

Financial Post

What the Republicans and Democrats want in the debt negotiations



REUTERS/Kevin Lamarque

Speaker of the House John Boehner with fellow Republicans.

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U.S. lawmakers will be locked in intense negotiations this weekend to hammer out a plan to cut the deficit and raise the U.S. Treasury's borrowing authority.

Last May, the U.S. government hit its legal borrowing limit of US\$14.3-trillion, prompting President Barack Obama to seek an increase to the debt ceiling of US\$2.4-trillion. Republicans have so far withheld approval until the administration agrees to an equal amount of spending cuts.

On Thursday, hopes increased that a deal could be struck, with reports saying leaders were even aiming for a blockbuster deal to double budget savings to US\$4-trillion over 10 years.

Below is what each party is angling for in the debate:

Republicans

From the beginning, Republican negotiators have insisted on reductions to government spending if they are to grant the federal government more borrowing authority. They bemoan indefinite trillion-dollar deficits and say the government cannot rely on borrowing alone to fill the sizeable budget hole.

“The President has asked us to increase the debt limit, in other words, to increase the limit on the credit card, without doing anything about the source of the problem. And we’ve got to deal with the source of the problem,” Speaker of the House John Boehner said in a recent interview. “I can tell you, my members won’t vote to increase the debt limit unless we’re taking serious steps in the right direction.”

By a few weeks ago, the commission led by Vice President Joe Biden had already identified up to US\$2-trillion in potential cuts. So it puzzled many that House Majority Leader Eric Cantor, one of the two Republican committee members, then chose to walk away from the negotiations.

“These conversations could continue if they take the tax hikes out of the conversation,” Mr. Cantor said, referring to US\$400-billion in additional tax revenue the Democrats are seeking.

Republican inflexibility on a relatively small piece of the puzzle may reflect political posturing as much as ideology.

The party has staked its credibility in the debt debate on imposing fiscal restraint, and tax increases hardly appeal to the Republican constituency or its caucus.

“They want to assuage the Tea Party base and they realize they got back in power in the House on a promise to cut spending,” said Tad DeHaven, a budget analyst at the Cato Institute. “So, it’s a dangerous game if you ultimately don’t deliver.”

But the same agreement must also be palatable to the president and Democratic Senate Majority Leader Harry Reid.

And most agree that the Republicans have no intention of triggering default and being tagged for a reprise of the economic collapse — with perhaps the exception of a vocal few.

A small party contingent, including House Budget Committee Leader Paul Ryan, has argued as to the merits of a “technical default” of a short period of time.

Such a tack would still see money coming into the Treasury after Aug. 2, enabling payment on debt securities while withholding cheques for social programs, a group of 17 Republican senators recently wrote in a letter.

“Even if the debt ceiling remains where it is, there will be more than enough money in the Treasury to make the government’s debt payments,” they said.

Democrats

The greatest complaint coming from Democrat circles is that their counterparts are playing a game of chicken while the country’s good financial standing hangs in the balance, and that the Republicans should not be using the debt ceiling negotiations as leverage to force through spending reform.

The stakes are too high, they say. “If investors around the world thought that the full faith and credit of the United States was not being backed up, if they thought that we might renege on our IOUs, it could unravel the entire financial system,” President Obama said recently.

The brinksmanship is fraying many nerves among global investors, said Bob McTeer, distinguished fellow at the National Center for Policy Analysis.

“I just don’t think it’s safe to play this game they’re playing,” he said, speculating on how the Republican gambit might unfold if default befalls the U.S. economy. “I’m afraid it might look a little bit like Lehman Brothers. The status of the dollar as a reserve currency in the world, and a transaction currency and a store of value would suffer. And the status of U.S. treasury securities as the safe haven place to park your money in times of stress would suffer.”

With Democrats capitulating on spending cuts, a deal seems to be within reach, Mr. McTeer said. But for the governing party to back off its proposed US\$400-billion in tax savings would essentially hand the Republicans “total victory,” he explained.

“My impression is the Democrats would feel humiliated by a deal like that and need some face-saving tax increases.”

The proposals include limiting deductions for wealthy Americans and killing tax breaks for the oil industry.

To some of the Republican party's newer members, and those looking to maintain support in the upcoming election, it just might be worth opposing those tax revisions in the hopes that Democrats blink before Aug. 2.

"This is heavy politics," Mr. Biden said last week. "And part of this is just vindictiveness."