Failure to Raise Debt Ceiling May Result in Stopped Funding for Federally Funded Projects

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As the federal government nears the brink of missing its self-imposed deadline for raising the debt ceiling, it's a good time to assess the potential impact on state and local governments and their contractors. (You can find a great assessment on the potential impact on federal contractors **here**.) Given that the federal government has never failed to raise the debt limit before, we have very little concrete information at hand.

- Moody's Investors Service **has warned** that it would downgrade the Aaa credit ratings for Maryland, Virginia, South Carolina, Tennessee and New Mexico within 10 days of a missed deadline. Maryland, New Mexico, and Virginia are the most reliant on federal spending and employment. All of the states have particular issues with Medicaid and other credit issues. However, despite some gubernatorial grandstanding, none of them faces a major fiscal impact from slightly higher interest rates.
- The Tax Policy Center **has pointed out** that state and local debt that is refinanced using regular U.S. treasuries (as opposed to special state and local government treasuries, or "SLUGs"), represents "only $130 billion out of a $2.95 trillion market" (4.4%). So, no big impact on refinancing.
- The PEW Center on the States has **produced a brief** with the most credible speculation as to what a federal shutdown (as a result of missing the debt ceiling) could mean for states and localities, and even they can't pin down a likely scenario with any sort of specifics. I **commented previously** on the likely minimal impact of a federal shutdown as a result of failing to pass a continuing budget resolution.

Analyst's Take
In the end, missing the debt ceiling deadline will mean only one thing: We will have moved from pre-deadline gamesmanship to post-deadline gamesmanship. Still a very dangerous business environment. Once the deadline passes, the initiative will move from the U.S. House of Representatives, which originates budgets, to the White House, which executes them. Without legislation to direct him, President Obama, will be free to implement cuts to discretionary spending and entitlements in any way the law is not expressly understood to prohibit--and even that might be up for debate. In the event of a missed deadline, state and local government vendors fulfilling contracts that rely on any sort of federal funding that is not currently in the bank of the customer should have contingency plans to deal with an immediate cessation of project funding for an indefinite period.