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THE SUPER COMMITTEE'S EPIC FAIL

What might this mean for economies & markets?

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Congress punts on third down. Unable to reach consensus, the Congressional super committee of 12 offered America a disappointing result Monday. Panel co-chairs Rep. Jeb Hensarling (R-TX) and Sen. Patty Murray (D-WA) announced that "it will not be possible to make any bipartisan agreement available to the public before the committee's deadline" on November 23, throwing in the towel with two days to go.[1]

The big divide was over the Bush-era tax cuts. While Sen. John Kerry (D-MA) reminded the public and his fellow legislators that "we are not a tax-cutting committee, we're a deficit-reduction committee," there was stiff opposition to rolling back the EGTRRA and JGTRRA cuts of the 2000s. The super committee paired some strange bedfellows among Capitol Hill legislators, so this head-butting was not unexpected.[2]

What happens now? As the super committee failed to create a plan to trim $1.2 trillion or more from the federal deficit, that sets things up for an automatic $1.2 trillion in cuts effective over a 10-year stretch beginning January 2, 2013. According to the Budget Control Act passed in summer 2011, that $1.2 trillion will be slashed almost 50/50 from the defense budget and government services programs. Social Security and Medicaid payments, military pay and veteran's benefits will be exempt from cuts; current Medicare recipients will not be directly affected. This default deficit reduction could mean as much as a 9.3% cut to some federal programs, by the estimate of the left-leaning Center for Budget and Policy Priorities.[3,4]

This is what the super committee's apparent failure means politically. Economically, it could result in pain for American investors given the probable impact on our credit rating, stock market, tax laws and economic growth.

Is another downgrade ahead? Standard and Poor's cut the U.S. credit rating a notch to 'AA+' on July 14, and it warned that another cut to 'AA' was possible by mid-2013 without decisive federal action on the issue. After the super committee conceded defeat on November 21, S&P, Fitch's and Moody's stood pat regarding a possible downgrade.[5,6]

What might be in store for the market? In a November 21 note to investors, Goldman Sachs equity strategist David Kostin warned that the S&P 500 could potentially correct to 1100 as a result of this gaffe. Other analysts are less gloomy; some feel that the market may have priced this one in and will at least maintain some momentum barring a second downgrade (Monday's selloff certainly could have been worse).[7]

What does this mean tax-wise? The Bush-era tax cuts are set to expire at the end of 2012 as part of the involuntary deficit reduction now set to occur. There could be other possible tax consequences as a result of the super committee's failure. Unless Congress unexpectedly passes the President's American Jobs Act, the payroll tax holiday will go away in 2012 (worth about $935 to the average worker, which some legislators wanted to make permanent). RBC Capital Markets analysts warn that taking the payroll tax back to 6.2% could shave 1% of U.S. GDP next year. For businesses, the current "bonus" depreciation write-offs for new capital equipment and the R&E tax credit could also become casualties. Additionally, when you do a broad cut to federal programs, you are impacting payments from Washington to state programs; state taxes could rise to compensate for that lost money.[4,8]

How about Medicare, the SSA & jobless benefits? While Medicare recipients won't be bitten by the default deficit reduction, payments to Medicare providers could be shrunk by 2%. Long-term unemployment insurance would also dry up for 2.1 million Americans by February, according to the Department of Labor's forecast; JPMorgan Chase economists think that development alone might hurt U.S. GDP by 0.75%.[4,8]

The Social Security Administration is in line for budget cuts as a result of the super committee's indecision, along with Head Start and federal job training programs. A Congressional Budget Office analysis shows that the Pentagon would face the largest cut in 2013 (10%). Federal agriculture, environmental and education programs would face cuts of approximately 8% starting in that year.[4,9]

Could congress "undo" this? President Obama is emphatic that there will be no rewind on this one. While there could be a move in Congress to try and nullify or alter the automatic budget cuts, the President has said he will not support such a bill.

There had to be deficit reduction at some point, and the legislators of the super committee faced a Herculean task to come up with a plan that satisfied their many constituencies. However, it will be difficult to convince economists and investors that doing nothing is better than doing something; this unpalatable easy out may leave many in the lurch.

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