WHAT WE’LL LOOK AT

• **Background**
  • The broader budget picture

• **The Fiscal Cliff**
  • How did we get stuck with the “fiscal cliff”?
  • What exactly is it and what are its components?
    • *Aside*: How does the debt limit fit in?
  • Is the cliff really *that* bad?

• **Outlook**
  • Current political situation – where does it go from here?
The Broader Budget Picture
FY 2012 BUDGET

- Medicare + Medicaid: 21%
- Social Security: 21%
- Other Mandatory: 15%
- Non-Defense Discretionary: 17%
- Defense Discretionary: 19%
- Interest: 7%

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BIPARTISAN POLICY CENTER
NEARLY ONE-THIRD OF OUR SPENDING IS BORROWED

Fiscal Year 2012 Outlays: $3.54 Trillion

Revenues: $2.45 Trillion
Deficit: $1.09 Trillion

Source: Congressional Budget Office (October 2012)
ABSENT REFORMS, DEBT IS SET TO SKYROCKET IN THE COMING DECADES

**Graph:**

- **Y-axis:** % of GDP
- **X-axis:** Years (1972 to 2052)

**Key Points:**
- Debt breaches 100% of GDP in 2027

**Note:** Unlike current law, the Bipartisan Policy Center’s Plausible Baseline assumes that the 2001, 2003, and 2010 tax cuts are extended, the AMT is indexed to inflation, Medicare’s physician payment rates are maintained at their current rate (the “doc fix”), the looming sequester from the Budget Control Act of 2011 is lifted, and troops stationed overseas decline to 45,000 by 2015.

**Sources:** Congressional Budget Office (January 2012) and Bipartisan Policy Center extrapolations
HEALTH CARE COSTS ARE THE PRIMARY DRIVER OF THE DEBT

Sources: Congressional Budget Office’s Alternative Fiscal Scenario (August 2012), additionally assuming that troops overseas decline to 45,000 by 2015; Bipartisan Policy Center extrapolations

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Sources: Congressional Budget Office’s Alternative Fiscal Scenario (August 2012), additionally assuming that troops overseas decline to 45,000 by 2015; Bipartisan Policy Center extrapolations

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Health Care Spending

Social Security

Discretionary Spending (Defense and Non-Defense)

Other Mandatory Programs (e.g., federal pensions, unemployment compensation)

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Revenues Averaged 20% of GDP When the Budget Was Balanced…

- 1998: 19.9%
- 1999: 19.8%
- 2000: 20.6%
- 2001: 19.5%
- (projected) 2012-2022 Average: 18.0%

...and that Was Before the Baby Boomers Arrived

Source: Congressional Budget Office Alternative Fiscal Scenario (August 2012)

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DISCRETIONARY SPENDING HAS ALREADY BEEN RESTRAINED

BCA Caps Achieved Similar Level of Cuts to Domenici-Rivlin

Note: Total discretionary budget authority (depicted above) includes funding for overseas combat operations, which has declined since 2011 and is scheduled to decline further over the coming years.

Source: Congressional Budget Office, BPC estimates

Source: Congressional Budget Office, BPC estimates
STILL IN MIDST OF A SLUGGISH RECOVERY

Source: Bureau of Labor Statistics
The “Fiscal Cliff”
HOW DID WE GET TO THE “FISCAL CLIFF”? 

Financial Crisis

Bush Tax Cuts (‘01,’03)

The “Great Recession”

Weak Economy

Patches and Fixes to Temporary or Broken Policies

Debt Limit 2011

Budget Control Act of 2011 (BCA)

Supercommittee Failure

Payroll Tax Holiday Extended

Extended Unemployment Insurance Continued

Sequestration

Debt Limit 2013

THE “FISCAL CLIFF”
WHAT IS THE “FISCAL CLIFF”? 

• Term was coined by Fed Chairman Ben Bernanke
  • Others have given it different names

• An array of federal fiscal (i.e., spending and tax) policies that are all scheduled to expire (or go into effect) at the same time

• The cliff will actually reduce – not increase – the deficit
WHAT IS THE “FISCAL CLIFF”? 

Upcoming Current Law Changes:

- Expiration of Bush Tax Cuts + AMT Patch $321 b
- Expiration of Payroll Tax Cut $115 b
- Expiration of Extended Unemployment Insurance $34 b
- Expiration of Tax Extenders $75 b
- The Sequester $78 b
- Affordable Care Act Taxes $24 b
- Expiration of Doc Fix $14 b

TOTAL: $651 b
SO WHY IS THE FISCAL CLIFF A BAD THING?

• Economic Impact

• Programmatic and “On-the-Ground” Impact
Congressional Budget Office Projections of 2013 Economic (GDP) Growth

Go Over the Cliff: -0.5%
Cancel Spending Cuts & Extend Tax Cuts: 2.4%
If we go over the cliff, the Congressional Budget Office projects for 2013:

- Change in GDP: **-0.5%**
- Unemployment Rate at end of year: **9.1%**

In other words: Another Recession
• Irrational policies
  • Sequestration
  • Doc Fix
  • AMT

• State and local program impacts and uncertainty
The Debt Limit
• **Debt Limit** = A statutory limitation on the amount that the federal government is allowed to borrow to finance its obligations

• Has been raised dozens of times since it was instituted in 1917, including under every president since FDR

• Currently set at $16.394 trillion by the Budget Control Act of 2011
1. The debt ceiling standoff of 2011 will cost the American taxpayer ~$19 billion over ten years

2. The federal government will next reach its debt limit in the second half of December 2012

3. Treasury’s “extraordinary measures” will last a shorter period of time than they did last summer

4. At some point in February 2013, Treasury will run out of cash to pay ALL of its bills (the “X Date”)
Layers of Defense Against Default

The Treasury Department has multiple means that can be used to pay the nation’s bills. If the debt limit is reached and Congress does not act in time, however, all of these layers of defense will be breached and the nation will default on its obligations.

**ISSUE NEW DEBT TO THE PUBLIC IN TRADITIONAL MANNER**

Debt Limit Reached

**EXTRAORDINARY MEASURES**

EM Exhausted

**DAILY REVENUE AND CASH ON HAND**

The X Date

**DEFAULT ON FINANCIAL OBLIGATIONS**
**WHAT HAPPENS ONCE WE REACH THE “X DATE”?**

**Treasury Cash Flow: February 2012**

<table>
<thead>
<tr>
<th>Monthly Inflows</th>
<th>Monthly Outflows</th>
</tr>
</thead>
<tbody>
<tr>
<td>$202 Billion in revenues</td>
<td><strong>$464 Billion in spending:</strong></td>
</tr>
<tr>
<td></td>
<td>• $112b IRS Tax Refunds</td>
</tr>
<tr>
<td></td>
<td>• $62b Medicare and Medicaid</td>
</tr>
<tr>
<td></td>
<td>• $55b Social Security Benefits</td>
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<tr>
<td></td>
<td>• $33b Interest on Debt</td>
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<tr>
<td></td>
<td>• $27b Defense Vendor Payments</td>
</tr>
<tr>
<td></td>
<td>• $26b Education Programs</td>
</tr>
<tr>
<td></td>
<td>• $14b Federal Salaries</td>
</tr>
<tr>
<td></td>
<td>• $125b Other Spending</td>
</tr>
</tbody>
</table>

**Monthly Cash Deficit:** $261 b

*Note:* This past February’s cash flows provide a rough estimate of the challenge of meeting the federal government’s obligations in February 2013 without the ability to issue net new debt to the public. Numbers may not add due to rounding.

*Source: Daily Treasury Statements*

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**“WILD CARDS”**

- **Fiscal Cliff**
  - Income tax withholding
  - Expiration of Alternative Minimum Tax “patch”
  - Delayed filing season

- **Additional Deficit Spending?**
  - Disaster relief funds
  - “Growth measures” in fiscal cliff deal

- **Economic Uncertainty**
  - Strengthening/weakening economy
  - Monthly fluctuations in spending and revenues
Is the Fiscal Cliff Really That Bad?

We Don’t Know…and That’s the Problem
IS THE FISCAL CLIFF REALLY THAT BAD?

- Actual impact of certain components can probably be delayed
  - Withholding for income taxes
  - Temporary delay of sequestration cuts

- Potential market reaction

- Continued (and growing) economic uncertainty
Current Political Situation – Where Does it Go From Here?
LOOMING FISCAL CLIFF

DECEMBER 2012

- 12/31/12 - Expiration of the Bush tax cuts
- 12/31/12 - Expiration of the Sustainable Growth Rate “Doc Fix”
- 12/31/12 - Expiration of extended Unemployment Insurance benefits
- 12/31/12 - Expiration of the Alternative Minimum Tax ‘Patch’
- 12/31/12 - Expiration of the current estate and gift tax rates
- 12/31/12 - Deadline for addressing tax extenders

JANUARY 2013

- 1/1/13 – Imposition of new Affordable Care Act (ACA) taxes
- 1/2/13 - Sequestration

FEBRUARY 2013

- Estimated breach of the $16.394 trillion debt ceiling (post-extraordinary measures)

MARCH 2013

- 3/27/12 – Expiration of Continuing Resolution to fund the government for Fiscal Year 2013
- 3/27/12 - Expiration of the Temporary Assistance for Needy Families (TANF) authorization
CURRENT POLITICAL STANCES AND POTENTIAL FOR RESOLUTION

- House GOP Budget

- President Obama’s Budget

- Boehner’s proposed outline
  - Rejected by the President
CURRENT POLITICAL STANCES AND POTENTIAL FOR RESOLUTION

• Can’t get everything done in the Lame Duck session

• Need a “Framework”

• Main issues to resolve:
  • Taxes
  • Entitlements
  • Growth policies
  • Debt limit