

U.S. Office of Public Policy

# Washington Weekly

Under the Dome: The Week in Review

May 11, 2012



**This Week:** The **House** approved the first in a series of bills *appropriating funds for government agencies for fiscal year 2013*, also a bill that would reallocate federal spending cuts scheduled for 2013 (see below). The House also reauthorized the *Export-Import Bank* (see below). The **Senate** failed to advance legislation *preventing a scheduled increase in federally subsidized student loan interest rates*.

**Next Week:** The **House** will be voting on a reauthorization of the *Violence Against Women Act* and legislation *authorizing Defense Department programs*. The **Senate** will take up the House-passed *reauthorization of the Export-Import Bank* and reconsider legislation to *maintain current federal student loan interest rates*.

## High-priority Financial Services Issues

**Volcker Rule Defense.** Former Federal Reserve Chairman Paul Volcker once again adamantly defended his namesake's rule in a Senate Banking Subcommittee hearing *this week*. Answering questions about whether or not the Volcker Rule would drain liquidity, the former chairman asserted that markets may have experienced too much liquidity prior to the crisis. He also rejected the suggestion that market-making trades may be misinterpreted as proprietary-trading. Though the rule has its champions, there are still many others in Congress with a different opinion, such as Senator Bob

Corker (R-TN) who believes the regulators "are making it overly complicated." *Despite its critics, Congress will not have a sufficient majority to repeal Dodd-Frank or any of its major elements like the Volcker Rule this year, or even next year. Instead, expect regulators to moderate some of the initial rule proposals.*

**The Fed's Mandate.** The Federal Reserve was back under the Congressional microscope *this week* during a hearing where legislation altering the Fed's mandate was debated. While displeasure with the Fed's asset purchase programs is nothing new in Washington, it was interesting to note that some Members of Congress are now pointing to another byproduct of those programs. Beyond potentially devaluing the dollar, some blame the Fed's extraordinary actions for inaction by Congress. It was suggested that with interest rates so low, the cost of financing the U.S. debt is reduced and therefore may be letting lawmakers off the hook from tackling deficit issues in a serious way. New legislation limiting the Fed's mandate to maintaining price stability has been introduced and may see action in the House. The legislation would also require the Federal Reserve Open Market Committee (FOMC) to give permanent votes to presidents of each regional Federal Reserve Bank, limit the types of FOMC purchases, and reform the Exchange Stabilization Fund. *Limiting the Fed's power has significant support in the House but is not going to be approved by the Senate anytime soon, so QE3 watchers can remove that variable from their equations.*

## Other Issues

**Pass-throughs.** Many small and some large businesses pay taxes through their individual owners' income rates, not at the corporate tax rate. These pass-through entities have proliferated over the years and so have the calls by some policymakers to rein them in. The biggest current fight in Congress is how to pay for the \$6 billion cost of another year of reduced federal student loan interest rates – 3.4% rather than a scheduled 6.8%. Senate Democrats and the White House are calling on some smaller S corporations to pay a greater share of payroll taxes on their profits. Republicans would rather take the \$6 billion from a federal health care fund. We continue to believe the reduced student loan interest rates will get extended, but not in conjunction with a new

tax on pass-through businesses. However, while Republicans are currently dug in on not allowing any tax increases, they are equally focused on reforming the tax code and when that happens, compromise will be the rule, not the exception. *Pass-through entities could potentially face significant changes to their tax model following the November elections when the process of tax reform will begin to pick up steam in Washington.*

**Continued Push on Housing Legislation.** We reported *last week* on the administration's efforts to make it easier for homeowners to refinance mortgages through the Home Affordable Refinance Program (HARP). *This week*, Housing and Urban Development Secretary Shaun Donovan urged lawmakers on the Senate Banking Committee to approve legislation to expand HARP as quickly as possible while mortgage rates are still historically low. One of the bottlenecks is how to pay for the bill. The White House has recommended a new fee on large financial institutions to offset the cost, but it has indicated a willingness to consider other options. A proposal circulated *this week* by Senator Dianne Feinstein (D-CA) would raise fees for mortgages guaranteed by Fannie Mae and Freddie Mac (g-fees) by 10 basis points. As we *noted last week*, however, the administration may have to pursue a more piecemeal approach as lawmakers are unlikely to agree on any major legislation affecting Fannie Mae or Freddie Mac before the election.

**Defense Spending.** Last year's debt limit debate resulted in a process for automatic spending cuts beginning in *January of 2013*. Half of those cuts are scheduled for defense programs while the other half are spread across a number of other government programs. Republicans have not been shy about their disdain for the defense cuts nor their intention to replace those cuts with alternative savings. *This week*, House Republicans put those intentions up for a vote and approved legislation that would avoid the defense spending reductions in favor of deeper cuts in other government programs. The legislation will be their marker for negotiations at the *end of the year* with Senate Democrats and the White House who will try to leverage the automatic defense spending cuts for some tax increases on higher income earners. *November and December* will be busy months in Washington with a lot on the line for the defense industry and taxpayers alike.

**Keystone Pipeline.** As House-Senate negotiators try to hammer out a final highway bill, expect to hear a lot about the Keystone XL pipeline project that has become controversial and a part of the presidential election sparring over energy policy. House Republicans will insist on including a provision in the highway bill to push the project along, while most Senate Democrats will object. This dispute will hold up a final version of the highway bill, a major priority in the Congress, and be a big public issue of debate in the *upcoming weeks*. *We believe the Keystone pipeline will ultimately be approved, if not in the highway bill, then in the near future, and further public attention to the issue will accelerate its approval.*

**Bipartisanship.** The House passed a three-year reauthorization of the Export-Import Bank *this week* with strong bipartisan support. The bill is a favorite of big business, particularly major exporters. The takeaway in the bill passage is that bipartisanship can work in the House in the right situations and particularly with issues less related to taxes and government spending. Opposition from a handful of conservatives over the bill's potential exposure to taxpayers and "corporate welfare" concerns were trumped by strong business lobbying and overall bipartisan support for the agency's mission, which is to guarantee export purchases by certain foreign buyers of U.S. goods. *We expect the Senate will also enact the bill in a strong bipartisan fashion in the weeks ahead, and Capitol Hill will record a rare bipartisan accomplishment that will not get the same public attention as other policy areas plagued by gridlock.*

## A Final Word

**Primary Colors.** Senator Dick Lugar (R-IN) failed to win his party's primary *this week*, one of only eight incumbent Senators in the *past 12 years* to do so, and one of only two in the same time frame to finish with less than 43% of the vote. In the *past 100 years*, there has been only one other six-term Senator who lost the primary election, Senator Kenneth McKeller (D-TN) in 1952. The last election in 2010 proved to be challenging for GOP Senators as well, with Senators Lisa Murkowski (R-AK) and Bob Bennett (R-UT) losing their primary/convention (though Murkowski went on to win the general election through a write-in campaign), and Senator Arlen Specter (D-PA) changing parties to avoid a primary loss, which proved to be unavoidable in the general.

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