

Budget Brinksmanship: a momentary episode in the U.S. financial cliffhanger

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“And to all of our friends and foes watching around the world, let me be crystal clear: Do not mistake this momentary episode in American politics as anything less than a moment of politics, or anything more than a moment of politics.” – U.S. Secretary of State John Kerry.¹

The U.S. government has shut down: 800,000 federal employees have been furloughed, national parks and museums have closed, and vital social services such as housing loans and nutritional programs have been disrupted. U.S. President Obama even canceled a trip to the Asia-Pacific Economic Cooperation (APEC) leaders’ meeting in Bali, Indonesia where he planned to push his Trans-Pacific Partnership economic package to members of the 21-nation organization.²

After witnessing prior acrimonious battles over the U.S. budget and debt limit, one must ask if the present fiscal stalemate is indeed grave, or is it just another “momentary episode” that will quickly fade into economic irrelevance. One may be tempted to conclude the correctness of Kerry’s remarks, since the U.S. government has shut down twice before – once for five days and once for 21 days – in 1995 to 1996.³ Nevertheless, a default by Washington could be a financial shock with worldwide repercussions, as global markets depend upon relative U.S. stability. Concurring with this view, International Monetary Fund head Christine Lagarde warned, “The government shutdown is bad enough, but failure to raise the debt ceiling would be far worse, and could very seriously damage not only the U.S. economy, but the entire global economy.”⁴

So what is different about the current budget battle that distinguishes it from previous financial cliffhangers? The answer is that now there is a convergence of two pecuniary problems: First, the U.S. has already exceeded its statutory debt limit, the maximum amount of monies it can borrow, back in May,⁵ and second, the U.S. Congress has failed to approve an interim continuing resolution (CR) to cover the funding gap created on October 1 due to entering the new fiscal year without an approved budget.⁶ As a result, even if U.S. lawmakers agree on a FY2014 budget, or pass an interim CR funding bill, the U.S. would not have sufficient funds to cover all of its obligations after October 17 unless Congress increases the government’s borrowing authority.⁷

Additionally, Tea Party extremists in the Republican faction have taken advantage of this dual dilemma to engage in a bit of budget brinksmanship engineered by Representative Mark Meadows of North Carolina. In a letter to the Republican leaders House Speaker John Boehner and House Majority Leader Eric Cantor, Meadows urged defunding the Patient Protection and Affordable Care Act, also known as ObamaCare, in “any relevant appropriations bill brought to the House floor ... including any continuing appropriations bill.”⁸ Cosigned by 79 of his colleagues, Meadow’s letter persuaded Boehner to propose a CR that would fund the government but not ObamaCare, which was due to go on line October 1. “Our intent has never been to shut down the government,” Meadows incredulously insisted, “It’s to stop the [health care] law.”⁹

Later in his letter to Boehner and Cantor, Meadows quoted the fourth U.S. president, James Madison, who wrote “This power over the purse may, in fact, be regarded as the most complete and effectual weapon ... for obtaining a redress of every grievance ...” Meadows and his

colleagues should read the very next line in the Federalist No. 58 where Madison asked, “But will not the House of Representatives be as much interested as the Senate in maintaining the government in its proper functions ...?” Judging by the actions of these U.S. representatives, apparently, it is not.

To better understand what led to this emerging imbroglio, we must briefly examine three powerful actors involved in Washington’s finances: the Congress, the Treasury and the Federal Reserve. According to Article I, Section 9, clause 7 of the U.S. Constitution, the U.S. Treasury cannot disperse funds except when authorized to do so by laws enacted by the Congress.¹⁰ While the legislature is armed with “the power over the purse,”¹¹ the president initiates the budget process by submitting a budget request estimating spending, revenue and borrowing for the coming fiscal year to Congress, which reviews it and passes the necessary appropriation and authorization bills. It is only after the president has signed these various bills that the budget actually becomes law.¹² Since the process takes almost an entire year to complete, a new budget is typically signed after the start of the new fiscal year, which begins on October 1, thus to avoid funding gaps, Congress must pass interim appropriation bills to keep the numerous government agencies open.¹³ This time however, by linking a debt limit increase to defunding ObamaCare, these Tea Party terrorists, whether intentionally or not, effectively ensured the defeat of any stop-gap funding bill, thus triggering the government shutdown.

The U.S. Department of the Treasury, which is tasked “to protect the full faith and credit of the United States,” has also played a large role in this financial fiasco. Having notified Congressional leaders on multiple occasions that the extended statutory borrowing limit was reached in May 2013, Treasury Secretary Jacob Lew instituted “extraordinary measures,” among which are debt swaps and a debt issuance suspension, in order to stretch the borrowing capacity of the U.S. without breaching the existing debt ceiling,¹⁴ which currently stands at about \$16.7 trillion. Technically speaking, the statutory debt limit was reached on December 31, 2012, but House Republicans cut a deal that exempted Treasury debt until May 19, 2013, but did not actually raise the statutory limit, in hopes that Senate Democrats would be compelled finally to pass a budget after having failed at this task for the last four years.¹⁵

When the U.S. government finds itself short of cash, the Treasury sells at public auctions a variety of financial instruments ranging from 1 to 7-day Cash Management bills, 4 to 52-week Treasury bills, longer term notes and 30-year bonds, as well as 5 to 30-year so-called inflation-protected securities.¹⁶ In 2012 alone, the U.S. Treasury auctioned over \$7.9 trillion in various securities to finance U.S. government public debt.¹⁷ And this is where the Federal Reserve (the Fed) enters the picture, since it is now holds more than \$2 trillion of U.S. Treasury securities:¹⁸ more than China with \$1.3 trillion, or Japan with \$1.1 trillion as of July 2013.¹⁹ In addition, the Fed holds another \$1.3 trillion in mortgage-backed securities,²⁰ the so-called toxic assets that were behind the 2008 global credit collapse, from which the U.S. economy is still struggling to recover. It should also be pointed out that the largest holder of U.S. debt is the much maligned Social Security Trust Fund, whose surpluses have been used to fund U.S. budget shortfalls.²¹

The U.S. economy, which was sputtering at best even before the latest Congress-induced cash crunch, has been receiving massive injections of money from the Fed through its monetary policy known as quantitative easing (QE). Attempting to stimulate the U.S. economy after the

2008 crash, the Fed has kept interest rates at near zero levels, but failing to achieve targeted growth goals, the Open Market Committee resorted to purchasing U.S. Treasury securities and mortgage-backed securities.²² One may be tempted to ask, where does the Fed get the money for purchasing these securities under its QE program? The answer is out of thin air. Using a process known as monetizing the debt, the Fed simply issues a credit to a member Federal Reserve bank to cover the transaction, which increases the bank's reserves and allows it to make more loans, effectively increasing the money supply without ever having to print a paper dollar bill.²³

Coming as a surprise to some investors, Fed chairman Ben Bernanke announced on September 18 that the Fed's QE policy would be continued at the rate of some \$85 billion per month: \$45 billion of Treasury securities and \$40 billion of mortgage-backed securities.²⁴ Obviously, this economic stimulus activity by the Fed increases indebtedness, so it will cease unless Congress raises the debt ceiling, which would then allow the U.S. government to issue more public debt.²⁵

Meanwhile, U.S. House Speaker Boehner steadfastly vowed, "I'm not going to raise the debt limit without a serious conversation about dealing with problems that are driving the debt up."²⁶ While this rhetoric resonates well with Tea Party troglodytes, the present monetary morass is not a recent development: it is the result of perennially bloated U.S. budgets, which typically have had annual deficits with few exceptions. Since 1931, only 1947, 1948, 1951, 1956, 1957, 1960, 1999 and 2000 have seen budget surpluses. Credit for the first budget deficits exceeding \$100 billion and \$200 billion goes to the "conservative" president Ronald Reagan in the years 1982 and 1983 respectively, while credit for the first \$500 billion deficit goes to George Bush in 2003, the year of his illegal invasion of Iraq.

Oddly enough, the U.S. had 11 successive budget surpluses in the years just before the Great Depression,²⁷ demonstrating that federal frugality alone does not ensure economic vitality. Similarly, neither the demagogic rhetoric of House Speaker Boehner, nor the budget brinksmanship of Representative Meadows, nor the trite reassurances of Secretary of State Kerry will help solve America's deeply imbedded financial foibles.

After considering the impact of the previous 2011 brush with a U.S. government default and its lingering financial impact estimated at \$19 billion over 10 years,²⁸ I must disagree with U.S. Secretary of State Kerry that the current crisis will be nothing more than "a moment of politics." On the contrary, this impasse has the potential to be a watershed event that not only could trigger widespread economic adversity, but also could signal the end of the U.S. economic empire.

Endnotes

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