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Quick Take - Washington Research: The Debt Ceiling Deal Reached...Now Comes the Hard Part

Highlights

- As we projected, the debt ceiling debate has gone practically all the way to the brink – but President Obama reached agreement with Congressional leaders last night on a multi-step deficit-reduction package expected to total $2.4 trillion over 10 years, to be accompanied by nearly matching increases in what is now a $14.294 trillion limit on the nation's borrowing authority. The announcement by President Obama came at 8:40 PM EST, in time to spark a rally in Asian markets.
- The deal still needs to be sold to wary Republican and Democratic rank-and-file members, passed by both the House and Senate and sent to President Obama's desk for his signature in time for Tuesday's deadline.
- ***But last night's agreement makes it almost certain the U.S. will not default on its obligations this week; preserving its pristine AAA credit-rating, however, may be another story as $2.4 trillion falls well short of the $4 trillion standard cited by Standard & Poor's last month.*** The fact that much of where the cutting will fall is still unspecified may be another black mark against the package.
- ***Timing:***
  - The Senate and House are expected to each vote on the package as early as today, which would send the legislation to President Obama's desk for his signature in time to head off default. However, that remains an extremely ambitious timeframe, and as of late Sunday, pen still hadn't been put to paper on final legislative text to be made publicly available. If necessary, Congressional leaders were holding out the possibility of a very short-term increase in borrowing authority to get through the end of the week if the process takes longer than expected to play out.
  - There is still much work to be done to see this measure over the goal line before the Treasury Department's borrowing authority lapses on Tuesday. Initial reports suggest that many Members of Congress on both sides of the aisle have concerns about the deal – some Republicans think it does not cut spending enough, others think it cuts too much from defense; many Democrats believe the lack of tax revenues in the deal puts greater pressure on domestic spending and social programs.
- ***The final deal appears to give Republicans much of what they wanted*: 1) Spending cuts equal to or greater than the amount of debt ceiling headroom granted; and 2) no tax increases. In concessions to Obama and Democrats in Congress, the agreement: 1) paves the way for at least $2.1 trillion in additional debt ceiling headroom, with Congress ultimately unable to block it, and 2) requires defense to shoulder a large part of the spending cuts, protecting domestic programs like Medicare from deeper reductions.**
- House Speaker John Boehner (R-OH), who outlined the agreement to his GOP Conference at 8:30 PM EST last night, can't afford to lose more than 119 House Republicans on the vote in order to maintain a

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threshold that a "majority of the majority" in the House supported the bill; there are 240 Republicans in the House.

- If Boehner were indeed to lose upwards of 100 Republicans on the vote, he would need to make it up with 80+ Democrats – and House Minority Leader Nancy Pelosi (D-CA) was reported to have expressed disappointment with the deal yesterday. Many of the 78 members of the Congressional Progressive Caucus, for instance, were expected to oppose the deal; if all 78 voted 'no,' that would leave a pool of only 119 Democrats from which to get to the 218 margin needed for victory.
- So while we still expect a strong bipartisan vote in the Senate, where Majority Leader Harry Reid (D-NV) and Minority Leader Mitch McConnell (R-KY) negotiated much of the deal together, all eyes will be on the House where the sledding is expected to be rougher.
- What the deal looks like-

  Stage One:

  – **Down payment**. An initial "down-payment" totaling $917 billion in spending cuts over 10 years, capping the rate of growth of discretionary spending programs funding about 45% of the federal government's day-to-day expenses. This category includes defense spending, which would be subject to about $350 billion of the proposed cuts over 10 years, not counting savings associated with winding down the troop presence in Iraq and Afghanistan. The package would also maintain the current maximum $5,550 Pell Grant for low-income undergraduate students, offset by reductions in student loan subsidies for graduate students.

  – **Debt limit increase**. An initial $400 billion boost in Treasury borrowing authority is granted, estimated to last through September 2011. At this point Obama would be authorized to request another $500 billion, estimated to last until February 2012. However Congress could vote on a "resolution of disapproval" to deny this second installment, which Obama could veto and Congress would likely be unable to override.

  Stage Two:

  – **Joint committee**. A joint committee of Members of Congress (made up of 12 lawmakers, equally divided between House and Senate, Democrat and Republican) would be charged with developing a package of at least $1.5 trillion in additional deficit-reduction measures by November 23, 2011, and guaranteed an up-or-down vote in both the House and Senate before December 23. Nothing would be off the table in these discussions, including additional tax revenues or reductions in entitlement programs – however, Republicans have successfully included a mechanism that effectively precludes any net tax increases from being part of this package. That means the entire $1.5 trillion would most likely have to come from spending cuts.

  – **"Trigger" fail safe plan**. If the joint committee does not come up with at least $1.2 trillion in spending cuts, then government programs with some exceptions would be subject to across-the-board cuts equal to the difference between the committee's recommendations and $1.2 trillion. So if the joint committee deadlocked and produced no bill, then $1.2 trillion in across-the-board cuts would kick in; if the joint committee came up with only $600 billion, then another $600 billion would be cut across the board. Across-the-board cuts would be divided equally between defense and non-defense spending. Cuts would only take effect beginning in fiscal 2013.

  - **Exceptions** – Social Security, veterans' benefits, federal civilian and military worker pay, unemployment insurance, Medicare benefits and programs affecting low-income individuals and

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families such as Medicaid, Supplemental Security Income, and child nutrition would be exempt from across the board cuts. Also, cuts in payments to Medicare providers and insurance plans would be capped at 2% of overall program costs, which under current projections is equal to no more than about $150 billion over 10 years.

- ***Debt limit increase***. At this point the nation's borrowing authority would be increased by the amount of spending cuts agreed to by the joint committee, or imposed across the board – at least $1.2 trillion in additional headroom and up to $1.5 trillion or more. Whatever the amount, it would again be subject to a "resolution of disapproval," which is unlikely to be successful due to the President's veto authority.
- ***Balanced Budget Amendment.*** In addition to the above steps, the deal also requires both the House and Senate to vote on a balanced budget amendment to the Constitution at some point between October 1 and the end of 2011. In contrast to the original Boehner House bill, which he struggled to pass for several days last week, it would not require the amendment to actually be sent to the states for ratification, however. In lieu of the joint committee being able to produce a spending-cuts package, however, passage of a balanced budget amendment that is actually sent to the states would enable the President to raise the debt ceiling by another $1.2 trillion without the threat of across-the-board cuts; this, however, is unlikely to occur.

- ***Key Takeaways/What to Watch:***
  - Overall, as we said earlier this deal appears tilted towards Republican objectives in the bargaining process, largely as a result of Tea Party-backed members drawing a firm line in the sand. This represents a continuation of a theme we saw with the fiscal 2011 budget debate this spring that led almost to a government shut-down, and even further back to the December 2010 deal to extend the Bush-era tax cuts for upper-income earners. ***Republicans have now clearly pulled Obama into the austerity camp on spending, and Democrats were still unable to wrangle any new tax revenues out of this deal, despite having control of the Senate and White House. Spending cuts will be historic if not unprecedented, and the battle will continue this fall and likely throughout the 2012 election cycle as well.***
  - It remains to be seen whether this apparent capitulation will backfire this week if it costs the votes of Democrats in the House who will likely be needed to offset GOP losses. However, Obama still does have one ace up his sleeve that his aides repeated throughout the day Sunday as rumors of the agreement leaked out: he can veto an extension of the Bush tax cuts for high earners when they come up again for a vote in late 2012. ***This is still a lever to force action on a comprehensive overhaul of the tax code before the end of next year, including lower rates for individuals and corporations and a thinning out of various deductions, credits and exclusions. The White House is hoping Obama can use this threat to get Democrats on board, but as the old proverb says: Fool me once…***

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