# Debt Ceiling Crisis: Breaking Down the Worst-Case Scenario

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Times are getting scary again. Between the debt ceiling, which is the crisis of the day, and everything else that is out there, people are starting to crack. With the Ukraine war still underway and with worries about China, inflation, and a recession, the debt ceiling looks like just the thing that could finally sink the ship. Even though we have done quite well so far and continue to, the worry is always that the next big thing will be the last straw.

## Could Happen Vs. Will Happen

Honestly, it could be. We can't absolutely rule that out. The worst-case scenario is something that could happen. But there is a big difference between *could* and *will*. There is a big difference between "there are risks and some bad things could happen, but there are also good things we can do to fix the bad situation" and "let's go straight to the worst case." Today, I want to talk about the worst case, why some are fixated on it, and why it will not happen.

## Taking the Worst Case Seriously

Let's take the worst case seriously: Congress refuses to raise the debt ceiling. Some U.S. obligations go unpaid. The standoff drags on indefinitely, leaving more and more damage in its wake. Eventually, bond buyers realize they will never be paid and abandon the U.S. dollar and debt. Economic collapse ensues. Certainly, all things considered, this is a bad outcome. But let's take each step and think about the solutions that could happen.

First, Congress— after a lot of theatre—has always raised the debt ceiling at the last minute, when a deal is cobbled together that lets both sides claim victory. That remains the most likely solution at this point. Indeed, negotiations are underway for just that outcome. Problem solved.

But what if Congress doesn't agree? Then we get the second-order solutions, the 14th Amendment argument, the trillion-dollar coin, the consol bonds, and so forth. All of these are less-than-ideal but reasonable (more or less) solutions that can, at a minimum, buy more time for a solution. And depending on how it goes, one may actually be that solution.

And if that doesn't work? The Treasury will do its best to prioritize payments, making sure the critical ones do get paid. Given that, the government can and will minimize the damage. It will be real damage, to be sure, but not the worst-case catastrophe the headlines are screaming about. Problem not solved, but damage limited to a point where things carry on.

But what if some obligations get defaulted on anyway? Here, the question really is not whether they will be paid, but when. A late mortgage payment, while certainly not ideal, is not equivalent to getting your house foreclosed. The U.S. can and will pay its bills, even if that payment is delayed. As long as we can pay the bills, a technical default will not lead to that worst-case scenario.

What if Congress still doesn't come to an agreement? That is when we hit the worst-case scenario. That is what the headlines are jumping to—and that is what people are really worried about.

## Assessing the Potential Damage

How likely are we to get to that point? During all this time, remember, the economic damage and the market damage are mounting. Constituents and campaign donors are calling their congresspeople to complain. The headlines are getting worse and worse. At some point, Congress will be forced to blink, as we have seen several times before.

On one hand, the question is how much damage will happen before Congress does so. History suggests not much, but there could be some. We will see. But the real message is that in none of these cases is the worst case actually going to happen. History suggests a deal will be cut, with no or minimal damage. But even if that doesn't happen, there are multiple off-ramps at each stage that allow the situation to be salvaged. What could happen will not happen.

## We Have Seen This Before

In the financial crisis, we could have had global collapse, but everyone eventually pulled together to prevent that. In the pandemic, we could have had U.S. economic collapse, but everyone eventually pulled together to prevent that. In previous debt ceiling confrontations, we could have had the catastrophe everyone is predicting today, but eventually everyone pulled together to prevent it. You get the idea.

So, there are two takeaways here. The worst case will not happen because a solution will be worked out. That's the good one. But the not-so-good one is a final word added to that sentence, which is "eventually."

A solution will be worked out—eventually.