



Analysis of the FY 2011 Budget Deal:

The Current Battle

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The fiscal year 2011 budget deal reached recently among President Obama, the Republican-led House and the Democratic-led Senate is the latest round in a philosophical battle about the size, shape and role of the federal government that existed between Republicans and Democrats for most of the 20th century. The current battle represents a political disagreement over government spending, taxes and regulation that commenced most recently during the presidencies of Ronald Reagan, Bill Clinton and George W. Bush. It is also an indication of how the two sides will approach a much larger and more profound battle over the annual federal budget deficit, the national debt and long-term fiscal plan of the United States. In the 21st century, U.S. government spending, either directly or indirectly, affects the bottom line of businesses; nonprofit organizations; and state, local and foreign governments to a much greater extent than even a generation ago.

The FY 2011 deal essentially guarantees that federal agencies will spend less this year and in future years, but it did not reverse larger trends. The United States remains in dangerous waters. In essence what Congress and the president did was similar to refinancing a home – they committed to spending less in the future. And by not addressing large entitlement programs such as Medicare, Medicaid and Social Security or significantly reducing defense and homeland security budgets, Congress and the president postponed negotiations on the largest sources of U.S. federal spending and debt.

What Happened

With the Obama Administration and Senate Democrats on one side – and House Republicans on the other – both parties established their positions on spending, regulation and taxes, setting parameters for the long-term debate later this year on the U.S. budget over the next decade. Both sides played to relative strengths and weaknesses and used the FY 2011 budget as a test case for agendas and arguments. And to some degree, both sides won and both sides lost.

For President Obama, he was able to blunt the immediate impact of budget cuts on health care reform, education, energy, transportation and a number of other areas and position himself more as a centrist. However, he may have surrendered the larger political agenda to the GOP by agreeing to cut or limit spending for traditionally Democratic priorities without getting equal sacrifices in return from Republicans on issues like the defense budget and tax rates.

The Republican House successfully achieved the goal of reducing government spending and cutting government programs to save \$38 billion in the fiscal year, largely by limiting the growth of government spending across multiple agencies. The House GOP framed the budget debate and dictated an outcome that was not possible before the November 2010 elections. Yet despite this success, most of the spending cuts occur in future years, and many Tea Party Republicans opposed the final deal. This dynamic has pulled Republican leaders to the political right on spending, while making President Obama appear to be a budget-cutter and a moderating force between the liberal wing of his party and the GOP.

What It Means

For the immediate future, the FY 2011 budget means that organizations, whether businesses, nonprofits or governments within the orbit of the federal government, could see less funding, depending on the federal agency and sector affected. Many of the spending reductions were to multi-million- and multi-billion-dollar federal agency programs where the monies go either directly or indirectly to outside groups or to support outside groups. The ripple effect of government spending on these programs will mean less public and private spending and a reduced federal footprint in the U.S economy.

For instance, the National Science Foundation will lose \$53 million, eliminating 134 grants and \$942 million from Community Development Fund block grants to rehabilitate and invest in low-income housing. In addition, \$504 million would be cut in the Women, Infants and Children's program to provide food to low-income families, and funding for high-speed rail would be cut by \$400 million for FY 2010 with no funding provided in FY 2011. Agricultural credit programs will be reduced by \$433 million, President Obama's loan program for community groups who support health care cooperatives is cut by \$2.2 billion, U.S. Department of Veterans Affairs would spend \$400 million less on information technology and construction projects, and the EPA would lose \$1.6 billion in funding, although it would continue its greenhouse gas regulations.

What's Next

The budget debate on the FY 2011 budget is a preview of the larger budget debate this summer over how much to reduce federal spending and how much of funding to cut. With the battle lines drawn by the FY 2011 deal, the next budget debate in May and June will center around the threat of another government shutdown and potential U.S. debt default unless government cuts spending. President Obama and Republicans recently released long-term budgets which will be the basis of their arguments and positions in the next budget debate, where the financial and political stakes are much higher.

In the grand scheme of things, there's very little numerical difference between President Obama's long-term budget proposal of \$4 trillion in cuts over 12 years and House Budget Chairman Paul Ryan's proposal of \$4.4 trillion over 10. However, they go about achieving those numbers in significantly different ways.

On the one hand, President Obama's plan cuts spending across the board for government programs, including military spending, farm subsidies and federal pension insurance. In addition, he proposes to eliminate loopholes in the tax code while letting the Bush tax cuts expire for top earners.

On the other, Ryan's plan is based more on the potential return of supply-side economics, with a firm belief that cutting the top tax rate for corporations and individuals will generate more employment, tax revenue and investment. Mr. Ryan's proposal also focuses spending cuts, but primarily dives into what economists believe is one of the most pertinent causes of the federal deficit: health care spending. By turning Medicare into a voucher program for individuals currently under age 55 and Medicaid into a state block grant program, Rep. Ryan estimates that

the United States could save \$771 billion over the next decade (in comparison to President Obama's cuts from these programs, which would only save \$100 billion).

The big question for businesses, nonprofits and governments, however, is not necessarily *what* the eventual agreement will be, but *when* lawmakers will come to it and what the short- and long-term effects may be. On Monday, Standard and Poor's rating of the federal debt position fell from "stable" to "negative" because of concerns that political agendas will get in the way of a plan to reduce long-term deficits. As a result, major markets across the globe opened down more than one percent.

But it could get even worse. The government has shut down five times during the past 25 years due to these types of disagreements, and the impact of these instances has lessened over time as more safety measures have been introduced. What *hasn't* ever happened before is the United States defaulting on its loans by failing to raise the debt limit, which would have very serious consequences for businesses, nonprofits and governments here and abroad.

If the debt ceiling isn't raised, the federal government would have to choose what they would or would not pay for. For example, it would have to choose between paying bondholders (including those in China and Japan) or issuing Social Security checks. As a result, interest rates would soar for everyone. Markets could fall dramatically, just as they did in September 2008 when the House voted down the Troubled Asset Relief Program (after which the Dow dropped 778 points, and the United States lost \$1.2 trillion in market value).

While there are budget mechanisms that can buy the federal government some time through as far down the road as July 8, businesses, nonprofits and governments should still be wary of the immense economic fallout with a U.S. debt default and government shutdown – events that could still take place if the president and Congress don't start collaborating and putting the country back on a sensible path toward fiscal responsibility.

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