

بحث مقدم إلى المؤتمر الدولي حول:

منتجات وتطبيقات الابتكار و الهندسة المالية

بين الصناعة المالية التقليدية و الصناعة المالية الإسلامية

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بعنوان:

The U.S.'s Debt Ceiling Crisis

And Budget Constraints

(Is October always Black in American History?)

(Is Obama's Administration Politically Bankrupt?)

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Abstract:

Modern research on feds highlights the significance of hard budget constraints and a strong central government to satisfy intergovernmental economic conflicts. The sharp political crisis that shook America reached to the settlement did not come out of any team victorious, whether President Barack Obama or his opponents Republicans, where Washington avoided disaster at the last minute approval of the text is likely stalled in the payback of their payments, and reopen the federal's department which was paralyzed for more than two weeks.

This article responds to the theoretical shortcomings with reference to the evolution of political crisis at the regional level and the representation of those regions at the national level. While both houses of Congress passed after 16 days of disruption, to settle out of the crisis, where they vote on raising the debt ceiling, and provides summary agreed to give the green light for the budget short-term extends until January 15, and to increase the debt ceiling to allow for the payment of the obligations of the government until Feb. 7, the Agreement provides a minor addition to the health care program, and calls to make sure the entry of individuals who are entitled to get help US government to pay for mandatory health insurance.

Keywords': Debt Ceiling, Crisis, Budget, Fiscal Year, Payments, Feds, U.S. Central Bank, Budget Constraints.

1.Introduction:

After the Global Financial Crisis that hit the world in 2008, which caused in the main by the Hybrid Assets, and after the Mortgage crisis that hit U.S. too from beginning 2007, and without forgetting the Black Monday (Wall Street crash) in October 24, 1929 this day witnessed a violent drop in several international markets, the world today faces the U.S.'s Debt Ceiling Crisis.

This paper takes many main points:

- 1.1. Why the government's debt raises?
- 1.2.(The Options Problem) If it does not raise the debt ceiling what are the options that can occur?
- 1.3.(The probabilities Problem) What are the probabilities if it does not the government pay its debt?
- 1.4.Is there any permanent solution for this matter? Contrary to what President Obama has done, where the decision that he signed was a temporary not long-term Solution.

1.5.(The Credibility Problem) What are the damages that consequences of the United States in terms of political and economic side because of this crisis.

Several days ago, in October 2013, the Fitch issued a stern warning to legislators Americans on raising the debt, saying that the U.S. rating (AAA) is in danger, and Fitch also noted to the risk of Washington failure to pay its debts as a result what it called the edge of the abyss, It is expected the Fitch agency join to the S&Ps that reduced the United States rating to (AA) in 2011.

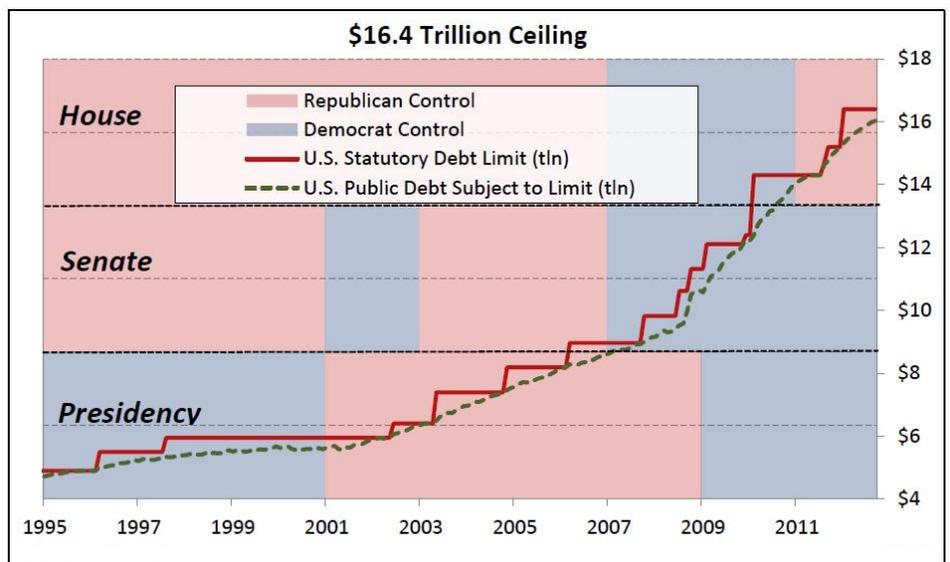
The October 16, 2013 was the most important days in the life of the U.S. Senate, where they were preparing for his last attempt to avoid a historic tumble to the government's ability to borrow, because this case will lead the country's failure to pay its debts and this is what a devastating hit to the global economy.

2.What is the Debt Ceiling?

At these times the world was taking his last breath in anticipation of what would have happened on the issue of the U.S. debt ceiling, which represents the upper limit debt allowed by Congress. So we can now definition the Debt Ceiling is: the upper limit Debt that allowed by the Congress.

It is worth noting that American Congress raise the debt ceiling in the last ten years, ten times, four times were in 2008 and 2009 only. As we can show in the Figure No (1) below¹:

Figure (1)
Chart of the Day Debt Ceiling

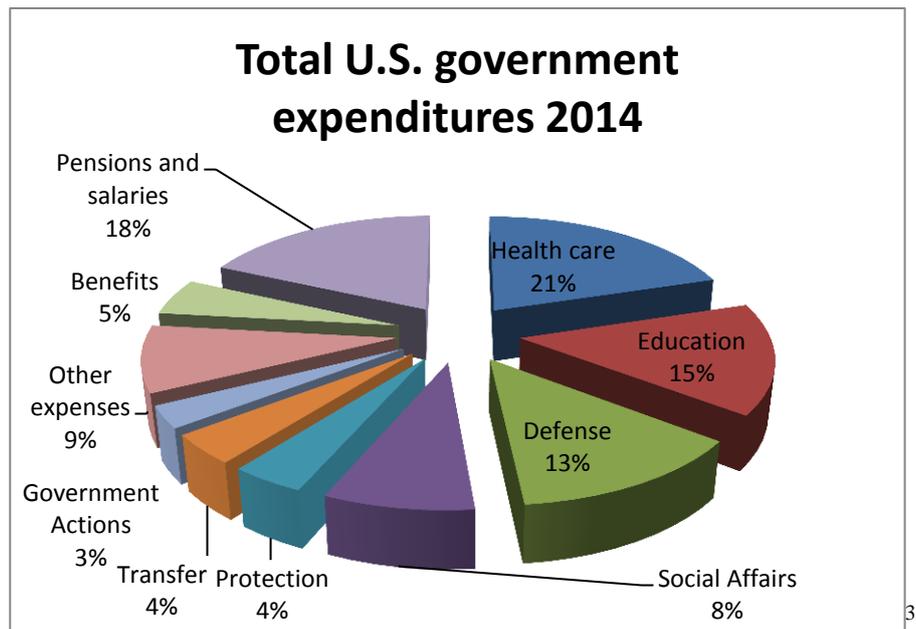


Notes from the figure above how the increase in recent years, especially after 2008, and the increase of the debt ceiling was not preceded in American history, and here do not know whether there is pressure from the ruling authority or is it from the brain of the U.S. Congress, in all cases, do not forget that the U.S. economy affects in the global economy not only impacts on Americans, but if the case was purely political who will pay the price?

3. Why the Government's Debt raises?

After the financial crisis in 2008 the U.S. government focused on increasing spending to revive the economy with the decline in revenue, and this is what led to the damage the economy and not as it should be happening. And by brief look to the Figure No (2) below we find that the share of Health Care from expenditures for the year 2014 became more than 20%, and is considered a relatively large share of the total budget for fiscal year 2014. And we can see the ratio of Education item arrives to 15% from the same budget. Which means the third of budget will spend on two service items².

Figure (1)
Total U.S. government expenditures 2014

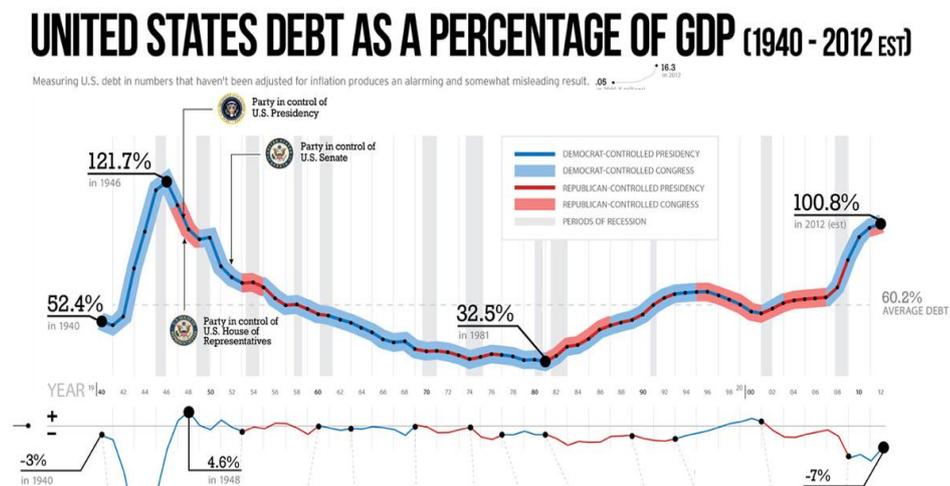


Appendix, Budget of the United States, Government, and Fiscal Year 2014 contains detailed information on the various appropriations and funds that constitute the budget and is designed primarily for the use of the Appropriations Committees. (*Literally from the budget*)

The debt ceiling in the economy concern or serious in the case exceeded the ratio of debt to GDP 90%, as is currently the case also shows in Figure No (3), because the state has become unable to

generate sufficient revenues to repay the debt to the owners, and this is called in economic thought insolvency or probability of default⁴.

Figure (3)
U.S Debt as a Percentage of GDP



At this stage controversy remains exists about the responsibility for the crisis is it back to the Republican Party or is it the work of the Democrats hands, informed that 53% of Americans blame Republicans for the crisis, and with both cases, I will repeat the same question ... Who will pay the price?

4.The Budget Constraints

Recent research on feds highlights the significance of hard budget constraints and a strong central government to satisfy intergovernmental economic conflicts (Wibbels 2003). Whereas regional political crisis determines the sub-national demand for soft as well as hard budget constraints, the coalition of those regions at the national level determines the likelihood of their provision (*ibid.*). Soft budget constraints (as such rules and practices are known) allow regional governments to overspend without eventually facing the associated costs (Oates 1972). Under soft budget constraints, regional governments are capable to petition the central government for ex post resources through ad hoc transfers, , state-owned enterprises, state owned banks, and so forth, which preclude the need for taxing their own citizens. Consequently, the common collection of national fiscal resources become the subject of intense political competition among the regions, all of whom have incentives to acquire additional federal bailouts at the expense of the federation as a whole (Cai and Treisman 2001; Rodden *et al.* 2002).

Soft budget constraints strengthen fiscal pressures (including debt crisis) on the general government (Rodden and Wibbels 2002), increase inflation as central governments monetize regional debts (Treisman 2000), promote spending on regional clientelist networks (Remmer and Wibbels 2000), and complicate exchange rate policy (Woodruff, 1999). In the same way with this study, the U.S. case examined in Wibbels (2003) study, and related research in other contexts, suggests that governmental transparency, balanced budget laws, and other institutions at the heart of recommendations to harden budget constraints are almost certainly a function of competitive electoral environments where politicians have incentives to generate such institutions. As such, the problem with fashionable technocratic answers to the intergovernmental fiscal challenges raised by this research mainstream is that they tend to ignore the politics underpinning the emergence and enforcement of hard budget constraints (see Wibbels, 2003).

In this way, the great challenge for the market-preserving theory of federalism is: how to move from soft to hard budget constraints. Increasingly, researchers find a political solution to soft budget constraints in increasing the authority of the central government. The logic behind reinforcing the center is clear. Intense collective action problems prevent either provincial governments or national legislatures from mounting a unified attack on bailout mechanisms. National executives, on the other hand, are elected by national constituencies and judged on the basis of national economic performance rather than more parochial, regional concerns. As such, the sole actor with the incentives to harden budget constraints is the chief executive (or the president Obama as in this study). The obvious ways to achieving market-preserving federalism, it would seem, would be to reinforce the most market-friendly actor in the federation. Hard budget constraints are self-reinforcing when they reproduce the interests of politicians at both the national and regional levels (see Wibbels 2003).

The prevalence of soft budget constraints in some feds is rooted in the reality that they inevitably provide specific benefits to regions with the political capacity to secure federal bailouts. (Tommasi, 2002). An examination of the U.S. debt crisis suggests analytical leverage on the issues discussed above for several reasons. First, this is a period of tremendous significance in U.S.

public finance, much as the transitions to market-based economies are for many contemporary feds. As Grinath *et al.* (1997) describe, "The U.S. state defaults of the 1840s, an era of fiscal crisis following a decade of fiscal exuberance, were one of the most spectacular episodes in the history of American public finance" (p. 1). Second, the 2000s represents a period that threatened the emergence of hard budget constraints in the U.S. states.

Indeed, budget constraints were not totally hard prior to the crisis: the federal government had assumed state debts on two instances (Garber 1991), excess federal revenue had produced ad hoc fiscal transfers to state governments (Ratchford 1966, p. 85), states had access to finance through their own banks (Grinath *et al.* 1997, p. 32; Sylla *et al.* 1987), and some states printed scrip to pay creditors and public employees (Ratchford 1966, p. 76). Although there is debate regarding the degree to which these factors comprised soft budget constraints, they do propose that the relationship between electorates and the spending behavior of governments was somewhat tenuous. Most important, the period of 1840s witnessed a strong movement for the federal assumption of state debts, which would have represented a clear bailout. Had the change for federal assumption been successful, it would have launched a precedent that led the United States down a path of hard budget constraints common to many contemporary feds. As Ratchford (1966) notes, "A second assumption would almost certainly have converted a precedent into a habit, the results of which are not pleasant to contemplate" (p. 104). Yet the debt crisis ended with a precedent that moved federal finance very clearly in the direction of market-based discipline. As such, the U.S. case can provide some insight into the process by which hard budget constraints are implemented and sustained.

The market-preserving resolution of the debt crisis underlines the centrality of state politics in shaping the demand for bailouts. As an example, the debt crisis of the 1840s has its roots in the 1820s and 1830s, when state governments assumed the responsibility of economic development by spending large amounts on infrastructure projects, particularly railroads and canals (Goodrich 1960; Sbragia 1996). By the late 1830s, the aggressive expansion of public works, weak revenue bases, heavy debt burdens, and a crisis of confidence in European capital markets precipitated a debt crisis for many states.

Without access to new credit, partially completed transportation projects ground to a halt, state banks failed, and the heavily indebted states found themselves in the most serious fiscal crisis since the period immediately following the Revolutionary War. In 1820, the total indebtedness of the states was only \$12.8 million. Two decades later that amount had increased by more than 1,300% to more than \$170 million (Ratchford 1966, p. 105). This crisis inspired nine state defaults, four partial repudiations of amounts owed, and a strong movement for the federal assumption of state debts (McGrane 1935, pp. 21-61; Ratchford 1966, pp. 73-104; Scott 1893; Wallis 2002; Wibbels 2003) by the early 1840s.

Accordingly, budget constraints were not as hard as they are nowadays, and the federal government was immobilized by controversial debates over the expansion of the union. Essentially, the 1840s was a case where the politically competitive and fiscally prudent states served as a check on the uncompetitive and fiscally profligate ones. Equally important, it was the way in which the crisis was resolved which provided the foundations for the fiscal rules that contemporary research is so focused on. As this study, Grinath *et al.* (1997) make clear, "Ultimately the debt crisis forced a change in the structure of state public finance. Beginning with New York in 1846, states began systematically to limit, by constitutional provisions, the issue of state and local debt"

(p. 34). By 1960, twelve other states reformed their Constitutions with an eye toward institutionalizing checks on the government's capacity to accumulate debt. Likewise, debt markets rapidly internalized the reality that the states would sink or swim on their own. Larson (2001) explains that only after the crisis "did the private capital market, nursed into being by a generation's experiments in public investment, step forward and claim a theoretical and practical superiority over public enterprise" (p. 6).

5. The Options Problem:

If it does not raise the debt ceiling may appear several options:

- 1.1. Having the U.S. Treasury Department to stop issuing bonds and thus borrowed from pension funds.
- 1.2. Withdrawing \$ 800 billion and keep it in the Central Bank of the U.S. or Feds.
- 1.3. Another proposal set to discussion which is that the Fed has to waive its debts in the Treasury (it arrive to \$ 1.6 trillion). And it's no right to claim it again.

6. The Probability Problem:

If the Treasury can't pay its Debt then it has to face one of these three probabilities:

- a. The government will not be able to pay any salaries or privileges for its employees and this necessarily has one meaning (stop Salaries).
- b. Rising returns on Treasury bonds in the secondary market which leads to raise interest rates and thus rising investment costs, and raise the Real Estate & houses prices and then get back again to the mortgage crisis that hit the United States in 2007.
- c. Foreigners will sell assets they own in America, and this necessarily lead to the drop of the dollar, and thus the decline standard of living of the American people, and thus get to the global economy can be called a catastrophe.

7. The Credibility Problem

What are the damages that consequence of the United States in terms of political and economic side because of this crisis:

a. At Political Side:

Crisis Conclusion recorded a big setback for the Republican team and its leader, Speaker of the House: John Boehner who called many times within weeks the executive authority to make special concessions on social expenditures before any vote on the budget. He said in a radio interview on Wednesday night / Thursday 'We fought a battle for a just cause, but we did not win.' And promised to continue to work to prevent 'catastrophe of the Act on the reform (system) health' labeled 'Obamacair' issued by Obama in 2010 and began applying incision key from the beginning of October.

So the Settlement approved did not touch the system 'Obamacair' substantially while the rate dropped public support for the Republicans sharply would send a hope among Democrats to restore the House of Representatives in the partial legislative elections to be held in November 2014 in the middle of the presidential term, according to the some polls reflected.

b. At Economic Side:

Led the U.S. federal government having to 'close' a number of agencies and activities to inflict the U.S. economy, losses measured in billions of dollars and damaged its flagship location in the global economy, The agency Standard & Poor's for credit rating estimated projected economic losses of 24 billion dollars, representing 0.6 percentage points from growth in the fourth quarter of the year.

The agency said 'in September we were hoping for growth of 3' at an annual pace in the fourth quarter because we thought then that politicians extracted lessons since 2011 'history of the

last financial crisis, and also Fitch agency warning about a possible downgrade of the U.S. classification of Debt, at a time the U.S. economy is still finding it difficult to promote and restore full performance after the recession and the financial crisis in 2007-2009.

8. The Conclusions :

Like new research on feds, this study highlights the significance of hard budget constraints and a strong central government to satisfy intergovernmental economic conflicts. The sharp political crisis that shook America reached to the settlement did not come out of any team victorious, whether President Barack Obama or his opponents Republicans, where Washington avoided disaster at the last minute approval of the text is likely stalled in the payback of their payments, and reopen the federal's department which was paralyzed for more than two weeks. The study concludes that the great challenge for the market-preserving theory of federalism is: how to move from soft to hard budget constraints.

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