



Highlights

The US Congress has just enacted a further extension, through the remainder of calendar year 2012, of several key measures that otherwise would have expired on February 29. The fact that these extensions are being finalized a full 12 days before the deadline suggests that the gridlock which has beset the federal government in the recent past has been broken, but in fact that is unlikely to be the case.

No end yet to fiscal gridlock

In December, Congress enacted a two month extension, through February, of the 2% point payroll tax holiday, emergency unemployment insurance benefits, and a correction to current law that prevents a 27% cut in payments to doctors who treat patients on Medicare. That extension had not come easily. The Senate proposed the two-month stop gap extension because of difficulties in finding ways to offset the costs. It was expected that the two month extension would allow time for finding such offsets that both sides could accept. The two-month extension was almost derailed in the House, by Republican demands for a full year extension or no extension at all. However, a severe political backlash forced them to back down.

Both sides got something out of the negotiations on the current just passed extension through the end of the fiscal year. The payroll tax holiday was allowed to go forward without being paid for, a win for the Democrats (their argument is that since this tax reduction was an emergency measure, it was not necessary to offset its costs). But the costs of the support for Medicare payments to doctors and the emergency unemployment benefits were offset by using income from spectrum sales, by transferring some funding from a prevention program established under President Obama's health care reform, and by requiring new federal employees to contribute more for their retirement benefits. In addition, the maximum period for benefits will be gradually reduced from 99 weeks to 73. Both the offsets and the curtailment of the maximum UI benefits are clear wins for the Republicans.

So we have actual, productive compromise. And it was achieved with a full 12 days to spare before the deadline. After the gridlock of last year, this is a truly remarkable accomplishment. Indeed, some have suggested that the more recalcitrant members of both parties but particularly the Tea Party members in the House, have learned that they must pick their battles more carefully and be willing to give ground on some points in order to accomplish more critical goals.



But it would almost certainly be overly optimistic to expect such cooperation to continue. The areas of disagreement are broad, the positions are polar opposites and very firmly entrenched, and there are several opportunities over the remainder of the year to battle over policy. We expect little agreement between the two sides between now and the end of the current congressional and presidential terms.

A case in point is the budget President Obama just submitted to Congress for fiscal year 2013, which also includes plans and projections for government financing over the next decade. It was met with immediate rejection from Republicans, who not unreasonably labelled it a political document (everything is political this year). Among other revenue-gaining measures, it called again for allowing the Bush-era tax rates to expire for high-income households while maintaining them for others and imposing a 'Buffett' rule for incomes above \$1,000,000 to replace the current alternative minimum tax. These are designed to appeal to the 99% and are guaranteed to be rejected out of hand by Republicans, who object to their impact on 'job creators'. The president's budget also calls for some reductions in spending, but it largely leaves the big entitlement programs – Social Security, Medicare, and Medicaid – untouched. Mr Obama also worsens the near-term deficit projections by requesting the expansion of the payroll tax holiday to a 3% reduction for both employers and employees – the current version reduces only the employee rate by 2%.

Congress will produce its own budget document next month, the budget resolution, which will also set out deficit reduction plans. As the Republicans control the House, which writes this resolution, it will be decidedly different from the President's budget, focused on maintaining or even reducing tax rates and making far more dramatic cuts to the entitlement programs. It will also be a political document, designed to appeal to the Republican base, including the Tea Party. That document will be rejected out of hand by Democrats, who will decry its impact on vulnerable citizens. The congressional budget resolution is supposed to guide the construction of the 13 appropriations bills, scheduled to be completed by the end of the current fiscal year (September 30) for funding the government in fiscal 2013. The probability of all of those appropriations bills being completed on schedule is virtually zero, so a continuing resolution will be required to keep government functioning in the autumn. That continuing resolution will have to be crafted with the presidential and congressional elections fully underway. It is unlikely to lead to a government shutdown, but such an outcome remains a possibility. More likely, it will continue spending on current programs, perhaps at a reduced funding level.

It is also beginning to look like the debt limit, which was supposed to be safe into early 2013, will need to be raised before then, creating another potential battlefield. And of course, the payroll tax holiday, extended unemployment benefits, and the Medicare payment fix will all expire at the end of the year along with other important measures, including the Bush-era tax rates. Those are likely to be addressed during the lame duck session, the period between the elections and the start of the new terms. How these issues are resolved will depend to a great extent to how the election turns out.