

US DEBT CEILING CRISIS



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The US debt ceiling crisis has been in the news. Hence it is important for us to conceptually understand this crisis



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- **The US has been a powerful country both economically as well as politically.**
- **Naturally its currency has been seen as safe and stable**
- **Therefore US has been in a position to borrow cheap from the rest of the world as well as from its own citizens**
- **US dollar therefore has been also seen as the reserve currency for most of the world citizen**



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However the US has been spending more than what it earns. The gap between its earnings and spends which has been constantly rising is funded with the help of borrowings from its own people as well as from other countries.



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Thus

- **US has been borrowing and borrowing.**
- **Due to the perceived stability of the dollar the US does not find it difficult to borrow cheap**
- **When it borrows dollars, it issues bonds to the lenders (these bonds are like IOUs)**
- **Also due to the perceived safety of the dollar the US bonds are rated AAA which qualifies it as one of the safest papers in the world**



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So

- **The US dollar continues to be in demand and hence remains a strong currency**
- **However the debt that has been created through repeated borrowing has gone too large**
- **US govt. is now finding it hard to service even the interest on the debt leave alone the principal**



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The republicans (the opposition party) are demanding a ceiling on such borrowings because they believe that such borrowings will increase the debt burden on future generation without helping the economy, unless a plan to make a balance act



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Debt ceiling would be possible if the government decides

- To reduce their expenditure
- To increase taxes

If government were to reduce expenditure its demand for goods and services would reduce. If the government would increase taxes the demand for goods and services of the people at large would reduce. Both these would impact the industry and create job losses. The government wants to stay away from such unpopular measures and instead would like to increase the debt ceiling.



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The government also needs to fund the social security and medical schemes which support the people for which it needs to borrow.

Thus the government has a lot to lose in terms of credibility if it were to limit the borrowing



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However what would happen
if the US government fails to
service its debt?



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- If the US were to start defaulting on its debt, the rating enjoyed by its Bonds would reduce from AAA to perhaps AA.
- If this were to happen most of the lenders would get uncomfortable holding on to the US Bonds and would want start selling the bonds.
- Higher selling pressure would cause the US bonds to lose value which would cause further stress for many countries who are sitting on huge piles of US Bond.
- Thus the contagion of default would impact the world.



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- From the US point of view its currency would get weak and it would become difficult for it to borrow at low rates.
- If the US won't be able to borrow effectively it will not be able to fund its deficit. This would lead to liquidity crunch. Factories would close down and job losses would alarmingly go up. Eventually this would lead to chaos and anarchy not only in the US but across the world like what happened in 2008 meltdown.



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Hope this story has clarified
the issue of “US debt ceiling”



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