



THE ECONOMIC COSTS OF DEBT-CEILING BRINKSMANSHIP

Executive Summary

The federal government effectively reached its borrowing limit on May 19, 2013. “Extraordinary measures” undertaken by the Treasury Department since then will allow the federal government to postpone default until mid-October. Even if an actual default is averted, a delay in lifting the debt ceiling could increase uncertainty, erode consumer confidence and result in higher borrowing costs for businesses and individuals.

Because a default would cause significant harm to the economy, even the mere prospect of a default can affect the decision-making of households and businesses. A default would disrupt financial markets, limit access to credit and raise financing costs. It could also trigger a run on money market funds and cause significant harm to the U.S. economy by forcing the country to renege on commitments to individuals, businesses and governments.

With so much at stake, debt-ceiling brinksmanship poses serious and unnecessary risks to the U.S. economy, a fact that became clear during the protracted debt-ceiling showdown of 2011. The Dow Jones Industrial Average dropped over 2,000 points in late July and early August of that year as Congress struggled to raise the debt ceiling, and Standard and Poor’s downgraded the U.S. credit rating. Consumer confidence also fell sharply in that period.

A delay in lifting the debt ceiling, and the resulting uncertainty, also increases borrowing costs for the government. The impasse on lifting the debt ceiling in 2011, for example, meant that the Treasury had to pay higher yields than otherwise would have been necessary, costing taxpayers \$1.3 billion.

This report examines the effects of debt-ceiling brinksmanship and outlines its impact on the U.S. economic recovery.