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Mock

## History of USA

Q2 Explore potential consequence if the US were to breach the debt ceiling. Assessing the economic, financial, and geopolitical ramifications and discuss historical instances where the US faced challenges related to the debt ceiling.

### Introduction:

In the United States, the debt ceiling or debt limit is a legislative limit on the amount of national debt that can be incurred by the US Treasury. This limits how much money the Federal government may pay by borrowing more money, on the debt it has already borrowed. Under Article 1 Section 8 of the United States Constitution, only Congress can authorize the borrowing of money on the credit of the United States. From the founding of the US until 1917, Congress directly authorized each debt issued. To provide more flexibility to finance the United States' involvement in WW1, Congress modified the method by establishing an aggregate limit, or "ceiling" on the total amount of new bonds that can be issued. From time to time, political disputes arise when the Treasury advises Congress that the debt ceiling is about to be reached and indicates that a default is imminent. When the debt ceiling is reached, it is up to Congress to increase the limit. Although there has never been a point of default.

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where the Treasury is incapable of paying US debt obligations; there have been several occasions when it has been close.

Breaching the debt ceiling in the United States has significant and far reaching consequences that can impact the economy, financial markets, and the country's geopolitical standing.

### Economic Ramifications

#### 1) Government shutdown

The US government may be forced to implement a partial or complete shutdown, as it would not have the legal authority to borrow more money to fund its operations. This could lead to the furlough of federal employees, suspension of government services, and disruptions in various sectors. As a result, the economy might also slow down and trigger a recession.

#### 2. Default on Obligations

The government might default on its financial obligations, including payments on Treasury bonds, salaries and entitlements. This could damage the government's creditworthiness and lead to higher borrowing costs in the future. Investors may also lose confidence in the gov't being too big to fail and reevaluate

its investment and profitability potential

### 3. Market Volatility

The uncertainty surrounding a breach of the debt ceiling can trigger market volatility. Investors may react negatively, leading to a sell-off in financial markets. Stock prices could decline, and there may be increased demand for safe-haven assets.

### 4. Interest rates and inflation

A default or even the threat of default could increase interest rates, affecting not only government borrowing costs but also interest rates for consumers and businesses. This, in turn, could impact economic growth and contribute to inflationary pressures.

### Financial Ramifications

#### 1) Credit Rating Downgrade

Rating agencies may downgrade the credit rating of the United States. This would signal to investors that US government debt carries a higher risk of default, potentially leading to a sell-off in Treasury securities and higher interest rates.

#### 2) Market Confidence

A breach of the debt ceiling could erode investor confidence in the US financial system. Investors, both domestic and

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international, rely on the stability of US assets, particularly Treasury securities, as a safe and reliable investment.

### ↳ Disruptions in Financial Markets

Financial markets, including the bond and equity markets, could experience disruptions as investors seek to adjust their portfolios in response to increased uncertainty and risk.

### Geopolitical Ramifications

#### 1) Global Economic Impact

The US economy is a major driver of the global economy. Any disruptions caused by a breach of the debt ceiling could have spillover effects on the global economy, affecting international trade and financial markets.

#### 2) Dollar's role as a reserve currency.

The US dollar serves as the world's primary reserve currency. A default or a significant breach of the debt ceiling could undermine confidence in the dollar and prompt calls for alternative reserve currencies, impacting the global monetary system.

## Historical Instances

### 1) Debt ceiling crisis of 2011

The US faced a major debt ceiling crisis in 2011, leading to heightened uncertainty and volatility in financial markets. While a last minute deal was reached to raise the debt ceiling, the episode had lasting consequences, including the first ever downgrade of the US credit rating by ~~S&P~~ S & P

### 2) Government Shutdown

While not directly related to breaching the debt ceiling, government shutdowns have occurred several times in US history, most recently in 2018 and 2019. These events highlight the challenges of reaching budgetary agreements and the economic consequences of disrupted government operations.

## Conclusion

It's important to note that breaching the debt ceiling is a serious scenario that policymakers typically strive to avoid. The potential consequences are severe and can have long lasting effects on the economy, financial markets and the global geopolitical landscape. Political negotiation and decisions to raise the debt ceiling are critical to maintaining the stability and credibility of the US government and its financial commitments.