US Debt Ceiling Crisis

For Prelims: US Debt Ceiling Crisis, Constitution's 14th Amendment, Credit rating, **Forex**.

For Mains: Fiscal deficit and its management by Indian Govt.

Why in News?

The United States Treasury Secretary has warned of the US defaulting on debt by June 1 if the House of Representatives and President's White House fail to reach an agreement to raise or suspend the debt ceiling.

What is the US Debt Ceiling?

- **About:**
  - The debt ceiling is the **maximum amount of money that the U.S. government** is legally allowed to borrow to fund its expenses and obligations.
    - It was established in 1917 during **World War I.**
  - The purpose of the debt ceiling is to provide the government with flexibility in spending **without requiring frequent approval from Congress** for each expenditure.
  - Under the U.S. Constitution, Congress has the **authority to control government spending.**
  - As of now, the current debt limit is **set at USD 31.4 trillion**. This means that the government **cannot exceed borrowing beyond this amount without congressional approval.**
- **Current Stand-off:**
  - The current stand-off involves the **Republicans (Members of Opposition party)**, who have a majority in the House of Representative and Democrat-run government.
  - The Republicans are refusing to **raise the US debt ceiling unless the government** agrees to include **significant spending cuts and other priorities,** arguing that the nation's debt is **unsustainable.**
    - They want to attach conditions to programs like **cash aid, food stamps, and Medicaid to ensure that government spending** is limited.
  - On the other hand, the President insists on **approving the debt ceiling with no conditions**, stating that defaulting on debt is non-negotiable.
  - This has created a deadlock and a **potential risk of default if an agreement is not reached before** the deadline.

What happens if the Government Defaults?

- **Government Default:**
  - The US government may not be able to meet its financial obligations, resulting in a default on its debt payments. This would be unprecedented and could have a catastrophic impact on the nation's economy.
- **Economic Downturn:**

- A default would lead to a loss of confidence in the US financial system, causing financial markets to become highly volatile. It could trigger a severe economic downturn, impacting businesses, investments, and employment.
- Analysts say the dollar would weaken, the stock markets would collapse, and millions might lose their jobs.

- **Downgraded Credit Rating:**
  - A default could result in a downgrade of the US government's credit rating, making it more expensive for the government to borrow money in the future. This would further strain the country's finances and increase borrowing costs.
- **Global Repercussions:**
  - The US economy is closely interconnected with the global economy. A default could have a ripple effect worldwide, causing disruptions in international financial markets and affecting economies around the globe.

Is there Any Back-up if Debt Ceiling Defaults?

- **Constitution's 14th Amendment:**
  - Under the **Constitution's 14th Amendment**, the President has the authority to raise the debt ceiling by their own without the support of Legislature.
    - The Constitution's 14th Amendment states that the **validity of the public debt "shall not be questioned."** This would involve asserting that **defaulting on the debt is unconstitutional** and taking action to prevent it.
- **Emergency Measures:**
  - The Treasury Department has certain emergency measures it can take to **continue paying the government's bills even after hitting** the debt ceiling.
  - These measures can provide temporary relief, but they are not a long-term solution.
  - They buy some time for the government to operate until a permanent solution is reached.
- **Bipartisan Agreement:**
  - It is possible that negotiations between the government and the opposition could continue until the last moment, and a **bipartisan agreement to raise the debt ceiling could be reached.** This would involve compromises and finding common ground on spending cuts or other fiscal measures.

Has anything Similar Happened Earlier?

- The similar situation occurred in 2011 when Barack Obama was President, but the House of Representatives was controlled by the members of opposition party.
- The crisis was resolved shortly before the deadline by reaching an agreement. In that case, the Ptresident agreed to implement **spending cuts totaling more than USD 900 billion** in order to resolve the crisis and raise the debt ceiling.

How Does India Manage Borrowing and Debt Obligation?

- India has a formal debt ceiling mechanism as per FRBM Act but does not have debt ceiling in terms of absolute amount like the US has. Therefore, Debt Ceiling in the US can be compared with **Fiscal Deficit** target in India.
  - In India this target is in term of % of **GDP (Gross Domestic Product)** not in and absolute amount like in USA.
- Indian government manages **borrowing and debt obligations** through various mechanisms and institutions such as,
  - **Fund raising through Securities and Bonds:** It issues government securities, such as treasury bills and government bonds, in the domestic market.
  - **Fiscal Responsibility and Budget Management (FRBM) Act:** It provides a legislative framework for **fiscal discipline and debt management** in India. It sets targets for fiscal deficits and debt-to-GDP ratios, aiming to ensure long-term fiscal sustainability. The government's borrowing decisions are guided by the principles outlined in the FRBM Act.
  - **Reserve Bank of India (RBI):** The RBI plays a significant role in managing the country's borrowing and debt. It acts as the **banker to the central government and facilitates**

the issuance, auction, and trading of government securities. The RBI also manages the government's **cash flows, ensuring smooth settlement of debt transactions.**

How can the US debt ceiling Impact Global Economy?

- A failure to raise the debt ceiling and the subsequent risk of a US government default can lead to **increased volatility in global financial markets.**
- A debt ceiling crisis may undermine the creditworthiness of the US dollar and may erode confidence in it, leading to a depreciation in its value. This depreciation can **have ripple effects on other currencies and trade relationships.**
- A debt ceiling crisis can undermine confidence in the stability and reliability of the global financial system. Uncertainty and fear in the markets can result in reduced **business and consumer spending**, hampering economic growth not only in the US but also worldwide.

What will be the Impact on the Indian Economy?

- **Rupee Depreciation:**
  - The Indian rupee may depreciate against the dollar, **making imports more expensive and potentially increasing inflationary pressures** in the Indian economy.
- **Trade Disruptions:**
  - The United States is one of India's major trading partners, and any economic downturn resulting from a **debt ceiling crisis can reduce demand for Indian exports.**
  - Reduced exports to the US can negatively impact Indian industries dependent on American consumers, such as information technology, textiles, and pharmaceuticals.
- **Impact on Forex:**
  - India holds a significant amount of **foreign exchange reserves,** including US Treasuries. A default or downgrade of **US debt can result in losses on these investments**, potentially impacting India's foreign exchange reserves and overall financial stability.

Source: IE