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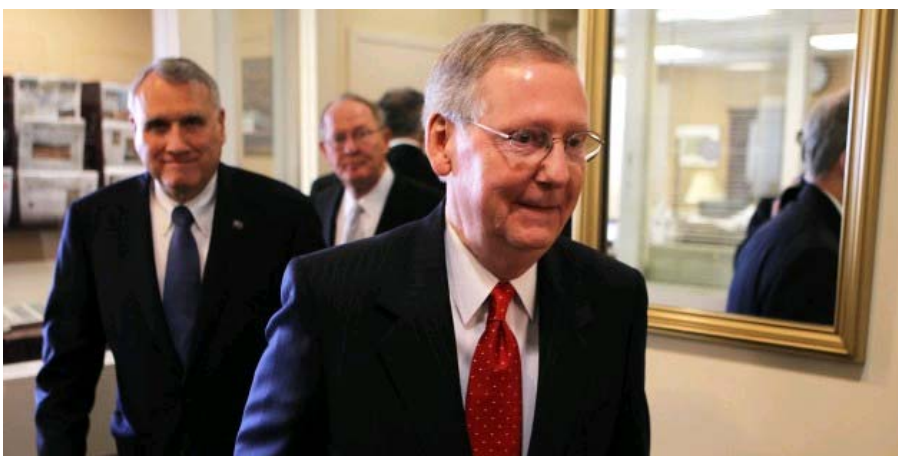
**NATIONAL SECURITY INSIDERS POLL**

BUDGET

## Why a Small Deal Will Rattle the Markets

By **Jim Tankersley**

Updated: July 21, 2011 | 2:02 p.m.  
July 20, 2011 | 9:45 p.m.



ALEX WONG/GETTY IMAGES

**McConnell plan:** Not enough?

In a few short months of fantastic bickering, lawmakers managed to transform a medium-to-long-range economic concern over debt into a full-blown, immediate crisis. They've so rattled investors that now, to pull the U.S. economy back from the brink, they may need to execute a bipartisan "grand bargain" of a size and at a speed that once seemed unfathomable.

Even for Congress, this is an impressive mess.

The sad bottom line of the debt-ceiling fight is that Republicans and Democrats have conjured the ingredients for an economic crisis from a few lines of federal code. If there were no statutory limit on U.S. borrowing that Congress needed to raise, and no members of Congress eager to turn said limit into a battle royale over tax rates and the size of the federal government, then there would be no anxiety today among consumers and bond markets over the prospect of the U.S. defaulting on its debts.

"Although there is still time for the president and Congress to agree on an extension of the federal debt ceiling before it forces severe government spending cuts, the impasse in Washington may already be having an impact on consumer behavior," Goldman Sachs analyst Andrew Tilton said in a research note this week. "A sharp drop in measures of consumer confidence in recent weeks coincides with a surge in news coverage on the debt ceiling, and details of two confidence indicators also are consistent with this interpretation."

Earlier this summer, or perhaps even earlier this month, lawmakers could have soothed that anxiety by reaching a relatively small-scale agreement to raise the ceiling—such as proposals to pair a \$2 trillion increase in the borrowing limit with commensurate spending cuts, or the proposal by Senate Minority Leader **Mitch McConnell**, R-Ky., to essentially foist the power to increase the limit onto President Obama.

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Now, that might not be enough. The credit ratings agency Standard & Poor's has indicated that it has so lost faith in Washington's ability to tackle big problems—because of the difficulty in solving such a simple one as how to avoid default—that simply raising the debt limit by August 2 won't be enough to spare the U.S. from what would be an earth-shaking downgrade of its credit rating.

Instead, the agency insists that lawmakers must agree to a \$4 trillion package of deficit reduction, at least, either as part of the ceiling deal or soon thereafter. That puts major pressure on Obama and Congress to cut a big deficit deal, or at least agree to a framework that markets find to be credible, possibly on the order of what the Senate "Gang of Six" is proposing.

"Even if they were unconnected, S&P and the ratings agencies have taken this opportunity to tie (major deficit reduction and raising the debt limit) together," said Adam Ozimek, an economist at Econsult in Philadelphia who co-writes the popular Modeled Behavior blog on economics. "Congress has allowed them to tie it together, and the reason is because you have these people who are willing to play this game of chicken, and they may be willing to drive the car over the cliff."

A downgrade, Ozimek notes, would be "a disaster" for the economy, rippling through the borrowing ability of large corporations and municipal governments nationwide. The market shocks that would very likely follow could push the nation back into recession. Negative growth would sock tax revenues and strain demand on the social safety net, worsening the nation's deficit problems even further.

It's hard to imagine anyone would trust Congress to set things right.

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This article appeared in the Thursday, July 21, 2011 edition of National Journal Daily.

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