

The US Shutdown

With just a few hours left to avert a Government shutdown, The US Senate rejected a Budget Bill passed by the Republican-led House of Representatives. The Republican-controlled House had passed a spending bill that maintains spending levels but does not provide funding to implement the Affordable Care Act. The Government runs on a fiscal year from Oct. 1 to Sept. 30.

The Democratic-led Senate voted 54-46 against the Bill which would have funded the Government with a condition attached - President Obama would have to defer his healthcare law by a year. This in turn has led to the shutdown wherein the government will temporarily ask a part of its staff to go on unpaid leave. This issue has been seen as being politically motivated between the Democrats and Republicans in the Senate and the House of Representatives. The core issue is that the Republican Party controls the lower house, or House of Representatives, while the Democrats control the Senate.

The background

One of the key points of contention in the political stalemate has been the healthcare law, popularly known as Obamacare. Republicans have been pushing for the budget to include cuts to Barack Obama's healthcare bill. Republicans in the House of Representatives and their allies in the Senate have demanded the law be repealed or stripped of funding as a condition for continuing to fund the government. This has not been agreed to by the President leading to the impasse.

Under US law a new bill to approve any funding for the next financial year is necessary. However, this has to be approved by the House of Representatives, Senate, and the President. This shutdown is hence a byproduct of the country's democratic system. Even though the President is the head of the state and the federal government, he is not guaranteed a majority in either of the legislative bodies. This is so as presidents, congressmen and women and senators are elected separately. Under the Federal law known as the Anti-Deficiency Act, it would be a felony to spend taxpayers money without an appropriation from Congress. The US government has shut down 17 times since 1977. However, it has not happened for 17 years, since the historic face-off between Bill Clinton and the Republican-controlled House halted services for 28 days in 1996. While shutdowns normally last for a few days, this time one expects it to last for up to two weeks which will also be the time point when the issue on debt ceiling has to be resolved.

What does this mean?

It has been estimated that around 700-800,000 Federal Government workers out of an estimated 2.1 mn employees would be out of employment temporarily or on unpaid leave. It is not clear whether they will get back this pay once the deadlock is over. Federal workers will fall into being in services considered to be essential or non-essential and those considered necessary will carry on. Air traffic control, military,

prisons, border security, mail delivery, anything related to national security and public safety, social security cheques, emergency medical care, and food would be essential.

What is the economic impact?

The economy would also take a hit because it costs money to prepare for a shutdown, to carry it out, and start the Government back up again. The last two shutdowns, which took place weeks apart in late 1995 and early 1996, cost taxpayers \$1.4 billion, according to estimates from the Office of Management and Budget.

One market estimate puts the loss at around \$ 300 mn a day which is a fraction of the US GDP of \$ 15.7 tn. The shutdown would also mean an interruption in services. These include:

- Visa and passport applications.
- Tourism industry would take a hit and national parks and museums would be closed. This will mean less revenue for the Government from things like national park user fees.
- Small business loans would not be processed and Government-backed insurance for home loans would not move forward.
- Tax refunds would pile up.

At a different level, some independent estimates state that a shutdown in US economy if prolonged could slice off 0.5% of GDP growth in this quarter. A shutdown would slow the expansion process because output lost when workers are out of work reduces the GDP. However, it is felt that the more serious standoff over the debt ceiling could have a bigger impact on the economy as businesses hold back investment and households defer spending at a time when it should be buoyant during Christmas season.

However, as long as this issue is not resolved, it could mean that the Fed could go slow on the withdrawal of the QE programme which will have a bearing on the flow of funds especially to the emerging markets including India.

More serious is the debt ceiling

The debt ceiling is the crux to the concept of the debt crisis which is different from the shutdown. In case of the debt ceiling, the Government is mandated to spend money but does not have the legal authority to borrow the same. By October 17, the Government would have reached the limit at which it can borrow money to pay its bills, the so-called debt ceiling –a legal limit on its borrowing of \$16.7tn dollars.

The Republicans have demanded a series of policy concessions notably on the health law and financial and environmental regulations in exchange for raising the debt ceiling. Under U.S. law, the Government must stay below a certain debt limit and Congress must pass legislation to allow the Government to exceed that limit. If it does not then the Government will not be in a position to pay its bills and would have to default on its legal obligations. This will have relatively deeper consequences on the economy. It has been estimated that just the threat of the same in 2011 is expected to cost the Government around \$ 19 bn in the coming decade as higher

borrowing costs. Also any kind of adjustments made by the Government which involve expenditure cuts would once again trigger contraction forces that could slowdown the pace of growth.

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