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Democracy Dies in Darkness

## ECONOMY

# World watches in disbelief and horror as U.S. nears possible default

Most nations don't have a fixed debt ceiling. But Washington's fight over raising the cap carries global implications.

By [Rachel Siegel](#) and [Jeff Stein](#)

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Gathered last weekend at the Toki Messe convention center and Hotel Okura in Niigata, Japan, the world's top economic officials were scheduled to discuss some of the biggest emergencies facing the global economy, such as the war in Ukraine and climate change.

But the finance ministers for the Group of 7 nations had another question for Treasury Secretary Janet L. Yellen: What is going on with the U.S. [debt ceiling](#)?

All of Yellen's counterparts were aware of the potential global ramifications if the United States were to default on its debt — so aware, in fact, that many asked her privately for updates on the status of negotiations between the White House and House Republicans, according to one person familiar with the matter, who spoke on the condition of anonymity to reflect private conversations. Yellen told U.S. allies that she agreed that a default would be devastating and that resolving the debt ceiling was a top priority for the administration, the person said.



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What will actually happen if we don't raise the debt limit?

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Talks over the debt ceiling also forced President Biden to cut short his own foreign trip, scrapping planned visits to Australia and Papua New Guinea after the G-7 summit so he can return to Washington on Sunday.

But well before that, the fight over the borrowing cap was alarming U.S. allies. Around the world, experts are watching in disbelief as the U.S. flirts with its first default, fearful of the potential international economic ramifications — and astonished by the global superpower's brush with self-sabotage.

Rich and poor nations alike fear a possible U.S. default, which would torpedo the financial markets and deal a massive blow to the dollar. Analysts say the impasse jeopardizes America's standing abroad. And foreign economists and policymakers are bewildered over why the United States has imposed a specific limit on its debt and then turned it into a political football.

“The U.S. Treasury market is Washington’s golden goose, and the market shows the golden eggs it lays are still very much in demand,” said Maximilian Hess, principal at London-based political risk firm Enmetena Advisory, which advises clients including credit insurers and other financiers. “And yet the U.S. has a rule in the debt ceiling that inexplicably says that the golden goose should be taken out back and shot unless it agrees to lay fewer eggs for a while.”

All the worry will dissipate — at least for a while — if Biden and House Speaker Kevin McCarthy (R-Calif.) can come to an agreement before June 1. In remarks Tuesday, after a meeting with all four top leaders from the House and Senate, Biden reiterated that defaulting was not an option, and that “our international reputation would be damaged in the extreme if we were to let that happen.” That’s on top of the risk of sending the country into a recession, jeopardizing millions of jobs and sending borrowing costs soaring.

But many global economic and financial systems are set up in ways that generally benefit the United States — specifically because U.S. Treasury bonds are seen as reliable and safe investments. That makes the prospect that the U.S. government might be unable to keep issuing more bonds both befuddling and unnerving for many allies.

More than half of the world’s foreign currency reserves are held in U.S. dollars, according to the Council on Foreign Relations, and many nations look to Treasury bonds to safeguard their own economies and guard against drowning in debt.

“I just cannot believe they would let such a major, major disaster happen of the United States defaulting on its debt,” European Central Bank President Christine Lagarde told CBS News on Sunday. “This is not possible. I cannot believe this would happen.”

The mere fact that a U.S. default is being talked about is enough to unsettle markets worldwide, experts say.

## Understanding the debt ceiling

### What is the debt ceiling?

It’s a restriction Congress has put on on how much money the federal government can borrow to pay its bills, which has been in place since 1917. Because the government usually spends more than it takes in, Congress needs to raise the debt ceiling fairly frequently to pay for its operations. (Sort of like a credit card bill.)



“It is perceived as an extraordinarily high level of dysfunction in an economy that provides the largest number of safe assets to the world, and is in principle seen as the most important cog in the global financial system,” said Eswar Prasad, an expert in international economics at Cornell University. “There is a real sense that the U.S. doesn’t pay much attention to the volatility and uncertainty it precipitates. That affects the rest of the world quite significantly.”

The debt ceiling is just one of many factors threatening the global economy. For some allies in Eastern Europe, the debt ceiling debate comes at a particularly important moment for U.S. strength. Michal Baranowski, managing director of the German Marshall Fund of the U.S., is watching the congressional fight closely from Warsaw, which has seen an influx of refugees from neighboring Ukraine since Russia’s invasion. A weaker U.S. on the geopolitical stage, Baranowski worries, could weaken support for Ukraine and, by extension, leave its neighbor Poland more vulnerable to Russia.

“For a close ally of the U.S. like Poland, the debate over the debt ceiling is unnerving,” Baranowski said. “We really need the U.S. as a strong leader in world affairs during this time of deep global instability. I worry that the debt ceiling debate burns up valuable political oxygen that I would rather the U.S. spend for leadership abroad. It makes the U.S. look inward-looking, at best.”

Even before Biden decided to cut short his trip to return to Washington over the debt ceiling talks, Yellen was warning that a failure to raise the borrowing cap and a fall into default would hurt the United States' international standing.

"It would spark a global downturn that would set us back much further," Yellen said in Japan last week. "It would also risk undermining U.S. global economic leadership and raise questions about our ability to defend our national security interests."

Even though Biden is returning early in hopes of averting a default, his schedule change brought some diplomatic setbacks anyway. The canceled trip to Papua New Guinea and Australia was expected to signal that after decades of neglect, the U.S. was directing more attention to a region where China has been a larger player. Biden's stop in Papua New Guinea was also going to be the first by a sitting American president. Now those plans — including the Quad Leaders' Summit between Australia, India, Japan and the U.S. — are off. (The summit's logo, featuring a multicolored Sydney Opera House, had a short shelf life.)

"A no-show from a United States president will never be a good news story, but the garbled messaging makes Biden's dismount look especially messy," the Sydney Morning Herald complained.

Gordon Flake, chief executive of the Perth USAsia Centre at the University of Western Australia, was in Seoul at a conference when news broke and spread through a surprised crowd that Biden had canceled the Australia leg of his trip. Canceled summit aside, Flake said he worries about how a widening political divide — and more empowered House GOP — can interrupt U.S. diplomacy.

"The real issue is this feeds into a broader unease, if not distrust, in U.S. domestic politics," Flake said, "and growing anxiety about the next election."

Then there is a basic befuddlement over why this is happening in the first place. Other developed economies — including some in the European Union and places such as Pakistan and Malaysia — set their debt limits as percentages of GDP, according to research from the Atlantic Council, a think tank focusing on international affairs.

But the vast majority of nations — including India, Japan, China, Australia and Britain — have no debt limit whatsoever. Only Denmark handles its debt ceiling like the U.S., but its limit is set so high that it is essentially a formality and will never be crossed. Most countries elsewhere can't afford even approaching the idea of not paying their debt, because that would create all kinds of price spikes and downgrades, and cause investors to flee, said Josh Lipsky, senior director of the Atlantic Council's Geoeconomics Center.

“Countries look around the world, and they just can’t understand it,” Lipsky said. “They can’t understand it because they don’t have a similar process. And they can’t understand that, even if you had a similar process, why would you risk defaulting?”

That question, and the scene playing out in Washington, is enough to persuade other countries not to go down this path, said Monica de Bolle, an expert on Latin America at the Peterson Institute for International Economics. She pointed to Brazil, which is in the process of rethinking its fiscal framework and ways to replace its fiscal cap. A debt ceiling like the one that exists in the U.S. stirred debate, but was never written into a proposal. It was shot down vehemently, thanks to the U.S. example.

“Everyone is going, ‘No, no, not a debt limit!’” de Bolle said. “It is very much on people’s minds, in a lot of different dimensions, and certainly in the sphere of what not to do in terms of policymaking.”