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FOR IMMEDIATE RELEASE

EVEN WITHOUT DEFAULT, FAILURE TO RAISE DEBT CEILING WILL PUSH U.S. ECONOMY BACK INTO A DEEP RECESSION, NEW LEVY STUDY SAYS

ANNANDALE-ON-HUDSON, N.Y.— With no end in sight to the U.S. government shutdown, and the threat of an unprecedented U.S. government default looming for October 17, the U.S. and global economies face considerable uncertainty. While the assumption is that the U.S. government will default on its debt if Congress fails to raise the debt ceiling, a new study from the **Levy Economics Institute of Bard College** argues that even if the government avoids default by prioritizing the interest and principal payments on its debt securities and immediately balancing the U.S. budget, the rapid fiscal consolidation that results will be enough to push the U.S. economy back into a deep recession.

In his policy note *A New "Lehman Moment," or Something Worse? A Scenario of Hitting the Debt Ceiling*, Levy Research Scholar Michalis Nikiforos examines a scenario in which the U.S. government is forced to balance its budget for the 2014 fiscal year. Using the Levy Institute's macroeconomic model of the United States and based on projections of the Congressional Budget Office for U.S. economic growth and the government's fiscal stance, as well as the International Monetary Fund's projections for the growth and inflation rates of U.S. trading partners, Nikiforos finds that this "balanced budget" scenario would cause the U.S. economy to shrink by almost 3 percent in 2014 and the unemployment rate to surge to more than 9.5 percent. The impact will likely be much worse, he contends, because the projections for U.S. trading partner growth used in the scenario are based on robust U.S. growth. "A recession in the United States would certainly exert a negative influence on growth in the rest of the world, which would in turn feed back to the States," he writes.

Furthermore, the failure of Congress to raise the debt ceiling would reveal the inability of

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Washington to effectively handle the US economy, which, Nikiforos contends, would have negative consequences for the economy in the United States and internationally, especially since it was largely automatic and discretionary fiscal spending by the United States that halted the recent downturn. “In the case of a new crisis originating from rapid fiscal consolidation, it is not clear who would play the role of system stabilizer,” writes Nikiforos. Finally, a plunge in the U.S. growth rate could further damage the balance sheet of the private sector and induce a new round of rapid deleveraging, which would further depress growth and also have negative spillover effects for the financial sector.

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Policy Note 2013/9: *A New “Lehman Moment,” or Something Worse? A Scenario of Hitting the Debt Ceiling*

To read the full text of this policy paper or to learn more about the Levy Economics Institute of Bard College, please visit http://www.levyinstitute.org/publications/?docid=1907.

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