What a U.S. default means for the world

By David Worthington | October 15, 2013, 8:51 PM PDT

Default brinksmanship risks dangerous consequences

The United States is on the brink of defaulting on its sovereign debt for the first time since the gold standard ended. The "full faith and credit" of the United States hangs in the balance as the Republican tea party caucus is recalcitrant against raising the debt ceiling, which limits how many bonds that the Treasury can issue.

Nothing less than a global economic crisis and the status of the United States as a world power are at risk if T-bills are downgraded from their coveted AAA status. We've already written about how catastrophic a default would be for the U.S.; here are some of the consequences of a default for the global business environment courtesy of experts that we spoke with today.

A U.S. economic collapse & fall of the dollar as a reserve currency?

- "A potential long-term concern is that persistent volatility of the dollar will support recent calls, including from China, for an end to its status as the world's reserve currency. But, there is currently no other currency to take the dollar's place." — Usha Haley, professor and director, Robbins Center for Global Business and Strategy, West Virginia University, and author of "Subsidies to Chinese Industry."

- "If the U.S. defaults on our debts, nations such as China and Japan that lend us money will no longer want to fund our borrowing. The U.S. dollar will no longer be the reserve currency. The result will be a large spike in treasuries, a precipitous fall in the dollar and a collapse in our housing market - which depends critically on low interest rates. Stock prices on Wall Street will also fall considerably due to increase risk. Trust is difficult to gain, but easy to lose. Nations and lenders will no longer trust that the U.S. government is functional. In the past, we swerved when we approached the cliff. Defaulting will be confirmation that Washington is not only dysfunctional but inept at solving this nation's economic problems. Government is supposed to enable businesses and our economic system to function properly - a default would be the government disabling our economic system. Since we left the gold standard, the current U.S. Financial system is based on trust. U.S. government interest rates are lower than private corporations, which are lower than the rate that individuals can borrow at, because the U.S. government has ALWAYS honored its obligations. The issue first came up when, Alexander Hamilton, our first treasury secretary, was asked by members of Congress not to honor our borrowing debts to individuals and countries who lent us money to fight the revolutionary war. Hamilton had the foresight to realize a good reputation of honoring ones debt is critical for a young nation" — Dr. Jack Stauss, chair and professor with the School of Finance at the University of Denver's Daniel Business College

- "The dollar would continue to lose its status as the world's reserve currency, investors would lose confidence in the U.S. economic story and investors would move more and more money overseas to take advantage of economic strength and opportunity around the globe, and especially in Asia. In fact, this may already be starting as a result of the government shutdown, and general dysfunction in Washington." — Financial advisor and columnist Aaron Katsman

- Ironically, U.S. Treasury securities in general will remain very popular with investors, although some specific securities - those with interest payments due between now and say mid-November - won't be. U.S. Treasury debt is the world's risk-free asset of choice, and there aren't any very close substitutes. So while investors may sell bills that have payments due in the next few weeks, they may well buy longer-dated securities instead. In fact, we're already seeing that happen. There are two reasons for the continued popularity of longer-term Treasurys. First is the view that a period of default would be very short, and that we'll get our collective act together eventually (or at least kick the next self-inflicted crisis down the road for a few months). The second is the flight-to-safety phenomenon that happens when financial markets get spooked. Investors look around for the safest assets available, which for the foreseeable future will continue to be Treasury bonds. One thing that will happen (and arguably already is) is that there will be questions about just how risky the world's risk-free assets have become, and therefore how much to re-price the risk inherent in other, riskier assets. The outcome of that process could be relatively mild and orderly at best, or at worst similar to the re-pricing of mortgage-related derivatives after Lehman Bros. went bankrupt." — High Point University economics professor Peter Summers

A global economic crisis

- "If a default were to occur — which we find highly unlikely — the consequences for the global economy are highly uncertain but could be as bad as the financial crisis of 2008." — Bill Adams, senior international economist for The PNC Financial Services Group and co-author of In Line Behind a Billion People: How Scarcity Will Define China's Ascent in the Next Decade

- "Ultimately, I think our legislators behaving badly is going to add to the unpredictability, and volatility of the global economy, which is currently on the verge of growth. An unprecedented, though unlikely, U.S. default on debt could potentially cause irreversible damage to short-term loan markets that grease the global financial system, resulting in potentially widespread damage to the world economy. I see as unlikely a sudden sell-off in U.S. treasuries from surplus countries like Japan and China. Such a sell-off runs counter to their economic interests, which hinge on a robust U.S. economy. We buy most of the products these countries export, for example. Internally, U.S. exporters may benefit from dollar depreciation because it would increase foreign demand for their goods (effectively making them cheaper). But, the same firms would also bear higher borrowing costs from rising interest rates." — Usha Haley

- "In terms of markets, central banks and political leaders across the globe would have to maneuver to avoid another recession. Beyond markets, the default of debt and credit downgrade would accelerate the transition into a new equilibrium, with a devaluation and loss of prestige of the dollar." — Laura Gonzalez, assistant professor of Finance and Business Economics, Fordham University

More nationalism, less democracy

- "This [default] would bring geopolitical and cultural changes in the influence that rising superpowers, like China, could exert in the world. It would erode the popularity of democracy in the countries aspiring to it, such as China and those in the Arab Spring. Trade agreements would start suffering, as nationalisms would increase." — Laura Gonzalez

The end of the U.S. as a superpower and the rise of Asia

- "While I don't think that the U.S. will default, in the event that there is a default it could be catastrophic for the global economy- short term, and reinforce the notion that the days of the U.S. as the world's economic superpower are numbered. We would be in uncharted territory and that uncertainty would almost certainly derail the tepid economic recovery that has been taking place. While U.S. economic growth is stuck at 2%, economies in Asia are growing at far stronger rates, and even Europe, which has brought up the rear in economic strength for almost a decade, is starting to show signs of a pickup in growth. This would all take a short term hit in the event of a default. Long term, this would be an added economic boom for the global economy, especially Asian economies, and bust for the U.S... The world is looking at the U.S. and shaking its head. They can't figure out why the politicians have taken the nation to the brink of default. Respect for the U.S. has been falling every day. In a recent Citigroup quarterly poll, professional investors rated European and Asia-Pacific stocks as their most preferred investment destination and U.S. pulling up third. Most economic data points to a mass economic shift eastward, as Asia will become the dominant economic power region over the next decade or two. Both Asian and emerging economies around the world will benefit from investment capital looking for a business friendly home. Economies that have low levels of regulation, encourage entrepreneurship and have fiscally sound economies will attract capital. Those that don't will lose investment capital. The current default crisis isn't helping U.S. economic prospects." — Aaron Katsman

Some conservative hardliners in the U.S. actually *want* the government to default. Former Reagan and George H. Bush staffer Bruce Bartlett wrote an op-ed for the *New York Times* about there being a "movement under way for some years among right-wing economists and activists not merely to default on the debt, but even to repudiate it." "Any number of Republicans in Congress have said they will never vote to increase the debt ceiling, no matter what. Others believe the threat of default is the only way to force President Obama to accept their demands, whether it's an immediate balanced budget or repeal of the Affordable Care Act," he said.
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