

An Excerpt From:  
K&L Gates Global Government Solutions® 2011: Mid-Year Outlook



## The U.S. Budget Debate: Gridlock and Catastrophe, or Compromise and Solution?



When the earth shook last November on Election Day, almost 90 freshman Republicans were elected to the U.S. House of Representatives, and a new majority was born. While the Democrats maintained control of the U.S. Senate, they have only a slim majority and thus are virtually unable to pass bills without Republican help.

What could cause such a massive shift in political power in Washington? Debt! All across the country people were dealing with their own fiscal problems by cutting back and saving money. They did not see the government taking those seemingly common-sense steps. While some leaders in Washington argued that the stimulus package was too small, almost \$800 billion was spent to stimulate the economy, and it only seemed to get worse.

With a divided government—a Democrat in the White House and the Congress split between Republicans and Democrats—many pundits foresaw gridlock at its worst and no solution to the country's growing financial problems. There is another way to look at this situation, however: with divided government both parties can claim some credit for good things that happen. It is

important to remember that the only time we have had a balanced budget in the last 40 years was in the late 1990s, when President Clinton, a Democrat, and a Republican Congress made it happen. Divided government is back, and it may be a good thing for the United States.

Consider that in the lame duck session completed last December just before the Republicans took control of the House, the Bush tax cuts were about to expire. The President wanted to extend unemployment insurance and the Bush-era middle class tax cuts. The Republicans wanted to extend all of the tax cuts, including those on upper income taxpayers that the President opposed. Both parties identified what they needed to make a deal, and both gave something to get it. Both won!

The next big hurdle was funding the government for the remainder of the 2011 fiscal year. The Congress had been unable to clear the appropriation bills before the end of the last Congress. Now with a new reality in the House and a total focus on cutting back on the size of government, Republicans wanted to dramatically reduce spending. They were prepared to allow the government to limp along week to week without any long-term (*i.e.*, six-month) agreement. The President made the argument that you cannot govern on a week-to-week basis and thus we needed resolution and clarity. Republicans argued that the country was broke and that if the President wanted his budget they would have to negotiate a price. Thus, billions of additional dollars in spending were cut, and an agreement was reached. Both claimed victory, just as they had in December.

The next major battle is the debt ceiling. Normally this is a non-controversial issue because the legislature is required to pass a measure that allows the government to borrow more money



to pay its obligations. Currently the federal government can only raise about 60 percent of the money it needs to spend through general taxes. Treasury Secretary Geithner announced in April that the United States had reached its legal borrowing limit. He also stated that by borrowing from federal employees' pension funds he could forestall forfeiture until perhaps the beginning of August. Perhaps coincidentally, Congress would begin its summer recess at that time; it may not be a coincidence because Congress, like much of humanity, will put off tough decisions until the last moment, and the desire to get out of the brutal heat of Washington for the joys of home and family may provide the needed deadline for action.

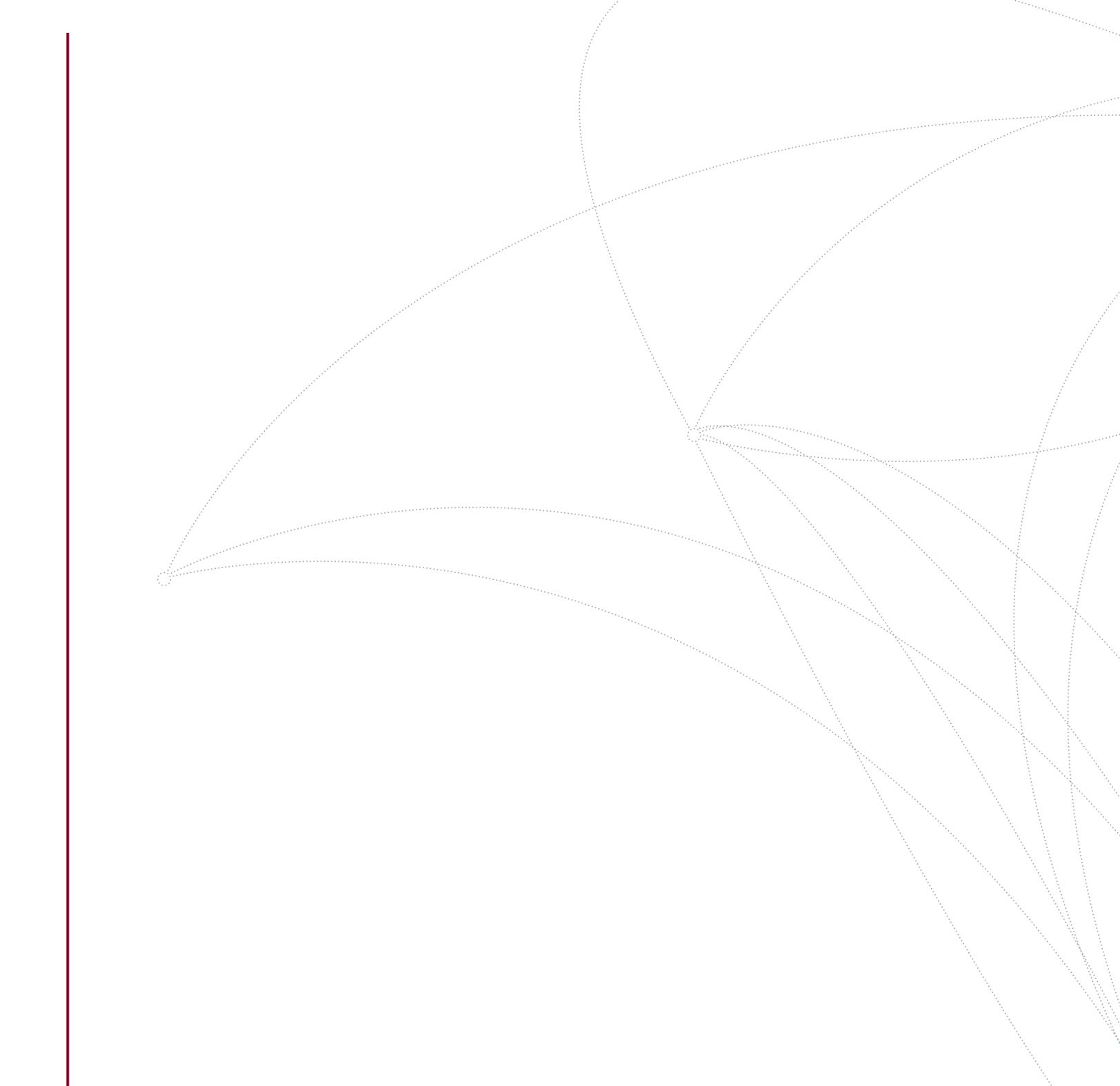
In all likelihood this issue will be resolved on or about midnight on August 5th or 6th. While there is always the possibility that the Congress will be more proactive, history is a great teacher. At the time of this writing there is some talk but little action.

The most likely outcome is that the debt ceiling will be raised, but possibly only enough to get through the year, which will create yet another doomsday scenario at the end of the fiscal year, unless a strategic budget deal can be reached encompassing mandatory spending (particularly entitlement programs such as Medicare, Medicaid, and Social Security) as well as discretionary spending.

Appropriations bills will have to be passed to fund the next fiscal year, and there will be heated debate about Medicare, Medicaid, and Social Security, which account for two-thirds of the spending in the U.S. budget. The Democrats will want to raise revenues (taxes), the Republicans will not. The Democrats will argue to maintain the status quo on the entitlement programs,

and Republicans will be portrayed as evil Scrooges hurting kids and old folks. The result? Deadlock; gridlock, possibly. But the history of divided government suggests a solution may be found. This political chemistry coupled with an electorate focused on the fiscal health of the nation and the possibility of a diminished future for their children give hope that compromise will come. And both sides and the country can win.

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