

RELEASE IN FULL

From: Sullivan, Jacob J <SullivanJJ@state.gov>
Sent: Wednesday, November 14, 2012 3:29 PM
To: H
Subject: Fw: Fiscal Cliff

----- Original Message -----

From: Hormats, Robert D
Sent: Wednesday, November 14, 2012 12:39 PM
To: Sullivan, Jacob J
Subject: RE: Fiscal Cliff

SENSITIVE BUT UNCLASSIFIED

Hi Jake,

Here is the first of our updates on this subject.

NOTE FOR THE SECRETARY

FROM:E – Bob Hormats

SUBJECT: Update on the “Fiscal Cliff,” including the recent White House Press Release

(SBU) On Friday, we provided you with an initial overview of the issues related to the “fiscal cliff,” including a sequestration update and primer prepared by F and RM, an analysis of the impact of the various fiscal cliff scenarios on the U.S. and global economies prepared by Heidi, and a think piece drafted by Jen addressing the potential impact on U.S. leadership around the world and on our ability to advance our foreign policy goals should the sequester scenario play out.

(SBU) As we noted, the “fiscal cliff” is a collection of dozens of tax hikes, budget cuts, and other policy changes set to occur simultaneously in January 2013. The most significant components are the sequester mandated by the Budget Control Act, the expiration of the payroll tax cut, the expiration of the Bush tax cuts and alternate minimum tax (AMT) patch, and the expiration of extended unemployment benefits. Their combined drag on the economy is estimated at five percent of U.S. GDP which, if fully implemented, could according to virtually all economists push the U.S. economy into recession.

(U) A White House press release yesterday noted that the President is reaching out to Republicans and urging the Congress to compromise and build consensus. To further that process, the President said that he will invite leaders of both parties to the White House next week. He also will bring in business, labor and civic leaders to obtain their ideas.(Several such meetings have already taken place)

(U) The press release warned that if Congress fails to come to an agreement on an overall deficit reduction package by the end of the year, everybody’s taxes will automatically go up. The press release stated that the Senate had already passed a bill that “protects 98 percent of Americans and 97 percent of small businesses from higher taxes at the end of the year” and that it is time that the House does the same.

(U) The bill referenced by the White House press release is the Middle Class Tax Cut Act, S.3412. It was introduced by Senator Harry Reid and passed the Senate on July 25, 2012, by a 51 to 48 vote with no Republicans voting for the bill. The Democrats' bill would not extend the Bush tax cuts for higher income individuals (above \$250,000 for married couples), would extend some small provisions from the 2009 stimulus, and would extend the AMT patch for one year. This bill also would extend depreciation provisions for small businesses.

(U) According to Congress' Joint Committee on Taxation, ending the Bush tax cuts on household income above \$250,000 would save the government nearly \$1 trillion over the next decade, compared to extending all of the cuts. In his address to the nation on Friday afternoon, the President said that he was ready to sign the Senate bill as soon as it passed the House. He urged immediate passage, arguing that it was only right that the top 2% of Americans pay their fair share.

(U) For FY2013, the contractionary amount of all these measures is around \$500 billion. This includes the expiration of the 2001, 2003, and 2009 tax cuts (extended in 2010) and the expiration of the alternative minimum tax (AMT) "patch," which indexes the AMT exemption for inflation. These together account for 44% of the figure. Other contractionary provisions include expiration of the temporary two percentage-point reduction in the employee's Social Security payroll tax (19%). Spending reductions include the automatic spending cuts under the Budget Control Act (13%); the expiration of extended unemployment insurance benefits (5%); and the "doc fix" that will lower Medicare payments (2%).

(U) Not all of these will impact the economy right away, but as they do, the negative impact on growth will build. And a prolonged Congressional impasse on this that suggests no compromise on budgetary/tax issues is highly likely to have a seriously adverse impact of stock markets well before that -- adding additional downward pressure to the economy.

(U) I will participate in a session next week with Pentagon officials to discuss how they see the impact of all this on their budget and US military strategy. Will report back to you.

(U) We will continue to monitor and update you on this rapidly unfolding situation.

-----Original Message-----

From: Sullivan, Jacob J
Sent: Saturday, November 10, 2012 4:02 PM
To: Hormats, Robert D
Subject: RE: Fiscal Cliff

Thanks Bob -- I'll make sure she has it, and let's stay in close touch.

-----Original Message-----

From: Hormats, Robert D
Sent: Saturday, November 10, 2012 4:00 PM
To: Sullivan, Jacob J
Subject: Fiscal Cliff

Hi Jake,

I sent S a note last night bringing her up to date, in so far as possible, on the Fiscal Cliff and some issues surrounding it. Please make sure the line puts it in her material as it gives her a lot of necessary background info.

I am sure it will come up everywhere.

We didn't have much time to put this together, but wanted to get her something to keep her current and explain the several dimensions of the subject.

We will regularly email you with updates on what is happening here and in the financial markets during your trip.

Please don't hesitate to send me any questions S or you may have.

Have a good trip.

Bob