Scary Default Scenarios Based on Faulty Treasury Department Release

Within hours of the "brinkmanship" press release by the Department of the Treasury, major media began to repeat the highly dubious risks outlined by the department without reading carefully exactly what it contained. The headline and opening paragraph were all that the echo chambers needed:

> **The Potential Macroeconomic Effect of Debt Ceiling Brinkmanship**
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> The United States has never defaulted on its obligations, and the U. S. dollar and Treasury securities are at the center of the international financial system.
>
> A default would be unprecedented and has the potential to be catastrophic: credit markets could freeze, the value of the dollar could plummet, U.S. interest rates could skyrocket, the negative spillovers could reverberate around the world, and there might be a financial crisis and recession that could echo the events of 2008 or worse.

First to pick up and repeat the canard was Toronto's *Globe and Mail* with the headline "The Doomsday Scenario of a U.S. Default." It reported that the Treasury warned that a default could be "catastrophic" and that banks were putting extra money into their ATMs, just in case. They found an "expert" to lend credence to the pending disaster (Jessica Hinds of Capital Economics, a London consulting firm that rates a single paragraph at Wikipedia), who tweeted:

> If Congress doesn't reach an agreement to raise the debt ceiling before the U.S. Treasury runs out of ways to keep the "essential" parts of the government running … then the U.S. may not have enough cash to meet … a debt interest payment of about $30 billion on November 15, potentially triggering a technical default.

A day later, Reuters opened its analysis of the Treasury Department's report with the title "Nightmare on Main Street," and then reviews, based on daily Treasury statements from a year earlier, just how a default might play out:

> On October 17, the Treasury Department exhausts all available tools.…
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> It takes in $6.75 billion in taxes but pays out $10.9 billion in Social Security retirement checks. By the end of the day, [the Treasury's cash cushion] has eroded to $27.5 billion.

On Wednesday, October 30, the Treasury, according to Reuters' analysis, will run out of money altogether:

> Default happens.… The government is $7 billion short of what it needs to pay all of its bills.
>
> [On Thursday] things get really spooky on Halloween when a $6 billion interest payment to bondholders comes due.

Reuters then enlists the help of another "expert" to help resolve the dilemma, this time the Bipartisan

Policy Center (BPC) — an obscure think tank founded a few years ago by former Senate majority leaders and big government advocates Howard Baker, Tom Daschle, Bob Dole, and George Mitchell. Reuters failed to mention that, however, and instead simply noted that according to a BPC "analyst," a solution is "very hard to predict," but "not making an interest payment on time is probably a worse way to default than not making other payments."

Things really get scary on Friday, November 1, again according to Reuters:

> In theory, the government could keep the bondholders whole indefinitely because tax revenues are more than enough to cover interest payments….
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> That would mean longer delays for everybody else. U.S. troops could fall behind on their rent payments, and seniors who rely on Social Security may have trouble buying groceries.

Or the government could stiff the bondholders by delaying payment of their interest:

> If … the Treasury missed the Halloween interest payment … the creditworthiness of the country could suffer. That would throw the value of almost every financial instrument into question: the U.S. dollar, bank loans in Asia, the cost of crop insurance in Illinois.

Barron's magazine got into the act in its weekend issue, calling the debate over spending a "dangerous game of fiscal chicken":

> The intractable battle of wills has gone on and on…. That has increased the odds of a debt default by the U.S. Treasury.
>
> The fanatical, small-government, free-market-loving Tea Party faction of the House'[s] Grand Old Party is engaged in a dangerous game of fiscal chicken with the equally fanatical big-government, welfare-state-loving Senate wing of the Democratic Party.
>
> Default looms, and neither side will blink.

What did the nefarious "brinkmanship" U.S. Treasury Department report actually say after the widely quoted opening paragraph? It iterated the impact of the debt crisis in the summer of 2011 with charts and graphs of such things as consumer confidence, small business optimism, stock market performance, and the VIX — a measure of stock market nervousness. It spoke wisely and profoundly on "Ten-Year BBB Corporate Bond Spreads" and "30-Year Conventional Mortgage Spreads," but never took the trouble to report on what actually happened to the economy after the passing of the Budget Control Act of 2011 on August 2. Instead, the Treasury was just all bluster and assumption:

> In 2011, U.S. government debt was downgraded, the stock market fell, measures of volatility jumped, and credit risk spreads widened noticeably….
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> To be sure, other forces also played a role, but the uncertainty surrounding whether or not the U.S. government would pay its bills took a toll on the economy.

Here would have been a perfect place for another graph, showing the Gross Domestic Product falling off the edge of the table in response to the debt ceiling crisis. Unfortunately, no such graph was presented because none exists. Instead, warnings of a similar "catastrophe" emanated from the seers at the Treasury:

> Increased uncertainty or reduced confidence could lead consumers to postpone purchases and businesses to postpone hiring….

> A precise estimate of the effects is impossible, and the current situation is different than that of late 2011 … but a large, adverse and persistent financial shock like the one that began in late 2011 would result in a slower economy with less hiring and a higher unemployment rate than would otherwise be the case.

With hard evidence lacking of just how the economy was impacted by the debt crisis of 2011, the Treasury barged ahead anyway with its EOTWAWKI (end-of-the-world-as-we-know-it) scenario:

> In the event that a debt limit impasse were to lead to a default, it could have a catastrophic effect on not just financial markets but also on job creation, consumer spending and economic growth — with many private-sector analysts believing that it would lead to events of the magnitude of late 2008 or worse, and the result then was a recession more severe than any seen since the Great Depression.
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> Considering the experience of countries around that world that have defaulted on their debt, not only might the economic consequences of default be profound, those consequences, including high interest rates, reduced investment, higher debt payments, and slow economic growth, could last for more than a generation.

A check of reality is long overdue. Standard & Poor's downgraded its credit rating of U.S. government debt by one notch, from AAA to AA+, on August 5, 2011, three days after the Budget Control Act was signed. But Moody's and Fitch continued to rate U.S. debt at AAA. The Government Accounting Office estimated that the modest increase in interest rates would cost the U.S. government an extra $1.3 billion in 2011. That works out to be three one-thousandths of the U.S. budget. And in 2012, the country's gross domestic product recorded growth of 4.5 percent, not bad for an economy that had just lived through such a harrowing experience!

It's also helpful to correct some misstatements offered as unvarnished truth by the media sources quoted above. In 1979, the United States defaulted (albeit briefly) on $120 million of Treasury bills. In 1989, the Treasury defaulted again when it was late in redeeming some securities. Tax revenues are averaging about $200 billion every month — way less than what the government is spending to be sure, but about five times the interest it owes on its debt. So much for troops about to be late in making their rent payments or little old ladies not being able to buy groceries because their Social Security checks will be late.

And there are those more reasonable souls who think that a default and a shutdown might actually do some good. Joel Skousen has riffed on how some 45 percent of the FDA's workforce would have to be laid off, along with those at the EPA, which Skousen calls "one of the most politically charged and evil of government agencies because it pursues a radical environmental agenda far beyond [its] proper mandate."

Skousen estimates that the CIA would be forced to lay off 12,500 employees, while 90 percent of IRS employees would have to be furloughed. It takes little imagination to perceive how such an event would be received by taxpayers, ignoring the cost savings.

Finally, have countries actually gone bankrupt and then come back into the credit markets? Well, yes. The scaremongers and naysayers at the Treasury Department should be asked: What about Argentina? Iceland? Mexico? Russia?

It's a shame that a report so poorly documented as that by the Treasury was picked up without critical skepticism and repeated without question by others in the media who should know better.

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