Think Strategically

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Not Raising the U.S. Debt Ceiling can cost $2.647 Trillion, leading to a Default and Government Shutdown; What is at Stake?

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Not raising the U.S. Debt Ceiling could cost $2.647 Trillion

Last Friday, before the U.S. stock markets closed, the Republican Debt Ceiling negotiators walked out, accusing the White House of delaying the discussions.

The point person in the meetings is Rep. Garret Graves, R-La., who stated, "Until people are willing to have reasonable conversations about how you can move forward and do the right thing, then we're not gonna sit here and talk to ourselves".

On Sunday, House Speaker McCarthy said that following a "Productive call" with President Biden on the debt limit and possible default, both agreed to meet in person on Monday upon the president's return from Japan. President Biden had been attending the G7 Summit and cut his trip short to return to Washington for the Debt Ceiling negotiations.

With so much drama surrounding the Debt Ceiling and possible U.S. Default, we have analyzed the impact of not raising the Debt Ceiling; let's begin.

If the United States were to default on its debt due to being unable to raise the debt ceiling, it would have significant implications for both the U.S. and global markets. Here are some potential impacts:

1. **GDP Impact:** A US debt default would likely have a substantial negative impact on GDP. Estimates suggest that a default could lead to a contraction; the GDP decline would depend on the severity and duration of the default and the subsequent economic fallout. Some studies have indicated that a default could result in GDP losses ranging from 2% to 10%.

2. **U.S. Financial Markets:** The U.S. financial markets, including stock and bond markets, would likely experience significant volatility and turmoil. Investors would become increasingly uncertain about the stability of U.S. government bonds and the overall financial system. This could lead to a sharp decline in stock prices, increased borrowing costs, and a general flight to safety.

3. **Global Financial Markets:** A U.S. debt default would also affect global financial markets. U.S. Treasury bonds are considered one of the safest investments in the world, and many international investors hold them as a part of their portfolios. A default would erode

confidence in these bonds, leading to a sell-off and potentially triggering a broader global financial crisis.

4. **Interest Rates:** A U.S. debt default would likely lead to higher interest rates. The increased risk associated with U.S. government debt would make investors demand higher returns to compensate for the uncertainty. This would translate into higher borrowing costs for businesses and consumers, potentially slowing economic growth and investment.

5. **U.S. Dollar:** The U.S. dollar, as the world's reserve currency, would likely face significant pressure in the event of a debt default. Confidence in the U.S. economy and the dollar's stability would be undermined, leading to currency depreciation. A weaker dollar would make imports more expensive, potentially fueling inflation and impacting the purchasing power of U.S. consumers.

6. **Global Economic Contraction:** A US debt default could push many developed countries into a worldwide economic downturn. The disruption in financial markets, higher borrowing costs, and reduced confidence would weigh heavily on businesses and consumer spending. Government spending could also be significantly curtailed, leading to a contraction in economic activity.

7. **Currency Impact:** A debt default would likely lead to a depreciation of the U.S. dollar. The loss of confidence in the U.S. economy and its ability to manage its debt would weaken the dollar's value relative to other currencies. This would make imports more expensive and could potentially lead to higher inflation.

8. **Confidence and Reputation:** The U.S. government's ability to meet its financial obligations is fundamental to global financial markets' stability. A default would severely damage the reputation and creditworthiness of the U.S. government, undermining confidence in U.S. financial instruments and the broader U.S. economy.

Below are some studies and estimates that provide an understanding of the potential costs to the U.S. during government shutdowns between 1995 and 2020:

It is worth noting that a U.S. debt default is an extreme scenario, and the potential consequences described here are based on historical precedents and economic theories. The exact impact would depend on various factors, including the duration of the default, the actions of policymakers, and the overall response of market participants; however, to properly frame the costs, we compare other Government shutdowns with its high economic costs, including lost productivity, delayed government services, and reduced consumer and business confidence.

1. **The Congressional Budget Office** has analyzed the economic impact of government shutdowns. According to their reports, the 35-day partial government shutdown from December 22, 2018, to January 25, 2019, cost the U.S. economy **$11 billion** in lost GDP. It's important to note that this estimate is specific to that particular shutdown.

2. **Standard and Poor's (S&P) Ratings Services**: In 2013, S&P estimated that the 16-day government shutdown from October 1 to October 16, 2013, shaved approximately 0.6% off the annualized GDP growth rate for that quarter, resulting in a $24 billion economic loss.

3. **The Office of Management and Budget** analyzed 1996, estimating that the two government shutdowns that occurred that year cost the economy approximately **$1.4 billion**.

4. **The impact using today's GDP number of $26.47 trillion**, according to the Bureau of Economic Analysis, thus a government shutdown and default could cost the U.S. economy as little as 2% of GDP or $52.94 billion to as high as 10% of GDP or $2.647 trillion.

However, it is essential to note that these estimates are specific to past shutdowns and our best assessment should the Debt Ceiling negotiations fail. A shutdown and eventual default occur **from June 1** onward. To perform a more comprehensive figure for the entire period, it would require a detailed analysis considering the shutdown's unique circumstances and the overall economic context during that period.

What would the impact be on Puerto Rico if the Debt Ceiling, the Government Shutdown, and the U.S. Default were not raised?

The Government shutdown can affect Puerto Rico; here are some potential impacts:

- **Economic Consequences:** A U.S. government default can lead to a loss of investor confidence and increased borrowing costs for the federal government. These effects can ripple through the economy and potentially impact Puerto Rico.

- **Reduced Federal Funding:** During a government shutdown, many federal agencies may temporarily halt operations, leading to delayed or reduced funding for various programs and services in Puerto Rico. Affecting more than $90 billion in infrastructure projects, disaster relief, healthcare services, and education programs, which rely on federal support.

- **Government Services Disruptions:** The shutdown of federal agencies can disrupt services provided by those agencies in Puerto Rico. For example, services related to Social Security, Medicare, and other federal assistance programs may experience delays or reduced capacity during a government shutdown.

- **Impact on Tourism:** Puerto Rico heavily depends on tourism as a significant source of revenue. A government shutdown or a potential default could affect travel plans and create uncertainty for tourists, potentially leading to decreased tourism activity.

- **Investor Confidence and Business Environment:** A U.S. government default or shutdown can have broader impacts on investor confidence and the business environment in Puerto Rico. It may deter potential investors, both domestic and international, from engaging in economic activities on the island.

The Final Word: Political Leaders must place the Nation Ahead of Their Political Ambitions.

Politicians must prioritize their Nation over personal ambitions for several crucial reasons. For one, the welfare and progress of a nation depend on effective governance and leadership. Placing the country first fosters trust and confidence among citizens, as it demonstrates a commitment to serving the public's interests. Moreover, prioritizing the Nation promotes stability and unity, as politicians work together towards common goals, transcending individual aspirations. Ultimately, leaders who prioritize the country foster a sense of purpose and ensure sustainable development, leaving a lasting positive legacy for future generations.

Lastly, a U.S. government default or shutdown can have significant economic and financial implications for Puerto Rico, the U.S., and the World.