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What We Hope to See from the Extensions Conference Committee
January 25, 2012

At the end of last year, lawmakers enacted a temporary two-month extension of several policies set to expire, including the temporary payroll tax holiday, expanded unemployment insurance, the doc fix, and various health provisions. Encouragingly, the $33 billion cost of the extensions was fully offset over a ten-year period and a Conference Committee was appointed to determine how any further extensions would be treated.

As the Conference Committee works to address these expiring policies, it should strive to focus on long-term solutions as opposed to short-term patches. Ideally, the Committee should view the extensions of these policies within the broader economic and fiscal context, using them as an opportunity to advance a comprehensive fiscal plan.

Structured correctly, such a package can have a positive short and long-term economic impact, providing certainty to businesses and individuals and putting the country on a more sustainable path.

To achieve this, the Conference Committee should:

1. Include policies to put in place, or move the country toward, a comprehensive plan to stabilize and reduce long-term debt.
2. Ensure that the costs of any extensions are fully offset over a five to ten-year period.
3. Put in place permanent solutions for expiring provisions where appropriate.

The Conference Committee should not:

1. Make temporary stimulus or job creation measures permanent, or make it easier to continue extending them in the future.
2. Dismantle the sequester or otherwise add to the deficit.
3. Rely on budget gimmicks for offsets.

Updated Costs of Extending Expiring Policies

The December extensions package included a $33 billion two-month continuation of the payroll tax holiday, unemployment benefits, the doc fix, and other health provisions. Although these extensions were fully paid for over ten years through increased mortgage guarantee fees from Fannie Mae and Freddie Mac, the cost of extending these policies through the rest of the year would be significant – about $155 billion in total.

If policymakers also extend several now-expired provisions (which can be reinstated retroactively) such as the AMT patch, the cost of an extension through 2012 would increase to about $385 billion. Further extending the non-stimulus measures through the rest of the decade would cost nearly $2.3 trillion.

For a more detailed look at each set of expiring provisions this year, see the Committee for a Responsible Federal Budget's analysis from December: http://crfb.org/document/dealing-expiring-provisions-fiscally-responsible-manner.

Fig. 1: Costs of Extending Expiring and Expired Policies (Billions)

Policy	Two-Month Extension (Enacted)	Full-Year Extension Through 2012	Ten-Year Extension
Policies Extended in December 2011			
One-Year Extension of 2% Payroll Tax Holiday	$21	$100	$100
"Doc Fix"*	$4	$15	$285
One-Year Extension of Expanded Unemployment Insurance	$8	$35	$35
Expiring Medicare Provisions	<$1	$5	$55
Sub-Total, Costs	**$33**	**$155**	**$475**
Offset: Increased Fannie/Freddie Fees	-$36	N/A	
Policies That Have Expired But Can Be Retroactively Enacted			
Ten-Year Alternative Minimum Tax (AMT) Patch^	N/A	$90	$690*
Bonus Expensing Provisions#		$5	$370
"Tax Extenders"		$35	$360
(Subpart F for Active Financing Income)		*($5)*	*($70)*
(R&E Tax Credit)		*($10)*	*($60)*
(Alcohol Fuel Tax Credit)		*($5)*	*($55)*
(Other extenders)		*($20)*	*($170)*
Subtotal, Costs	**$0**	**$130**	**$1,415**
Total Non-Interest Costs	**-$2**	**$285**	**$1,890**
Interest Costs	$4	$95	$385
Total Costs	**$2**	**$385**	**$2,280**

Source: CRFB estimates based on Congressional Budget Office and Joint Committee on Taxation data.
Note: Estimates rounded to nearest $5 billion, except for two-month extension column, and may not add due to rounding.
*Estimates reflect the costs of a freeze in payments against current law projections.
^Excluding costs of any interaction with possible extensions of the 2001/2003/2010 tax cuts.
#Cost of one-year extension reflects costs of continuing 100 percent bonus depreciation rule, while ten-year extension reflects cost of continuing the 50 percent bonus depreciation that is set to expire at the end of 2012.

Principles for a Fiscally Responsible Solution for Expiring Provisions

Should lawmakers choose to extend any policies that expire in February, or retroactively extend other policies that expired in December, they must follow several principles to ensure the expiring policies help to promote broader fiscal reforms.

1. Include policies to put in place or move the country toward a comprehensive plan to stabilize and reduce long-term debt.
We cannot as a country afford to continue deferring the hard choices necessary to achieve a sustainable fiscal path. The fact that extending various expiring provisions will add to the debt actually *strengthens* the case for enacting these extensions in the context of a comprehensive debt reduction package. A comprehensive package can merge short and long-term priorities in a way that provides substantial certainty and reassures markets that the benefits of stabilizing and reducing the medium and long-term debt will overwhelm the costs of any short-term borrowing.

The number of plans and policy options available should be sufficient for members of Congress to work toward a comprehensive plan. However, if lawmakers feel they need more time to develop and consider savings proposals, there are many intermediate changes they could propose to make enactment of a plan more likely. For example, lawmakers could propose extending the fast-track process granted to the Super Committee to any bipartisan debt reduction plan that achieves certain fiscal goals. Senator Lieberman proposed something similar in December.

Importantly, whatever the Conference Committee proposes should move the country closer to achieving a comprehensive fiscal consolidation plan, not further away.

2. Fully pay for the costs of any temporary extensions with permanent savings.
As the first principle states, lawmakers ideally would address expiring provisions within the context of a full, comprehensive deficit reduction package. While this should remain the central goal among lawmakers until they can enact such a package, *at the very least lawmakers should fully pay for the costs of any extensions.*

Though lawmakers did hold themselves to this standard for the two-month extension in December, we recommend that they consider going further this time by adhering to a slightly stricter minimum threshold. In December, offsets took place over ten years and expired once the costs had been paid for. Instead, we would prefer that lawmakers rely on permanent offsets so that the extensions would be fully paid for within five to ten years and reduce the debt over the longer term.

Although offsets will not be as effective as a comprehensive plan in reassuring markets, they will at least send the signal that lawmakers are serious about not making the country's fiscal challenges any larger.

3. Put in place permanent solutions for expiring measures where appropriate.
Regardless of the merits of extending several policies that are set to expire, lawmakers should be able to agree that budgeting for only two months at a time is no long-term solution. Policy uncertainty makes it more difficult for businesses and households to plan and invest. In addition, having recurring debates over the same measures threatens to detract from finding solutions to the country's longer-term fiscal problems and instead focus only on very short-term issues.

To this end, policymakers should aim to find more permanent solutions for the various expiring provisions. It is clear that there is little justification for permanently continuing the payroll tax holiday, expanded unemployment benefits, and other temporary policies after the economy recovers. And experts have recommended ways to redesign the Sustainable Growth Rate (SGR) to better set provider reimbursements based on quality of care instead of quantity, and to control costs for other providers in addition to specialists.

Lawmakers need to think of ways to reform these measures to either make them cheaper (for example, in the case of the doc fix) or to help unwind them as the economy recovers. A gradual unwinding could be useful both in ensuring that temporary policies remain temporary and in providing a soft landing for economic actors who have come to (directly or indirectly) rely on these temporary policies.

Fig. 2: Summary of Recent Proposals to Extend Expiring Policies

Senate Democrats' Proposal (Updated from December Proposal)
Proposal: The plan would cut the employee payroll tax in half (from 6.2 to 3.1 percent). **(Cost: $150 billion)**
Offsets: The plan would enact a temporary 1.9 percent surtax on income over $1 million (to expire after ten years), adopt the Republicans' offer to curtail unemployment benefits and food stamps for millionaires, and increase the fees that Fannie Mae and Freddie Mac charge mortgage lenders to guarantee loans (enacted). **(Savings: $150 billion)**

House Republican Proposal (Updated from December Proposal)
Proposal: The plan would extend the current two percentage point payroll tax holiday through 2012, enact a two-year doc fix, extend but scale down unemployment insurance, extend 100 percent bonus depreciation, and extend various Medicare provisions through 2012. **(Cost: $170 billion)**

Fig. 2: (continued)

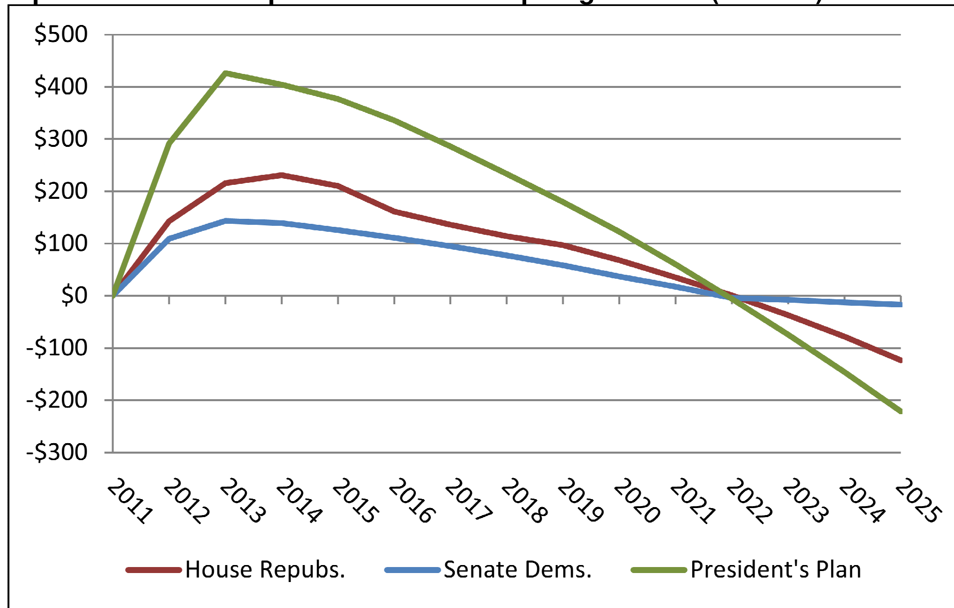
Offsets: The plan would lower the discretionary caps by freezing federal salaries for an additional year in 2013, increase the fees that Fannie Mae and Freddie Mac charge (enacted), reform federal civilian retirement, increase Medicare premiums for high earners, auction spectrum licenses, reform flood insurance, reduce child tax credit fraud, reduce spending from the health care reform law, reduce Social Security overpayments, and make other changes. **(Savings: $170 billion)**

President Obama's American Jobs Act (Updated from September Proposal)

Proposal: The plan would cut the employee and employer payroll tax (up to $5 million in payroll costs) in half through 2012 (from 6.2 to 3.1 percent), extend unemployment insurance, implement various infrastructure projects and create an infrastructure bank, support teacher rehiring and first responders, and extend 100 percent bonus depreciation, among other proposals. **(Cost: $445 billion)**

Offsets: The plan would limit itemized deductions for higher income earners to 28 percent of the value of those deductions and exclusions, tax carried interest as ordinary income, and eliminate tax preferences for oil and gas companies. **(Savings: $450 billion)**

Debt Impact of Recent Proposals to Extend Expiring Policies (Billions)



Note: Estimates of proposals adjusted to begin in March 2012.
President's plan refers to the American Jobs Act.

Note: Numbers rounded to the nearest $5 billion. Cost estimates updated to incorporate two-month extension enacted in December.

What Lawmakers Need to Avoid in a Fiscally Responsible Solution

A fiscally responsible solution for any extensions of expiring policies and for rising debt also entails avoiding some traps that could actually make the problem worse.

1. Don't make temporary stimulus or job creation measures permanent.
We need permanent *solutions* for expiring measures where appropriate to help address rising federal debt, not categorical permanent *extensions*. Lawmakers cannot afford to make the country's fiscal situation any worse by making expiring measures permanent when they don't need to be – or to make it easier for future politicians to do so. A multiyear extension or talk of permanently extending various measures could raise the risk of them becoming permanent.

2. Don't dismantle the trigger or trade deficit-increasing policies in exchange for extending expiring policies.
Lawmakers should use expiring policies as an opportunity to address mounting federal debt, not as an opportunity to make future deficits and debt worse or to reduce the likelihood of future deficit reduction. As the 2010 tax cut extension package illustrated, lawmakers have at times traded additional deficit increasing measures in exchange for extending various policies – a win-win for politicians but an overall loss for future generations.

Lawmakers must also avoid all efforts to weaken or dismantle the $1.2 trillion in automatic spending cuts to defense and non-defense programs set to go off in January 2013. That sequester should not be allowed to go off, but nor should it be removed without at least the $1.2 trillion of additional deficit reduction called for by the Budget Control Act, either.

The expiration of the tax cuts and the implementation of the trigger at the beginning of next year represent two of the most compelling reasons for lawmakers to continue negotiations on deficit reduction. Eliminating or reducing that pressure outside of a comprehensive plan would not inspire confidence that lawmakers are up to the challenge.

3. Don't rely on budget gimmicks.
Lawmakers need to rely on real savings to pay for policy extensions, not games and gimmicks. Gimmicks to watch out for include:

- **Phony savings.** Lawmakers should avoid extending real policies with fake offsets. Many politicians have suggested, for example, using savings from the war drawdown to pay for new spending. That drawdown is already in place,

and policymakers should not be able to take credit for it as new savings in order to finance expensive programmatic expansions.

- **Excessively back-loading savings.** While it is desirable to gradually phase-in savings to give the economy time to recover and the public time to prepare for any significant changes, putting savings off too long will bring their credibility into question. Lawmakers should not enact future savings if they believe those savings will be canceled later, and instead should focus on reforms which are both credible and sustainable.

- **Offsetting tangible policies with unspecified savings.** Offsets should ideally be at least as specific as the policy extensions they pay for. Promises of future deficit reduction should not be considered sufficient, nor should simply increasing the size of the sequester set to go off at the beginning of next year.

Conclusion

It was encouraging to see lawmakers committed to paying for the costs of any extensions during negotiations in December, especially policies that have not always been paid for in the past. At the very least, they did not allow expiring provisions to put the country further in a fiscal hole.

However, simply not making the problem worse is a far cry from actually working to solve the problem. Lawmakers need to enact permanent solutions to expiring provisions, and ideally would do so through a comprehensive approach to debt reduction that put the debt on a downward path as a share of the economy. Only a downward debt path can truly give confidence to businesses, households, and investors that the U.S. has its finances under control.