

America flirts with self-destruction
By Martin Wolf in THE FINANCIAL TIMES

The fallout of a US government default, particularly one that lasts, is beyond prediction. Is the US a functioning democracy? This week legislators decided to shut down a swath of the federal government rather than allow an enacted health law go into operation at the agreed moment. They may go further; if they do not vote to raise the so-called “debt ceiling”, they risk triggering default on US government debt – a fate far worse than the shutdown or fiscal sequestration. If the opposition is prepared to inflict such damage on their own country, the restraint that makes democracy work has gone. Why has this happened? What might be the result? What should the president do?

The first question is the most perplexing. The Republicans are doing all of this in order to impede a modest improvement in the worst healthcare system of any high-income country. The Patient Protection and Affordable Care Act (known as “Obamacare”) is modelled on one introduced in 2006 in Massachusetts by then governor Mitt Romney. Its apparently criminal aims are to cover 32m uninsured people and ensure coverage of those with pre-existing conditions. True, the programme is complex. But it builds on a defective system. That most working people get insurance through their employers is an obstacle to labour market flexibility since it complicates decisions about leaving a job, particularly for people with chronic medical conditions. It is a form of serfdom.

Compare the US health system to those of the other large high-income countries. The US spends 18 per cent of its gross domestic product on health against 12 per cent in the next highest spender, France. The US public sector spends a higher share of GDP than those of Italy, the UK, Japan and Canada, though many people are left uncovered. US spending per head is almost 100 per cent more than in Canada and 150 per cent more than in the UK. What does the US get in return? Life expectancy at birth is the lowest of these countries, while infant mortality is the highest. Potential years of life lost by people under the age of 70 are also far higher. For males this must be partly due to violent deaths. But it is also true for women. (See charts.)

The idea that one should close the government – or risk a default – to stop universal insurance, which other high-income countries take for granted, seems mad. Maybe this shows how much some Republicans loath Barack Obama. Half of the legislators who called on John Boehner, the Republican speaker of the House of Representatives, to defund the health law come from the old south. Its dislike of the federal government may be part of the explanation. Republicans might fear not that the programme will fail, but that it will work, cementing the credibility of government. So what happens now? Shutdowns are relatively predictable. They have also happened before. Goldman Sachs notes that “the longest shutdown equivalent to the current situation occurred in 1995 and lasted

five days". Goldman estimates that about 800,000 federal employees will be put on furlough. Only activities funded by the specific route of congressional appropriations – about one-third of federal spending – will be affected; a little over half the activities within that category are likely to be exempt. In areas not exempt, employee salaries would be cancelled during the shutdown, but most procurement of goods and services would subsequently be made good. Yet this will still be a nuisance. Thus most analysts assume the shutdown will not last very long. Goldman estimates that a two-day shutdown would reduce growth in the fourth quarter by 0.1 percentage points at an annualised rate, while a week-long shutdown would cost 0.3 percentage points.

Now consider the debt ceiling. According to Goldman, without an increase in the ceiling, the Treasury would no longer be able to issue debt from October 17 and would deplete its cash by the end of the month. Much confusion exists about what would happen if the Treasury ran out of cash and could not increase its outstanding debt. The optimistic view is that it could meet its priorities, including debt service, by managing its payments. If so, no default need occur. Jack Balkin of Yale University argues just this. The pessimistic view is that managing its cash flows in such a way would be illegal and possibly impossible – not least because cash receipts fluctuate substantially. But the Treasury, playing a game of chicken, would argue the pessimistic case even if it believed it could cope. At best, a failure to raise the debt ceiling would necessitate a sharp cut in spending. At worst, the US would default. Analysts at Bank of America Merrill Lynch argue that hitting the ceiling would require the US to balance its budget at once, cutting spending by about 20 per cent, or 4 per cent of GDP. That would push the US into another recession – even if there were no default. The consequences of an actual default, particularly one that lasted for some time, are beyond prediction. Unlike a shutdown, there is no precedent, for good reason. The notion is suicidal.

So what should the administration do? In a democracy, people overturn laws by winning elections, not by threatening the closure of government or even an outright default. It is impossible to run the government of a serious country under blackmail threats of this kind. Every time the administration gives in, it stores up more difficulty for itself. It has to stop doing so. Some argue that the 14th amendment of the constitution, which states that "the validity of the public debt of the United States, authorized by law ... shall not be questioned", gives the president the power he needs to borrow, in order to redeem debt. But such a presidential action would be risky. The Supreme Court might side with the president, but a constitutional crisis could itself impair US ability to borrow on favourable terms. Again, the clever proposal to mint a trillion-dollar coin and use that as security at the Federal Reserve might also cause mayhem. Playing chicken with credibly reckless people is always scary. But the administration cannot give in. I remain, like Winston Churchill, optimistic: the US will do the right thing in the end, though not before first exhausting all the alternatives.