

The U.S. shutdown: all you need to know about the govt. impasse | Al Arabiya (Oct 2, 2013)

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As of Oct. 1, 2013, the U.S. government began to shut down due to the absence of an agreed funding bill by the Senate and the House. If you call up the White House switchboard you will get a recorded response: “you have reached the Executive Office of the President. We apologize, but due to the lapse in federal funding, we are unable to take your call. Once funding has been restored, operations will resume. Please call back at that time.” This is the first partial shutdown in 17 years since the Clinton era for the U.S. – around 800,000 Federal employees (out of a total of just under 2.9 million civilian employees) who are deemed “non-essential” will be on unpaid furlough leave. Previously, when the U.S. government shut down (for 21 days) in 1995-96, it cost 0.5 percentage points of Gross Domestic Product (GDP) growth and more than \$2 billion in unnecessary expenses.

The immediate direct impact on the U.S. economy and international repercussions will depend on the duration of the shutdown and also which services get shutdown. Currently, only non-essential services and purchases are likely to be affected – e.g. the Internal Revenue Service would cancel audit appointments, the National Institutes for Health would stop making grants, the Smithsonian museums would be closed as well as the National Zoo.

The regional impact can be substantial: in Colorado Springs,

Virginia Beach (North Carolina), Honolulu and Washington, D.C. government and military employees represent more than 15% of total employment. In past shutdowns, Congress approved retroactive back pay for employees furloughed by government shutdowns, but the current fiscal nightmare and poisonous political atmosphere in the U.S. leaves little hope for such a measure this time round! Interestingly, congressmen would continue to be paid their salaries, irrespective of the shutdown – the reason being that the 27th Amendment prevents any Congress from changing its own pay.

The why: U.S. political schism

Politics took centre-stage in the build-up to the shutdown. [The Economist](#) summarised it succinctly: “the Republican-controlled House sent the Democrat-controlled Senate a bill to fund the government for six weeks and repeal Obamacare. The Senate took that bill, stripped out the part about repealing Obamacare, and sent it back to the House. The House then sent the Senate a funding bill that would merely delay much of Obamacare for one year. Today the Senate again sent the House back a clean funding bill.”

Dysfunctional U.S. politics and divisions are leading to uncertainty about the future course of U.S. fiscal and debt policy in addition to health care and policy, which affects some 15% of Americans who are uninsured. It is telling that the Tea Party, a minority of Republican hardliners, which supported the shutdown due to their opposition to Obamacare, are able to dictate their party's policies.

The U.S. political schism implies that Obama has become a lame duck president even before he enters the second half of his second mandate. There will be a growing question mark on his ability to deliver on major issues, such as the important matter of U.S.-Iran relations, which is critical to the security, political and economic landscape of the Middle East and the GCC countries. The government shutdown would also

affect U.S. foreign policy: delays in critical foreign-policy related hearings in Congress, paring back nuclear and other critical energy programs to the bare minimum etc.

A *Bloomberg* national poll conducted during Sept. 20-23 showed that Americans narrowly blame Republicans for what has gone wrong in Washington, just as they did when the government closed in 1995 and 1996 – two of the 17 times U.S. funding stopped since 1977. The Economist's YouGov poll suggests a roughly even split on who gets blamed for the shutdown. But a CBS News-New York Times poll found that were the government to shut down, 44% of the public would blame Republicans, while 35% would blame Mr Obama and the Democrats.

How much does it matter? The economics

A shutdown of up to 4 weeks could reduce U.S. GDP by up to 1.4% in Q4 – the largest impact would be the output lost from furloughed workers and on federal contractors. Federal workers would be forced to rethink their spending plans given loss of income and seek alternative employment. Businesses directly dependent on federal spending and services would be adversely affected. Federal contracting business (from defence to health care) is worth some \$1.5 billion per day and will face growing uncertainty. The process of getting approval for a home loan could take much more time, slowing a housing recovery that is one of the few sectors witnessing a gradual improvement. However, these are temporary, transient effects. But the longer shutdown continues, the greater the impact on consumer and business confidence and the more disruptive to the economy. A two month shutdown could tip the weak U.S. economic recovery back into recession, weaken the global economy and oil prices. Middle East oil exporters would be directly affected.

Financial market indices are already feeling the pressure with Japanese stocks falling 2.1% on Monday and the Euro Stoxx 50 index down 0.9% and the S&P 500 losing 0.6%. Since then the

dollar has come off an eight-month low and some stock market indices have brushed aside concerns of the U.S. shutdown, with the S&P 500 up 0.8% yesterday. However, the MSCI All-Country World Index of global shares dropped 0.8% yesterday, the most since Aug. 27. The yield on 10Y Treasury notes rose and was trading near an almost seven-week low on “safe-haven” demand. The cost of insuring against a U.S. default for a year has rocketed in the past 10 days or so, reaching its highest level since 2011, reflecting investor bets that the government could fall behind on its debt payments in the coming weeks. It now costs \$46,570 to insure \$10 million of U.S. bonds against default for one year, up from just over \$8,000 in mid-Sept.

Again, these are temporary effects – markets can be expected to rebound once an agreement is reached. The more important effects come from growing economic policy uncertainty which will hurt medium and longer term investment and hiring plans of U.S. business. Financial market volatility will rise over the coming months.

What next? Policy uncertainty hurts markets and economies

The U.S. is now likely to lurch from one fiscal crisis to another. The next confrontation will be on the debt ceiling which currently stands at \$16.699 trillion. The risks of default outweigh the costs of the shutdown – the Treasury Department has warned that it will have only about \$30 billion in cash on hand by Oct. 17 – but we should not expect a default of the Federal government on its obligations. It is highly probable that a political compromise will be found in the coming weeks as the U.S. has no choice but to raise its debt ceiling.

The economic cost is likely to have higher yields on U.S. government obligations. Accordingly, the GCC countries that are major investors in U.S. government debt will not be adversely affected. However, confidence and trust in the U.S.

as a sovereign obligor is being eroded by political divisions and squabbling. We enter the last quarter of 2013 with two major sources of U.S. policy risk: an uncertain course for monetary policy and the onset of QE tapering and uncertainty on debt and fiscal policy. Both could jeopardise the budding U.S. economic recovery and weak global economic growth.