A Sustainable Budget Deficit: Overview of Major Expiring Policies in 2011 and 2012 and Their Budgetary Impact

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Introduction

The federal government runs a deficit when spending (mandatory, discretionary, and interest payments on the debt) is greater than revenues (taxes and fees). Between 2009 and 2011, deficits relative to the size of the economy (i.e., as a percentage of gross domestic product (GDP)) have been at their highest levels in the post-World War II era. In 2011, the federal deficit was 8.5% of GDP, while from 1946 to 2008, the budget deficit averaged 1.7% of GDP.

Many experts believe that deficits must be reduced to "sustainable" levels in order to avoid a budgetary crisis. Large budget deficits can result in a budgetary crisis for two principal reasons. First, as deficits persist, government incurs debt and as a nation's debt grows, so too would interest payments on that debt, limiting spending on other parts of the budget. Second, increasing deficits and debt could also trigger fear among creditors about a government's ability to repay its debts, resulting in an unwillingness by creditors to lend at affordable rates.[1]

A budget deficit can be "sustainable" if deficits are small enough so that the accumulation of annual deficits—the debt—does not grow faster than GDP. Experts differ on what is the exact size of a sustainable budget deficit, but they generally cite figures below 3% of GDP. The President's Deficit Reduction Commission produced a proposal that would reduce the deficit to 2.3% of GDP by 2015.[2] House Budget Committee Chairman Paul Ryan's 2012 budget proposal, as analyzed by the Congressional Budget Office (CBO), would lower the deficit to 2% of GDP by 2022.[3] Prior CRS analysis estimated that annual budget deficits would need to be no larger than 2.5% to 3.0% of GDP over the next 10 years in order to stabilize the debt as a share of GDP at its projected 2011 level (69% of GDP).[4]

The federal budget deficit is projected to be at a sustainable level (1.2% of GDP) by 2021 if (1) Congress maintains spending in line with levels set forth by the Budget Control Act[5] (BCA) and (2) does not extend several major policies scheduled to expire in 2011 and 2012. Congress may instead choose to extend some or all of these policies. If Congress does extend all of these expiring policies, and they are not offset, the deficit is projected to become unsustainable. Of the expiring policies, extension of the Bush tax cuts would comprise nearly three-quarters of the increase in the deficit.

This report compares the budgetary implication of allowing all the policies to expire versus extending all of them in order to show their impact on the medium-term deficit. In the past, when these policies have been extended, they have generally not been offset. This report assumes that future extensions would also not be offset. This report first examines six major policies that are scheduled to expire in 2011 and 2012 and the deficit implications of their extension. Then the

[1] For more information on the economic impact of budget deficits, see CRS Report R40770, *The Sustainability of the Federal Budget Deficit: Market Confidence and Economic Effects*, by Marc Labonte.

[2] The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth*, December 2010, p. 14.

[3] This analysis is from April 5, 2011. See Table 1 in http://www.cbo.gov/ftpdocs/121xx/doc12128/04-05-ryan_letter.pdf.

[4] For more information, see CRS Report R41778, *Reducing the Budget Deficit: Policy Issues*, by Marc Labonte.

[5] P.L. 112-25. For more information on the budgetary implications of the Budget Control Act, see CRS Report R42013, *The Budget Control Act of 2011: Effects on Spending Levels and the Budget Deficit*, by Marc Labonte and Mindy R. Levit.

report provides data on the annual and aggregate budget implications of extending these major policies.

Major Expiring Policies

Six major policies briefly described below are scheduled to expire in 2011 and 2012,[6] including

- the payroll tax cut,
- extended unemployment insurance (UI),
- the "doc-fix,"
- "tax extenders,"
- the AMT "patch," and
- the Bush tax cuts and several tax provisions enacted in the American Recovery and Reinvestment Act (ARRA).[7]

Among these major policies, two of them—the payroll tax reduction and the extended unemployment insurance (UI) programs—were enacted in response to the economic downturn. Potential future extensions of these two policies are expected to be short, and in this report they are assumed to be extended for one additional year. The remaining policies are longer-standing polices and are assumed to be extended until the end of 2021.[8]

The budgetary effects of extending these policies are all calculated over the same 10-year budgetary window (2012-2021), although policies like the payroll tax cut, extended UI, and the Bush tax cuts might not be in effect for every year in this period.

Payroll Tax Cut[9]

The payroll tax cut reduced Social Security taxes from 6.2% to 4.2% for employees and from 12.4% to 10.4% for the self-employed on the first $106,800 of wages in 2011.[10] The one-year reduction in the payroll tax for employees and the self-employed in 2011 was intended to provide an economic stimulus by increasing workers' take-home pay. Extension of the payroll tax cut for one additional year (2012) is estimated to cost $121 billion over 10 years, 2012-2021 (see **Table 1**).

[6] This report does not include the budgetary impact of every policy that is scheduled to expire in the next two years. For more information on other policies that are set to expire, see Table 27-6 in the Analytical Perspectives of the President's FY2012 Budget. In addition, for a list of expiring tax provisions, see Joint Committee on Taxation, *List Of Expiring Federal Tax Provisions 2010-2020*., JCX-2-11.

[7] P.L. 111-5.

[8] This could be as a result of a single 10-year extension or a series of extensions over that time period.

[9] For more information on the payroll tax reduction, see CRS Report R42103, *The Temporary Payroll Tax Reduction: A Brief Description and Economic Analysis*, by Donald J. Marples; and CRS Report R41648, *Social Security: Temporary Payroll Tax Reduction in 2011*, by Dawn Nuschler.

[10] This provision was enacted as part of the Tax Relief, Unemployment Reauthorization and Job Creation Act of 2010 (P.L. 111-312).

Extended Unemployment Insurance (UI)[11]

Extended unemployment insurance (UI) benefits provide 73 additional weeks of unemployment compensation to the long-term unemployed. Prior to the recession, the permanent Unemployment Compensation (UC) program provided up to 26 weeks of unemployment benefits in most states. During the recession, Congress temporarily increased the number of weeks of benefits to 99 (26 plus 73) through two separate programs, the Emergency Unemployment Compensation (EUC08)[12] program and the Extended Benefit (EB)[13] program.[14] Eligibility for these 73 additional weeks is scheduled to expire at the end of 2011. The estimated cost of extending the EUC08 and EB programs for one additional year (2012) is $44 billion over 10 years, 2012-2021 (see **Table 1**).

The "Doc-Fix"[15]

The "doc-fix" prevents statutory cuts in Medicare reimbursements to doctors. By law,[16] if Medicare payments for doctors' services exceed an aggregate spending target over a certain period, future payments determined using the Sustainable Growth Rate (SGR) are reduced to bring spending back in line with that target. Since 2002, the actual amount of Medicare expenditures for physicians' services has been greater than the amount allowed under the SGR, triggering the statutory reduction in doctors' payments. Congress has, with the exception of one year when a cut occurred, enacted laws to temporarily override the payment reduction prescribed under the SGR. These overrides are often referred to as the "doc-fix." The most recent "doc-fix" expires at the end of 2011. If Congress does not override the SGR, Medicare payments to physicians will fall by about 27% in January 2012. If Medicare reimbursement rates remain fixed at their 2011 levels through 2021 (i.e., are not cut), Medicare spending would increase by an estimated $351 billion over the next 10 years, 2012-2021 (see **Table 1**).

Tax Extenders[17]

Congress routinely extends some temporary tax provisions, collectively called "tax extenders" (excluding individual income tax provisions included in 2001, 2003, and 2009 legislation, which are discussed below). CBO has estimated that approximately 80 tax provisions will expire over the next 10 years.[18] Of those, more than 60 expire at the end of 2011.[19] These tax provisions affect

[11] For more information on unemployment insurance benefits, see CRS Report R41662, *Unemployment Insurance: Legislative Issues in the 112th Congress*, by Katelin P. Isaacs and Julie M. Whittaker. For additional details on all three of the UI programs (UC, EB, and EUC08), see CRS Report RL33362, *Unemployment Insurance: Programs and Benefits*, by Katelin P. Isaacs and Julie M. Whittaker.

[12] This program was created by P.L. 110-252 and subsequently extended.

[13] This program was created by P.L. 91-373.

[14] These programs were last extended by P.L. 111-312.

[15] The "doc-fix" was last extended by P.L. 111-309. For more information on the SGR, see CRS Report R40907, *Medicare Physician Payment Updates and the Sustainable Growth Rate (SGR) System*, by Jim Hahn and Janemarie Mulvey.

[16] P.L. 105-33.

[17] For more information on the tax provisions expiring at the end of 2011, see CRS Report R42105, *Tax Provisions Expiring in 2011 and "Tax Extenders"*.

[18] Congressional Budget Office, *The Budget and Economic Outlook: An Update*, August 2011, p. 27.

individuals, businesses, charitable giving, energy, community development, and disaster relief. They include provisions ranging from the state and local sales tax deduction, to tax credits for alternative fuels. Extending the roughly 80 provisions that are scheduled to expire in the next 10 years through 2021 is estimated to reduce revenues by $920 billion between 2012 and 2021 (see **Table 1**).

The AMT "Patch"[20]

The AMT "patch" prevents millions of Americans from paying the Alternative Minimum Tax (AMT). The individual AMT was designed to ensure that taxpayers who could claim tax preferences under the regular income tax would pay some tax by paying the AMT. When calculating the AMT, taxpayers are allowed to exempt a flat amount of income from taxation. The AMT exemption amount is not indexed for inflation, meaning that every year additional taxpayers are subject to the AMT.[21] The Bush tax cuts temporarily increased the exemption amount under the AMT. This temporary increase in the exemption amount, known as the AMT "patch," was extended several more times and is currently in effect through the end of 2011.[22] In 2012, roughly 26 million additional taxpayers will be subject to the AMT if it is not patched.[23]

The revenue losses associated with an AMT "patch" depend on the regular income tax. CBO estimates that, because of the interaction of the regular income tax under the Bush tax cuts and the AMT, the revenue losses associated with extending both these policies together would be greater than the sum of extending them individually.[24] Since both the Bush tax cuts and the AMT "patch" have been extended together before, this report assumes revenue losses of extending both policies together in the future (although data on the deficit implication of each policy individually are also provided in **Table 1**). The cost of extending the AMT "patch" for 10 years, assuming the Bush tax cuts expire, is estimated to be $809 billion over 10 years, 2012-2021.

The Bush Tax Cuts and the 2010 Tax Act[25]

The Bush tax cuts originally lowered individual income and estate tax liabilities between 2001 and 2010 by lowering marginal tax rates, reducing the so-called "marriage penalty," reducing tax

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(...continued)

[19] See CRS Report R42105, *Tax Provisions Expiring in 2011 and "Tax Extenders"*, by Molly F. Sherlock

[20] For more information on the AMT, see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Steven Maguire.

[21] In addition, under current law, certain personal tax credits are temporarily allowed against AMT tax liability. An AMT patch generally also includes a provision which extends the applicability of these credits against the AMT.

[22] The last AMT "patch" was included in P.L. 111-312.

[23] For more information, see http://www.taxpolicycenter.org/taxtopics/AMT.cfmhttp://www.taxpolicycenter.org/taxtopics/AMT.cfm.

[24] If the Bush tax cuts are extended without an AMT patch, then few if any taxpayers would receive a tax reduction as the applicability of AMT would offset most of the tax reduction.

[25] For more information on the Bush tax cuts, see CRS Report R42020, *The 2001 and 2003 Bush Tax Cuts and Deficit Reduction*, by Thomas L. Hungerford. For information on the individual income tax provisions of the 2009 stimulus which were extended by the 2010 Tax Act, see CRS Report RS21352, *The Earned Income Tax Credit (EITC): Changes for 2011 and 2012*, by Christine Scott; CRS Report R41873, *The Child Tax Credit: Current Law and Legislative History* , by Margot L. Crandall-Hollick; and CRS Report R41967, *Higher Education Tax Benefits: Brief Overview and Budgetary Effects*, by Margot L. Crandall-Hollick and Mark P. Keightley.

rates on investment income, expanding certain tax credits, and reducing the estate tax. At the end of 2010, these provisions were extended for two years.[26] In addition, certain individual income tax provisions of ARRA were also extended through the end of 2012—modifications to the child tax credit, the earned income tax credit, and an expansion of a higher-education tax credit.

Extending both the Bush tax cuts and certain ARRA tax provisions through 2021 is estimated to reduce revenues by $2.9 trillion over the next 10 years, excluding the AMT "patch." When the impact of the AMT "patch" is included, revenues are estimated to fall by $4.6 trillion over the same time period.

Budgetary Impact of Policies that Are Extended

Allowing Policies to Expire as Scheduled Under Current Law

CBO estimates that under current law, which assumes major policies expire, the deficit will fall below 2% of GDP by 2014 and average 1.9% of GDP over 10 years (2012-2021), as illustrated in **Figure 1** and **Table 1**. The decline can be attributed to the expiration of temporary provisions and a strengthening economy. In addition, the Budget Control Act of 2011 (P.L. 112-25) is estimated to decrease spending by $2.1 trillion over the next 10 years. All of these factors are included in CBO's current law baseline.[27]

[26] The Bush tax cuts were extended by P.L. 111-312.

[27] For more information, see the Congressional Budget Office, *The Budget and Economic Outlook: An Update*, August 2011.

Table 1.Increases in the Deficit Resulting from the Extension of Certain Policies 2012-2021

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2021
					Billions of Dollars							
Total Deficit: CBO Current Law Baseline	1,284	973	555	286	217	288	240	220	270	288	292	3,630
Medicare "Doc-Fix"	0	12	19	24	27	32	36	41	46	53	59	351
Payroll Tax Reduction[a]	0	91	30	0	0	0	0	0	0	0	0	121
Emergency UI[b]	0	28	16	0	0	0	0	0	0	0	0	44
"Tax Extenders"	0	13	78	116	106	98	97	97	100	104	111	920
Bush Tax Cuts, Certain ARRA Tax Provisions and AMT "Patch"[c]	0	11	241	348	402	453	510	570	633	702	778	4,647
Bush Tax Cuts, Certain ARRA Tax Provisions[d]	*0*	*2*	*109*	*239*	*277*	*305*	*334*	*363*	*392*	*424*	*457*	*2,904*
AMT "Patch"	*0*	*9*	*94*	*41*	*49*	*60*	*74*	*89*	*108*	*130*	*154*	*809*
Total Deficit: Current Policy	**1,284**	**1,128**	**940**	**774**	**752**	**871**	**883**	**928**	**1,049**	**1,147**	**1,240**	**9,713**
					Percent of GDP							
Total Deficit: CBO Current Law Baseline	8.5	6.2	3.4	1.7	1.2	1.5	1.2	1.1	1.2	1.3	1.2	1.9
Medicare "Doc-Fix"	0.0	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Payroll Tax Reduction[a]	0.0	0.6	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Emergency UI[b]	0.0	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
"Tax Extenders"	0.0	0.1	0.5	0.7	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Bush Tax Cuts, Certain ARRA Tax Provisions and AMT "Patch"[c]	0.0	0.1	1.5	2.1	2.2	2.4	2.5	2.7	2.9	3.1	3.3	2.4
Bush Tax Cuts, Certain ARRA Tax Provisions	*0.0*	*0.0*	*0.7*	*1.4*	*1.5*	*1.6*	*1.7*	*1.7*	*1.8*	*1.9*	*1.9*	*1.5*
AMT "Patch"	*0.0*	*0.1*	*0.6*	*0.2*	*0.3*	*0.3*	*0.4*	*0.4*	*0.5*	*0.6*	*0.6*	*0.4*
Total Deficit: Current Policy	**8.5**	**7.2**	**5.8**	**4.6**	**4.1**	**4.6**	**4.4**	**4.4**	**4.8**	**5.0**	**5.2**	**5.0**

Source: Congressional Budget Office, *The Budget and Economic Outlook: An Update*, August 2011; Congressional Budget Office, *Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act*, September 2011; Congressional Budget Office*, Cost Estimate of S. 1549 American Jobs Act of 2011*, October 2011; and Congressional Budget Office, *Budgetary Effects for S.1931, the Temporary Tax Holiday and Government Reduction Act.* November 2011.

Notes: Items may not sum due to rounding. Abbreviations are CBO: Congressional Budget Office; BCA: Budget Control Act of 2011; UI: Unemployment Insurance; ARRA: The American Recovery and Reinvestment Act (P.L. 111-5).

a. The payroll tax cut is assumed to be extended for one year (2012), whereas the other policies (except the extension of emergency UI benefits) are assumed to be extended for up to 10 years. One of the recent proposals to extend the payroll tax cut, the Temporary Tax Holiday and Government Reduction Act (S. 1931), proposes extending the current payroll tax cut through the end of 2012. In this report, the revenue estimates for the employee payroll tax reduction component of S. 1931 are used as a reasonable approximation of the budgetary cost of an extension of the payroll tax cut. Importantly, the revenue loss estimates in this table reflect the revenue losses of extending this provision, but they do not reflect the overall budgetary cost of the bill since the bill offsets the cost of the extension. The deficit impact of the extensions of the payroll tax cut does not include the associated debt service related to these provisions, whereas the debt service associated with the other provisions in this Table (except emergency UI benefits) is included in their total budgetary cost.

b. Emergency UI benefits are assumed to be extended for one year (2012), whereas the other policies (except the payroll tax cut) are assumed to extended for up to 10 years. The President's American Jobs Creation Act of 2011 (introduced in Congress as S. 1549, H.R. 12, and S. 1660) has proposed a year-long extension of eligibility for the EUC08 program. The bill has also proposed 100% federal financing of EB and the use of a three-year lookback for EB triggers through calendar year 2012. The CBO score of this bill is used to estimate the budgetary impact of this proposal, assuming that the extension is not offset. Importantly, the cost estimates in this table reflect the cost of extending this provision, but they do not reflect the overall budgetary cost of the bill since the bill offsets the cost of the extension. The deficit impact of the extensions of emergency UI benefits does not include the associated debt service related to these provisions, whereas the debt service associated with the other provisions in this table (except the Payroll Tax Cut) is included in their total budgetary cost.

c. Due to the interaction of the regular income tax under the Bush tax cuts and the AMT, the revenue losses associated with extending both these policies together is greater than the sum of extending them individually.

d. In this table, data for "Bush Tax Cuts, Certain ARRA Tax Provisions" refer to the individual income and estate tax provisions that were part of the Bush tax cuts and which were originally scheduled to expire at the end of 2010 as well as several ARRA tax provisions pertaining to tax credits that were also scheduled to expire at the end of 2010. These provisions were extended through the end of 2012 by the 2010 Tax Act (P.L. 111-312).

Extension of Major Expiring Provisions

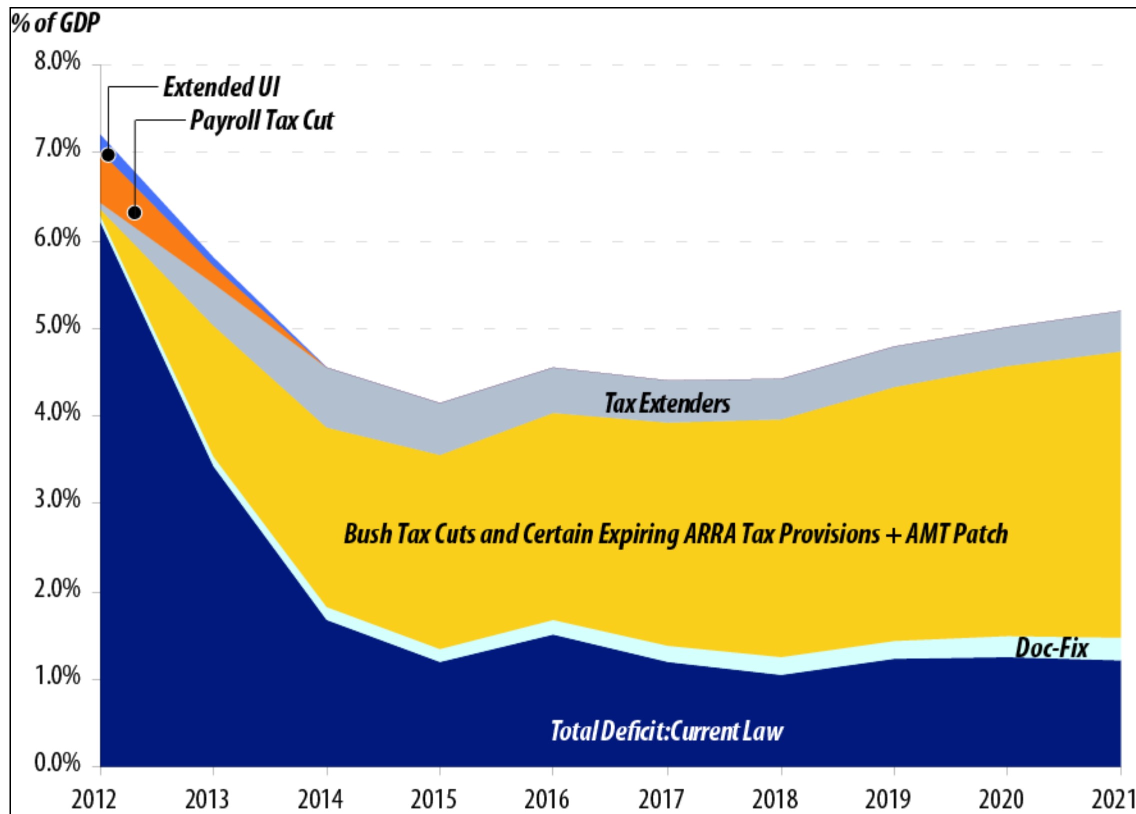
The budget deficit will be higher if policies scheduled to expire in 2011 and 2012 are extended, as discussed above for each policy. If all the current policies discussed in this report are extended, the deficit would be above 4% of GDP for every year over the next 10 years and the average deficit (2012-2021) would more than double from 1.9% of GDP to 5.0% of GDP (see **Table 1** and **Figure 1**). Approximately three-fourths of this change would be a result of extending the income and estate tax provisions of the 2010 Tax Act[28], and analysis of the 2010 Tax Act indicates that the majority of the budgetary cost of this law—approximately 93% in 2012—can be attributed to the Bush tax cuts.

If all current policies are extended except the Bush tax cuts and certain ARRA tax provisions, deficits would still rise but not as substantially. Between 2012-2021, budget deficits as a percentage of GDP would increase on average by 0.1% as a result of a one-year extension of the payroll tax cut, 0.2% as a result of maintaining Medicare reimbursement rates at 2011 levels through 2021, and 0.5% as a result of extending the roughly 80 tax provisions that expire in the next 10 years through the end of 2021. The one-year extension of UI benefits would not increase the deficit over the 2012-2021 budget window, although it would result in an increase in the deficit in 2012 and 2013. One factor in the limited budgetary impact of extending UI benefits and

[28] P.L. 111-312.

the payroll tax reduction is that these extensions are assumed to only be for one year. (The payroll tax reduction and the extended unemployment insurance (UI) programs were enacted in response to the economic downturn. Current proposals to extend UI benefits and the payroll tax reduction extend these polices for one year.) If they are extended annually for the next 10 years, their impact on the deficit would be larger. In total, extending these three policies (the payroll tax cut for one year, the doc-fix and tax extenders for up to 10 years), excluding an extension of the individual income tax provisions of the 2010 Tax Act, would result in deficits falling below 2.5% of GDP by 2015.

Figure 1. Increases in the Deficit Resulting from the Extension of Certain Policies 2012-2021



Source: CRS calculations using data from the Congressional Budget Office (CBO).

Conclusion

As several major policies are scheduled to expire at the end of 2011 and 2012, Congress may choose to allow these policies to expire or choose to extend some or all of them. If Congress allows the six major policies described in this report to expire, the budget deficit is scheduled to fall below 2% of GDP beginning in 2014 and remain below 2% of GDP through 2021. Budget deficits under 2% of GDP are viewed by many economists as sustainable because they will not result in the debt—the accumulation of deficits—growing faster than GDP under current projections.

If Congress chooses to extend current policies, annual budget deficits would increase significantly and are projected to become unsustainable unless the cost of extending these policies is offset. Offsetting the cost of extending these policies would require Congress to enact policies that lower the cumulative budget deficit by nearly three times the amount prescribed in the BCA—$6 trillion over the next ten years, 2012-2021, or on average $600 billion each year.

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