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Budget and Appropriations Update

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With the Republican-controlled House of Representatives insisting on dramatic reductions in federal spending, and the Democratic-controlled Senate and White House opposing many of these cuts, the stage has been set for a complicated process for finalizing Fiscal Year 2011 appropriations and moving forward with the budget and appropriations process for Fiscal Year 2012. While the final outcome may not be known for several months, we do know that the GOP goal to shrink the budget to Fiscal Year 2008 levels, the President's call for a five-year freeze in federal spending levels, and a rejection of earmarks by both Congress and the President have created a budget and appropriations process unlike any seen in recent memory.

FY11 Continuing Resolution

After five days of open debate, and in a rare late night weekend session, the House of Representatives passed, along a nearly party-line vote, HR 1 – the full year Continuing Resolution (CR) for Fiscal Year 2011. The previous Congress had approved a short-term CR funding the federal government through March 4, 2011.

HR 1 would fund most government activities through September 30, 2011 (the end of the current fiscal year) at FY10 levels, minus additional funding cuts totaling $61.5 billion. It is important to remember that these spending cuts are not spread out over the course of the full fiscal year, but would be compressed into the remaining 7 months of FY11 so their impact will be felt more intensely.

While nearly 600 amendments were filed, 153 were ultimately considered during debate, and 67 of these were approved. All Democrats voted against HR 1 and were joined by three Republicans.

As a portent of the contentious battle ahead, one amendment, offered by members of the conservative Republican Study Group, would have cut an additional $22 billion, but was rejected with 92 Republicans joining all Democrats to vote against the measure. The reduced level of spending in HR 1 is nearly $100 billion less than what was requested by the President in his FY11 budget request.

HR 1 would need to be approved by the Senate and signed by the President to come into effect, but Senate Democrats have voiced strong objections to the bill, and the President has said he would veto the legislation if brought to his desk. With that said, there is no chance of HR 1, as passed by the House, becoming law, and some observers are beginning to talk

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about the spending impasse leading to a government shut down if some compromise cannot be reached.

In light of the "dead on arrival" nature of HR 1 in the Senate, House Republicans will unveil, later today, a short-term two week CR to allow for more time to negotiate a compromise. While there are few details available at this point, the proposed short-term House CR will likely include a $4 billion spending cut – the $61.5 billion in reductions in HR 1 prorated for a two week period. This has already been rejected by Senate Majority Leader Reid, who says he wants to see a "clean CR" (i.e. with no new spending cuts) funding the government at current levels until a compromise is reached.

Senator Reid intends to introduce, next week, a short-term spending measure that would continue to fund the government at current levels for one month, while congressional Democrats work to negotiate with the GOP a long-term CR for the remainder of the fiscal year that has spending cuts that are more palatable to the President and to them. The long-term CR will likely include the elimination of $8.5 billion in scheduled earmarks, as well as accelerate some of the $33 billion in program terminations and reductions the President included in his budget request for the next fiscal year.

Minority Leader Mitch McConnell (R-KY) wants to see spending reductions in any short-term CR so it is unclear whether the Democrats, with their reduced majority of 53-47, will be able to pass the measure Reid introduces next week.

President Obama's FY12 Budget Request

While the Congress and Administration continue their efforts to resolve FY11 appropriations -- which was punted to them when the previous Congress failed to enact a single spending bill for the current fiscal year -- the President has also submitted to Congress his Budget Request for Fiscal Year 2012.

At $3.7 trillion, the request includes a five-year freeze in non-security discretionary spending, and the White House claims that it will cut the federal deficit by $1.1 trillion over ten years. The proposed budget would downsize or eliminate more than two hundred federal programs, while increasing federal support for transportation and infrastructure, telecommunications, medical research, education, energy and other efforts.

To offset the targeted increases in spending, the President has called for new tax revenues of $1.6 trillion over the next ten years. These taxes would, primarily, affect wealthy individuals and corporations. Proposed tax increases include an end to federal subsidies for the oil and gas industry, new fees for financial institution that benefitted from the Troubled Assets Recovery Program (TARP) bailout, limits on itemized deductions for households earning more than $250,000 annually, and an end to the so-called "Bush tax cut" for high-income households that was just recently extended with the support of President Obama.

However, the GOP, newly emboldened by their ascent to the House majority, will engage the Administration and their Democratic colleagues in Congress in a fierce battle to drastically reduce federal spending far beyond what the President has called for. Senate Democrats have already announced their support for President Obama's call for a five year freeze of domestic discretionary spending, while, as mentioned earlier, Republicans support a return to Fiscal Year 2008 spending levels

New House rules give the Chairman of the Budget Committee significant powers to dictate the overall spending levels, and Chairman Paul Ryan (R-WI) is an ardent advocate for slashing federal spending to FY 2008 levels (the last year of the George W. Bush Administration). The new rules allow the Chairman of the Budget Committee to unilaterally set spending and revenue limits and caps by publishing them in the Congressional Record, but without votes or debate in the House. While the Budget Resolution, which sets spending caps for the year, is not binding, the Chairman's spending decision is under the new rule, so any appropriations bill that passes out of committee and goes beyond his spending limits would be ruled out of order. This is a tremendous change in how the House of Representatives will do business, and will mean that the coming months will see a protracted battle between the House GOP one side and the Administration and Senate Democrats on the other over how much to reduce federal spending.

On the issue of earmarks, last year, House Republicans chose to impose a moratorium, while Democrats continued to support requests along with both parties in the Senate. In the current Congress, the new GOP majority in the House banned earmarks for the FY11 CR and FY12 spending bills, while the Senate leadership, for a while, argued that earmarking was a congressional prerogative they were willing to defend. Ultimately, with the President announcing in his State of the Union address that he would not sign any spending bill that contained earmarks, Senator Daniel Inouye (D-HI), Chairman of the Appropriations Committee, saw the writing on the wall and announced that his committee would not accept any earmark requests.

House and Senate Appropriations Committees will not begin work on the FY12 spending bills until the FY11 CR is resolved, so an already rigorous workload will be compressed into a fairly short amount of time if the appropriations bills for FY12 are to be finalized by October 1, 2011 when the new fiscal year starts.

Debt Ceiling Increase

The debate on FY11 and FY12 spending will likely culminate sometime in the early Spring when Congress will be forced to turn its attention to a debate over an increase in the federal debt ceiling. Raised 12 times since 1995, the debt ceiling is, in very simple terms, the cap on how much money the federal government can borrow to pay its bills. Currently, the federal government is limited to borrowing $14.294 trillion, and the Secretary of the Treasury has said that this cap could be reached as soon as April 5, 2011.

Many congressional Republicans have indicated that they will oppose an increase in the debt ceiling unless they have an agreement from Democrats to drastically reduce federal spending. The Congressional Research Service has said that, in order to avoid raising the debt ceiling, the federal government would need to see, over the next 6 months, spending cuts or increased revenues of as much as $738 billion – far higher than anyone in Congress or the Administration is talking about with regard to the FY11 and FY12 bills.

The Government Accountability Office (GAO), in a report issued this week titled "Delays Create Debt Management Challenges and Increases Uncertainty in the Treasury Market," has said that opposition to an increase in the debt ceiling is nothing more than political theater: "While debates surrounding the debt limit may raise awareness about the federal government's current debt trajectory and may also provide Congress with an opportunity to debate the fiscal policy decisions driving that trajectory, the ability to have an immediate effect on debt levels is limited. This is because the debt reflects previously enacted tax and spending policies." However, the report also calls for swift action on increasing the ceiling, saying that the longer Congress waits the more difficult it becomes for Treasury to do its job.

Potential Government Shutdown

The impasse over spending for the remainder of FY11 could ultimately lead to a government shutdown as happened during the Administration of President Clinton in 1995 and 1996. This situation is further complicated by potential inaction on increasing the debt ceiling. In the debate on the nation's debt, opposition to an increase is led by "Tea Party" Republicans, while most other members of the GOP are in agreement with their Democratic colleagues on the necessity of taking action. How all of this comes together in the end is hard to read, but it is likely that Republicans will use support for increasing the debt ceiling as a bargaining chip for reductions in federal spending.