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FINALLY, A DEBT DEAL GETS DONE

Here are the particulars of the Budget Control Act of 2011.

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The Budget Control Act of 2011 is poised to become law - just in time to meet the August 2 Treasury deadline and reassure world financial markets. The framework of the new law is complex and shows that both Democrats and Republicans can claim some victories.

The federal deficit will be reduced by at least \$2.1 trillion. That figure comes from the non-partisan Congressional Budget Office. The savings will be realized over a decade ... although it isn't yet clear where the bulk of the cuts will be made.¹

- More than \$900 billion will be saved through the first wave of cuts.
 - Discretionary spending on defense and non-defense programs will be reduced by \$741 billion over a 10-year period. This includes a \$350 billion cutback in defense spending at the Pentagon (a Democrat goal in the negotiations).
 - Another \$156 billion in savings will emerge as a result of shrinking interest costs on the national debt.
 - Another \$20 billion will be cut from education loan initiatives and through efforts to identify fraud and abuse in other mandatory federal programs. (Student loan funding will be reduced to \$22 billion by 2021, but Pell Grant funding will increase by \$5 billion by 2015.)^{1,2}

A bipartisan committee of 12 will have to recommend between \$1.2 trillion and \$1.5 trillion in additional federal budget cuts by November 23.

- This committee will likely propose cuts to Social Security, Medicare and Medicaid and perhaps further reductions to the defense budget. Its membership will be handpicked. House Minority Leader Nancy Pelosi (D-CA) and Senate Majority Leader Harry Reid (D-NV) each get to select three Democrats; House Speaker John Boehner (R-OH) and Senate Minority Leader Mitch McConnell (R-KY) each get to pick three Republicans.
- Congress has to vote on their recommendations by December 23. If the bill is defeated, then automatic budget cuts will kick in on January 2, 2013 - at least \$1.2 trillion worth, divided almost evenly between defense and domestic spending. (Social Security, Medicaid, military pay and veteran's benefits would be exempt; Medicare would not be, according to House Speaker Boehner.)

- In addition, a Congressional vote on a balanced budget amendment to the Constitution will occur before the end of 2012. An approved balanced budget amendment would have to be ratified by two-thirds of the states. (This was a key victory for Tea Party Republicans.)^{2,3,4}

The debt ceiling will be raised by up to \$2.4 trillion. It will be raised incrementally from the current \$14.3 trillion level, dependent on a series of triggers:

- *The first trigger: the bill's passage.* Congressional approval amounts to a formal declaration that the federal government is less than \$100 billion away from hitting the debt cap. Once the Budget Control Act of 2011 is made law, President Obama may immediately raise the debt limit by \$400 billion.
- *The second trigger: the initial \$400 billion increase.* This move initiates another formal request to hike the debt ceiling by another \$500 billion dependent on Congressional authorization. It is widely assumed that Congress will disapprove this request, with President Obama vetoing the disapproval and Congress failing to override the veto. The probable outcome: the debt limit rises by the desired additional \$500 billion.
- *The third trigger: what Congress does by December 23.* Here are the possibilities that could play out during the holiday season:
 - If Congress fails to pass the deficit-reduction bill generated by the bipartisan committee of 12, then President Obama can formally request another hike in the debt limit - a \$1.2 trillion increase. Congress would likely reject this request, President Obama would use his veto power in response, and Congress would likely fail to override the veto.
 - If Congress passes the deficit-reduction bill, then President Obama gets automatic authority to raise the debt cap by an amount equivalent to the budget cuts defined in the new law.
 - Alternately, if Congress passes a balanced budget amendment and sends it to the states, President Obama immediately gains the authority to raise the federal debt limit by \$1.5 trillion.³

Tax hikes for the rich? Not immediately. In a key Republican victory, the two-step bill does not include tax increases or new levies for those in the highest tax brackets. House Speaker Boehner said July 31 that the forthcoming 12-member committee could not approve tax hikes - it would be "impossible" under current federal budgeting rules. Yet with the expiration of the Bush-era tax cuts increasingly probable in 2013 and the possible elimination of some deductions and exemptions in the tax code to generate additional revenue, there is a good chance many Americans will pay out more to the IRS in the near future. The White House says \$1 trillion could be saved alone by not extending the EGTRRA/JGTRRA cuts further.⁵

December isn't that far away. Expect more drama on Capitol Hill as 2011 ends, with a chance of added volatility in our financial markets.



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Citations.

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