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SHUTDOWN COUNTDOWN

Economists: Gridlocked Congress 'Playing With Fire' As Failure To Legislate Could Devastate Economy

By William Alden

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NEW YORK -- Political infighting in Washington may seem irrelevant to many Americans. But in the coming weeks, as Congress attempts to pass a budget and debates whether to increase the federal debt limit, these rivalries now have the potential to devastate the U.S. economy.

If lawmakers don't reach an agreement to fund the government by Friday, an array of programs will shut down. The freeze, if it lasts for several weeks, could wound Americans' confidence enough to tip the economy into recession, Mark Zandi, chief economist of Moody's Analytics, said last week.

But even that scenario wouldn't be as damaging as if the government defaulted on its debt, a consequence that could come sometime in the next several months if lawmakers, locked in a political stalemate, fail to increase the federal debt limit.

A government shutdown has the potential to cause a recession if it lasts long enough, experts say. A default would likely ravage the economy almost immediately. Both could be caused by gridlock in Congress.

"It would be a big, big, big deal" if the United States defaulted on its debt, said Nariman Behravesh, a chief economist at IHS Global Insight, a financial and economic analysis firm. "It could mean the collapse of the dollar. People would run away from the U.S."

"That's playing with fire," he added.

At stake is the ability of the United States government -- and indeed of all of its citizens -- to borrow money cheaply, something Americans have long taken for granted as an essential feature of their first-world economy. If interest rates rise high enough, the economy essentially grinds to a halt.

"People playing chicken think it's a good idea to put at risk something that the country paid a dear price to preserve for so many years," said Gary Burtless, a former Labor Department economist and a current fellow at the Brookings Institution, in Washington. "For a rich country to play these types of games does strike me as being foolish in the extreme."

For months, top economic officials in the Obama administration have warned of the perils of refusing to increase the federal debt ceiling, while Republicans in Congress have portrayed the limit as a means of enforcing fiscal austerity. The U.S. government continuously issues new debt to pay principal and interest on older debt, which means that if the debt burden isn't allowed to grow, the U.S. could be forced to miss payments to creditors. If lawmakers fail to legislate, the debt ceiling will likely be hit.

But in the current political climate, legislation has been met with a fierce, protracted stalemate. In the past few weeks, lawmakers on both sides of the aisle have dug in their heels, generally refusing to compromise on a budget bill.

Gridlock could lead to a shutdown on Friday. A month later, the costs of not legislating will be even more dire.

Treasury Secretary Tim Geithner testified before the Senate appropriations subcommittee on Tuesday, laying out the dangers of inaction. Failing to raise the debt ceiling would send the country into crisis mode by May 16, he said, at which point the government would resort to emergency measures to stave off default for a few more weeks.

"Default by the United States would precipitate a crisis worse than the one we just went through," Geithner said, according to a transcript of his remarks. "I think it would -- it would make the crisis we went through look -- look modest in comparison."

A default by the United States could set off a dangerous chain reaction. It would likely cause interest rates to rise and the value of bonds to fall, as what is arguably the world's safest security would now be perceived as risky. Those higher rates would ripple throughout the economy, raising borrowing costs for homeowners, students, car-buyers, entrepreneurs, investors and all types of businesses. Financial markets everywhere would likely be thrown into panic.

Credit ratings agencies would likely be forced to lower the United States' top ranking, a seal of approval that investors across the world take for granted. The Federal Reserve's massive asset-purchase program, designed to lower interest rates to encourage the flow of money through the economy and stimulate a recovery, would likely be undermined.

As the United States would scramble to calm investors, the government would be forced to cut payments to the military, Geithner said. The full ramifications, moreover, cannot be foretold.

"That would be absolutely catastrophic and very likely set the stage for the U.S. economy to have a relapse into recession," said **Bernard Baumohl**, chief economist of the Economic Outlook Group. "That is the worst possible kind of outcome that we could have from Washington. It would be absolutely irresponsible."

In the event of a government shutdown, payments for struggling families could be delayed. In the case of a federal default, something similar could happen, but on a far larger scale. Investors across the nation and around the world hold U.S. government paper.

If that debt weren't paid, myriad investors -- from retirees just scraping by to the biggest Wall Street firms -- would see their investments suffer.

Eventually, these investors would almost certainly be made whole. But even a brief hiccup on the part of the U.S. government could trash the nation's borrowing ability for years to come.

"There's no question people will be paid back on their bonds," said Mark

Vitner, a senior economist at Wells Fargo. "The risk to the economy is: Does the stature of the U.S. debt market suffer because people misinterpret a temporary glitch in the Treasury market?"

That glitch could be ruinous.

"It's a hell of a mess," Vitner said.