Supercommittee Failure Poses Threat to U.S.

The implosion of the congressional supercommittee is likely to delay any major deficit-reduction agreement until after the next presidential election and may pose an immediate threat to the struggling U.S. economy.

The committee’s failure to reach a deal means several tax programs, including a payroll tax holiday, risk expiring at the beginning of next year, weighing on the household spending that accounts for about 70 percent of the world’s largest economy.

The panel’s inability to agree on $1.2 trillion in budget cuts, which drove stocks down yesterday and Treasuries higher, also stoked doubts about U.S. lawmakers’ ability to overcome partisan gridlock and safeguard the nation’s fiscal health.

“They could not agree even on the smaller challenge of $1.2 trillion,” said former White House budget director Alice Rivlin, among a coalition of officials who pushed the panel to “go big” and find $4 trillion in savings, in an e-mail. “I do not see a way to get to the big deal before the election, if then. It is really discouraging!”

Still, Standard & Poor’s reaffirmed it would keep the U.S. credit rating at AA+ after stripping the government of its top AAA grade on Aug. 5. Moody’s Investors Service reaffirmed its AAA rating with a negative outlook. Fitch Ratings noted in a statement that it said in August that a supercommittee failure would probably result in a “negative rating action,” likely a revision of its outlook to negative, and that a review would be concluded by the end of this month.

Trigger in Jeopardy

S&P said its rating would stand because the committee’s failure triggers $1.2 trillion in automatic spending cuts, which were put in place in the event no compromise could be reached. Easing those automatic spending limits may cause “downward pressure on the ratings,” S&P said in a statement.

That so-called trigger may be in jeopardy, with both Democrats and Republicans leery of steep cutbacks at the Pentagon that Defense Secretary Leon Panetta has called “Draconian.” Congress has succeeded in the past in undoing debt-reduction enforcement mechanisms.

Republican Senators Lindsey Graham of South Carolina and John McCain of Arizona already are looking for other cuts to take the place of those the Pentagon faces. Representative Howard McKeon of California said he’ll introduce legislation to prevent the spending reductions to defense.

“They have to really be careful not to mess with that,” said Robert Bixby, head of the nonpartisan Concord Coalition, which presses for debt reduction. “To dismantle it would be totally unacceptable.”

Economic Risk

Investors have largely shrugged off S&P’s August downgrade of U.S. debt to AA+ from AAA. After the move by the ratings company, the government’s borrowing costs fell to record lows as Treasuries rallied.
The yield on the benchmark 10-year Treasury note fell from 2.56 percent on Aug. 5 to below 1.72 percent on Sept. 22. The yield on the 10-year note declined 6 basis points, or 0.06 percentage point to 1.96 percent in New York yesterday, according to Bloomberg Bond Trader prices. The Standard & Poor's 500 Index dropped 1.9 percent to 1,192.98.

Trouble may lie ahead for the economy. The supercommittee was considering rolling into its final product expiring tax provisions that must now be addressed before January.

Representative Dave Camp of Michigan, chairman of the tax-writing House Ways and Means committee, has expressed concern about the cost of extending the payroll tax cut. Other Republicans on that panel, including Representative Kevin Brady of Texas, have said they'd be opposed to an extension.

Bad Hand?

Bill Hoagland, a former Republican staff director of the Senate Budget Committee, said this position puts Republicans in a bind. During the debt negotiations, they objected to ending the tax cuts enacted under former President George W. Bush for upper-income earners. If Congress fails to extend the payroll tax cut, which affects many more Americans, “that's going to play into somebody's hand,” Hoagland said, meaning Democrats.

An end to the reduction in payroll taxes would subtract 0.5 percent from gross domestic product in 2012, while failing to extend unemployment benefits would cause a separate 0.3 percent decline, according to JPMorgan Chase & Co. chief U.S. economist Michael Feroli.

At the same time, any extension of the tax holiday will add to the nation’s debt now that there’s no broader deficit-trimming agreement.

“It’s certainly going to look awkward to do a number of these things that expand the deficit over the next year,” said Bixby.

**Impairing Economic Growth**

Earlier this year, the Congressional Budget Office estimated that U.S. debt will reach 187 percent of gross domestic product by 2035. Even after the trigger takes effect, the debt will grow to between 134 percent and 164 percent of GDP in 2035, according to the New York-based Peter G. Peterson Foundation, which works to focus public attention on the U.S.’s fiscal deficit.

“History suggests that a debt-to-GDP ratio of more than 60-90 percent can impair economic growth and produce crises,” Peterson said in a statement.

After addressing these more immediate agenda items, congressional lawmakers are likely to turn to altering the trigger’s equal blend of domestic and defense cuts.

So far, Graham and McCain have proposed a 10 percent reduction in pay for members of Congress and a 5 percent cut elsewhere in the budget. The two members of the Senate Armed Services Committee haven’t spelled out other targets.

**$1 Trillion Reductions**

If Republican efforts to reverse the automatic defense cuts fail, the Defense Department’s budget would face reductions of about $1 trillion over a decade, the most of any department.
The Pentagon already is cutting about $450 billion from its budget over the next decade as a result of the
Budget Control Act that President Barack Obama signed into law Aug. 2, the same measure that created the
supercommittee. The panel’s failure to reach an agreement increases the defense cuts by about $500 billion,
excluding interest savings, starting in January 2013.

On the domestic side, the CBO estimates 71 percent of the cuts would come from programs such as education,
the environment, transportation, housing assistance and veterans’ health care.

A senior administration official who briefed reporters said the president will oppose any effort to alter the
automatic cuts and veto any attempt to undo the legislation. The White House is still hoping the enforcement
mechanism, which doesn’t take effect for 14 months, will force Congress into a deal, said the official, who spoke
on condition of anonymity.

**Medicare, Medicaid**

The supercommittee’s failure to reach an agreement takes the Medicaid health-insurance program for the poor
off the table for potential cuts. Cuts to Medicare, the federal insurance program for the elderly and disabled, are
limited to a maximum of 2 percent for payments to hospitals, doctors and other health providers and to private
health plans participating in the Medicare Advantage program.

The supercommittee was largely derailed by a standoff between Democrats and Republicans over the expiration
of the tax cuts enacted under Bush.

Republicans wanted to extend them all, and Democrats pushed to allow the tax breaks for top earners to lapse.
If Congress does nothing, the cuts will expire in January 2013, and taxpayers will face higher rates on wages,
capital gains and dividends.

“Republicans did overreach by taking the position they had to extend all of the expiring tax provisions,” said
Hoagland. “Democrats were just completely unwilling to make any kind of fundamental structural changes to
Medicare.”

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