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City Manager's Office

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Betsy Shotwell

SUBJECT: SEE BELOW

DATE: December 17, 2012

Approved

Date

12/17/12

SUBJECT: PATTON BOGGS UPDATE ON U.S. FISCAL CLIFF CRISIS

INFORMATION

Attached is a special update from City's Federal lobbyist firm of Patton Boggs on the fiscal cliff negotiations. Patton Boggs financial services and tax policy team is providing these updates on the negotiations for their clients.

BETSY SHOTWELL

Director, Intergovernmental Relations

Attachment: Patton Boggs LLP: Fixing the Debt: Update on U.S. Fiscal Cliff Crisis 12/17/12

FIXING THE DEBT: UPDATE ON U.S. FISCAL CLIFF CRISIS

December 17, 2012

SUMMARY

Outlook for a deal improving; no resolution yet on major items, but differences are narrowing.

- Fiscal cliff negotiations are accelerating between President Obama and Speaker Boehner, and a small handful of their most senior staff. This is a positive indication that a deal this week remains possible, though real challenges still remain.
- In sum, differences are narrowing, especially on tax revenue, and to a lesser degree, on entitlement spending savings. If that trend continues it will be a very positive sign that a deal is near; however, until that happens there remains a very real possibility that no deal will materialize. As a result, both sides are planning for either outcome, though should talks fail it remains unclear what the legislative path forward might be.
- Discussions now appear to have greater intensity, which is what one would expect with Christmas approaching. However, this enthusiasm should be tempered somewhat by the fact that there are big “ifs” that still must be resolved, not the least of which are the size and structure of proposed spending cuts and tax increases and, relatedly, the amount of new debt ceiling authority. Of these three critical factors, significant progress has been made with respect to tax revenue by virtue of Speaker Boehner both proposing a marginal rate increase for income above \$1 million, and increasing his total offer of new revenue from \$800 billion to \$1 trillion over 10 years.
- There has also been some positive movement on narrowing differences on both spending cuts and the debt ceiling, although the movement on revenue has been more robust.
- Since significant differences remain between the President and Speaker on all fronts, both sides are actively planning for two distinct outcomes: deal or no deal.

FORMAL PROPOSALS

- After a Thursday evening meeting with the President that both sides said was unproductive, during a phone call on Friday the Speaker proposed a new plan that begins to significantly bridge the differences of the initial offers in three key respects. First, the Speaker increased his tax revenue offer from \$800 billion to \$1 trillion, with a big chunk to occur up front by allowing marginal tax rates to increase for income above \$1M beginning in 2013, and the remainder to follow in expedited tax reform next year.
- The Speaker also reduced his spending savings number from \$1.2 trillion to \$1 trillion, and for the first time included increased debt ceiling authority for one year in his offer.

- Assuming a deal is reached, it would very likely be along the lines of what we have suggested for several weeks now:
 - \$1 to \$1.2 trillion in new tax revenue (some up front, with expedited tax reform to follow next year);
 - \$800 billion in spending cuts (some up front, with expedited entitlement reform next year);
 - It remains to be seen what legislative backstop might be included to compel both to occur next year;
 - Debt ceiling increase of some duration; and
 - Extras: tax “extenders” (likely to be negotiated very quickly by the Committees of jurisdiction), likely delay of the spending sequester, enhanced unemployment insurance (UI) extension, Medicare “doc fix,” Medicare extenders, and possibly payroll tax holiday.

POSSIBLE TRAPS

- There is not yet agreement on the tax and debt ceiling components of the negotiation, and both of those issues are significant enough that we cannot assume either will be wrapped up easily. For example, a major difference exists between President Obama’s preferred policy of immediate tax rate increases on income above \$250,000 versus Speaker Boehner’s \$1 million approach. Yet, the outlook here is improving.
- We have not yet seen a real narrowing of the differences on spending (mainly entitlement) cuts between the parties. Speaker Boehner has reduced his demand from \$1.2 trillion in spending cuts to \$1 trillion, but President Obama has not yet increased his initial offer of \$600 billion in spending (including \$400 on entitlements).
- In addition, a significant difference in the type of spending cuts proposed remains, with Speaker Boehner asking for structural reforms to Medicare (means testing, age adjustments), and using a “chained” CPI for purposes of calculating the social security COLA. All three are controversial with Democrats, especially the age adjustment and social security COLA.
- However, there is a growing perception that President Obama is willing to increase both the spending reduction number from his last offer in order to get a deal, though to what level remains an unknown; anything short of 1:1 (spending cuts to tax increases) will be difficult for many House Republicans to agree to, in the same way that increasing the entitlement spending number remains difficult for House Democrats. It also remains to be seen whether President Obama will agree that entitlement cuts focus on structural reforms as opposed to his preferred method of trimming such spending from providers of Medicare services.

TIMING

- As mentioned previously, discussions have accelerated but it is impossible to know when or if they will reach a framework deal. Should that happen in the next day or so, it remains possible such a framework could be drafted into legislation and considered in the House and Senate prior to Christmas.
- While they will need some time to score and draft a deal, that process should occur relatively quickly given that most of the concepts being discussed have been well vetted (scored and drafted) in the recent past, including by the Super Committee.
- Of course, both sides will have to spend at least some time rounding up support for a deal; that process could be quick, especially with Christmas coming next Tuesday, or it could take a few days depending upon bill details and how Members react to them.
- Speaker Boehner will have the opportunity, should he want it, to discuss where things stand with his Members tomorrow morning at the regularly-scheduled Republican Conference meeting.

FOR MORE INFORMATION

For up to-the-minute fiscal cliff updates, please contact a member of the Patton Boggs Tax Policy team:

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