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The US Government Shutdown

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The US Federal government shut down during the first half of October, the first two weeks of a new fiscal year, which began on October 1. It was the first shut-down since 1996, and it took place for similar reasons. Under the American system, no government money can be spent without the agreement of three parties: the two houses of Congress (called the House and the Senate) and the President, currently Barack Obama. Following what unfortunately has become normal practice, the Congress failed to pass a budget for the new fiscal year before October 1. It is normal under such circumstances to pass a "continuing resolution," which allows government agencies to spend funds in the new year at the same rate as in the previous year. In recent years, these continuing resolutions have run well into the new fiscal year, last year half way through before a new budget was passed. This time, no continuing resolution was passed by October 1. The majority of the House, controlled by the Republican Party, wanted to use the continuing resolution to reverse or at least delay legislation duly passed in 2010, concerning medical coverage of the American public. This would not be against any formal rules, but it is strongly against normal practice, the last instance being in late 1995 when a similar Republican-controlled House attempted to add new legislation to the continuing resolution. Moreover, it would set an extremely bad precedent. A continuing resolution is a stop-gap measure to allow the government to continue functioning while the Congress does its job of passing a proper new budget, which is the correct place for disagreements and subsequent compromises over policy and expenditures. The Senate and the President quite properly refused to negotiate legislative changes as part of a continuing resolution, so the government closed.

The closure was only partial. Some parts of the government, such as the Federal Reserve (America's central bank) do not depend on appropriated funds. Other parts, such as air traffic controllers, involve protection of life and property, and were allowed to continue. But many government employees were "furloughed," that is told not to come to work, since they could not legally be paid. In all, 818,000 employees (out of a total of 1.4 million civilian employees), including many in US embassies abroad, were furloughed. No new contracts could be let. No new government statistics could be released, and some websites closed. National parks were closed. But pension checks continued to be sent to retired persons.

It is important to note that only the Federal government closed, plus the District of Columbia (Washington). The fifty states continued to operate. Schools remained open, and policemen continued to patrol the streets. The Federal system of the United States divides responsibilities between the Federal government and the fifty state governments, and each has its own sources of revenues. Most contacts of Americans with government are with their state governments, not the federal government. The American economy and society are less dependent on the central government than are many other countries, so while the shutdown had some negative impact on the economy, through lost pay (which

will be subsequently made up) and uncertainty about new contracts, the damage was limited (it has been estimated as 0.15 percent of GDP).

The impasse was finally broken in the evening of October 16 with a continuing resolution (which will permit the government to run until January 15) linked to another issue: increasing the allowable ceiling on outstanding US government debt. This ceiling was soon to be reached, preventing the US government legally from issuing new debt above the ceiling (outstanding debt of course could continue to be rolled over).

The legal ceiling on US Federal debt goes back to 1917, when the United States entered the First World War. Before then each bond issue had to be approved by Congress, which did not make sense under wartime conditions. The US government has run deficits in most years since then and the debt ceiling has been raised routinely dozens of times. The ceiling is in fact superfluous, since the US government can neither spend money nor raise taxes without congressional approval. The Republican-controlled House threatened not to raise the ceiling in July 2011, and President Obama then mistakenly made concessions to get the ceiling raised, thus leading to the unwanted “sequester” of government spending in 2013 and subsequent years – mindless across-the-board cuts in expenditures. Obama properly refused to negotiate this time, and default on the US debt (for the first time ever) was widely feared.

In fact, there is no serious prospect of default on the US government debt. If the ceiling had not been raised, the President would have wide discretion as to how to respond, including but not limited to ceasing to pay interest on the debt. But to avoid harming the future credit-standing of the government, he would certainly not select that option. In making that decision, he could draw on the 14th amendment to the US constitution, which states that “The validity of the public debt of the United States...shall not be questioned.” Instead, he could cut government expenditures across the board by about 20 percent, or he could simply elect to float debt over the ceiling, which would be indistinguishable from new debt constantly being issued to replace maturing debt. This could be done by interpreting the debt ceiling to exclude the \$4 trillion of debt held by government agencies, such as the Social Security Trust Fund. Some price would be paid for that in financial markets, but it would probably be a modest one. Ironically, closure of the government, with its reductions in spending, postponed the time at which the ceiling would have been reached. Nevertheless, default was never a serious prospect. Extensive fears expressed in the media were misplaced.