp back up.

However, shutting the government down for three or four weeks would do significant economic damage. Furloughed government workers would begin to act as if they were effectively unemployed. The housing recovery would be hurt as potential homebuyers couldn't get a Federal Housing Administration loan, and small businesses would have trouble getting a loan from the Small Business Administration. Tourist spots would suffer as national parks and museums stay closed.

And this likely understates the economic fallout, as it does not fully account for the impact of such a lengthy shutdown on consumer, business and investor psychology. Any

interruption much longer than a few weeks would cause GDP to stall out at the end of year, and much longer than a month would cause investors to discount the real possibility that lawmakers could breach the fast-approaching debt limit.

Lawmakers must increase the \$16.7 trillion Treasury debt ceiling before October 17. At that point, the government would be able to pay bills with only the cash it has on hand.

Operationally, the Treasury might be able to prioritize interest payments on U.S. government securities, as those payments are handled by a different computer system than other government obligations. But practically that would be difficult; it would entail paying bond investors (i.e. China and Japan) before Social Security recipients, for example.

Prioritizing other payments would likely not be possible, as the Treasury wouldn't be able to sort through the blizzard of payments due each month to decide which to pay. More likely, the Treasury would wait until it received enough cash to pay a specific day's bills. Initially, the resulting delays would be short, but they would increase over time. For example, if the Treasury hit its borrowing authority on October 17, payments to Medicare and Medicaid providers due that day would be delayed one business day, to October 21. But checks to be issued on November 1 for Social Security, veterans benefits and active-duty military pay would not go out until November 13.

For all of November, the Treasury would be as much as \$130 billion short on paying all its bills. This is whopping 9% of GDP (annualized). The economy would quickly unravel into another severe recession. Especially when considering that the Federal Reserve wouldn't know how to respond given that the interest rates it controls are already at zero and can't go lower.

It has become typical for Congress to run down the clock, but in the end it has never failed to come through. The motivation is clear: Any delay in raising the debt ceiling would have dire economic consequences.

But even if they do what everyone expects, the harsh political vitriol is weighing heavily on the collective psyche. Businesses are more reluctant to invest and hire, and entrepreneurs are less likely to attempt startups. Financial institutions are more circumspect about lending and households are more cautious about spending.

This was clearly evident in the near-debacle that occurred in summer 2011, when lawmakers raised the debt ceiling at the very last minute. Brinkmanship nevertheless undermined consumer confidence, and sent stock prices reeling. The bitter showdown led Standard & Poor's to cut its AAA rating on Treasury debt. Although policymakers acted before the debt ceiling was reached, the fallout nearly caused the fragile economic recovery to stall.

Despite Washington's budget battles, the economic recovery is four years old and counting, and the private economy has made enormous strides in righting the wrongs that triggered the Great Recession. Business balance sheets are about as strong as they have ever been, the banking system is well-capitalized, and households have significantly reduced their debt loads. The private economy is on the verge of stronger growth, more jobs and lower unemployment.

The key missing ingredient is Congress' willingness to fund the government after the end of this fiscal year and to raise the Treasury debt ceiling. It is time for Congress and the Obama Administration to call a cease fire in the budget wars. If they do, then the still-fragile recovery will quickly evolve into a sturdy self-sustaining economic expansion.

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