

THE ECONOMIC OUTLOOK GROUP



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ECONOMIC TALKING POINTS

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Briefing update: The Government Shutdown & Debt Ceiling

With a government shutdown now in place, two questions loom.

How long will the shutdown last? And second, how likely is that the U.S. will breach the more critical debt ceiling around October 17th?

We have been telling clients that the shutdown itself is very likely to be a brief one, lasting a maximum of two weeks.

Secondly, the probability of this country actually breaching its debt ceiling and defaulting on U.S. sovereign debt is not 25%, or 10% --- but zero!

Let's first turn to the matter of the government shutdown.

By not allowing a clean CR vote on the House floor, House Speaker John Boehner has momentarily aligned himself with the mostly Tea Party and Libertarian factions of the Republican Party. He has demonstrated he can stand firm and carry out his threat to do whatever is necessary --- even a government shutdown --- in an effort to de-fund or postpone the implementation of the Affordable Care Act.

To further fortify his position with conservatives, Boehner may allow the shutdown to continue for several more days. But make no mistake; he is also painfully aware that a

lengthy shutdown has the potential of doing his party and nation considerable harm. We believe that within in the next week or two, the Speaker will call in his chips and “firmly” urge his caucus to accept a clean CR for the broader interest of the GOP. If that does not work, we expect Boehner will ultimately permit a clean CR vote on the full House floor, where he knows a combination of Democrats and Republicans will successfully put an end to the shutdown.

Of course, a CR is by definition a temporary measure to keep the government functioning. But with the 2014 midterm elections a year away, a stop-and-go funding strategy every few weeks or months just to stop Obamacare may carry too many political risks for the GOP. So our assessment is that the grip the right wing faction holds over the Republican Party has likely peaked.

The Debt Ceiling:

Breaching the debt ceiling is, of course, a far much more ominous event, one that would prove catastrophic for the US and global economy. Will House Republicans go so far as to block an increase in the borrowing authority of the US and thereby push the nation into default?

We doubt it. But even if House Republicans show sufficient solidarity to prevent the Treasury from borrowing additional funds, we expect the White House will instantly take the unprecedented step of unilaterally raising the debt ceiling. They will justify this by invoking section 4 of the 14th amendment in the Constitution, which explicitly states that “the validity of the public debt of the United States, authorized by law... shall not be questioned.” Of course, this will set off a major legal firestorm, since that section was originally meant to apply to Congress, which is the only body that can appropriate and borrow money for the United States. But legal scholars have argued that the President has also taken up the oath to “preserve, protect, and defend the Constitution” and that a government default would so damage the Republic that the executive branch can justifiably intervene.

So while many analysts still have jitters over the possibility of a default by the US government, we believe the Supreme Court will ultimately uphold the White House option to prevent such a debt crisis and allow the executive branch to authorize the Treasury to borrow additional funds and honor its obligations---so long as it is to pay for programs that Congress has already approved and spent.

