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Fiscal Cliff Deal Added $47 Billion in Spending

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Because most of the fiscal cliff debate focused compulsively on how much Congress would raise taxes, the spending side of the argument nearly became an afterthought. This resulted in another shell game that added net spending and set up another confrontation in less than two months.

The agreement delays until March 1 $110 billion in 2013 across-the-board spending cuts (sequestration) that would, among other things, slash base national defense spending by 10 percent ($55 billion). To replace the lost savings, the legislation shifts future revenue from private retirement accounts within the 10-year budget window and lowers the caps on annually appropriated spending over the next two years, with no specific policies identified. The legislation then adds enough new spending to more than wipe out these alleged savings.

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Thus the ostensible pursuit of "balanced" deficit reduction has once again yielded hefty tax hikes and no spending reductions.

Delaying Sequestration. The onerous and grossly imbalanced "sequestration" mechanism in the 2011 Budget Control Act (BCA) was intended to force Congress to adopt alternative savings rather than let the crude, across-the-board cuts take place. Because the BCA scheduled the mechanism to start in January 2013, rather than at the beginning of the 2013 fiscal year on October 1, it ensured that Congress would delay any resolution until the post-election lame-duck session.

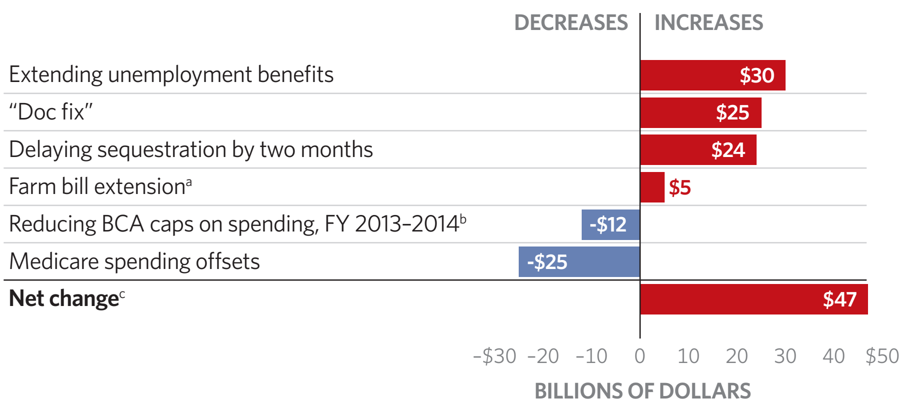
To its credit, the House of Representatives in May passed legislation replacing the sequestration cuts with specific, targeted program reforms.[1] The Senate ignored the legislation, as did the President, and House Republicans failed to push for it in cliff negotiations. In the final fiscal cliff agreement, Congress and the President merely delayed sequestration for two months, failing to reach any permanent resolution. The sequestration is now scheduled to kick in on March 1.

As a kind of fiscal fig leaf, the cliff agreement contains $24 billion in alternative "savings" to replace two months of sequestration. Of the total, $12 billion comes from a revenue timing shift. It allows taxpayers to move retirement savings from traditional tax-deferred plans to Roth accounts. Tax-deferred plans allow contributions of pre-tax income, with taxes paid on disbursements during retirement. In contrast, contributions to a Roth account come from after-tax income, but distributions during retirement are tax-free. In converting from a traditional plan to a Roth, the account owner pays to the account, in a lump sum, the income tax that would have been due on past contributions. This has the effect of raising near-term tax revenue, while foregoing future revenue.

The other $12 billion in "savings" comes from reducing the BCA caps on annually appropriated spending. The agreement lowers the caps by $4 billion in fiscal year (FY) 2013, and another $8 billion in FY 2014—with no specific policies identified to achieve the savings. In other words, the cliff legislation takes two years of unidentified spending cuts to offset *one half of two months' worth of sequestration.* Further, because only half the sequestration is replaced by lower spending, the result is a net spending increase compared to simply leaving the sequesteration in place.

CHART 1

Spending Effects of the Fiscal Cliff Agreement



Notes:
a—The Congressional Budget Office (CBO) shows the farm bill extension as having no cost because the CBO baseline assumes the extension even though the authorization has expired.
b—The legislation offsets another $12 billion through a revenue timing shift from traditional tax-deferred retirement plans to Roth accounts.
c—The CBO analysis also shows $276.5 billion in higher spending that merely results from refundable tax credits included in the extension of current tax policies in the fiscal cliff agreement.

Source: Heritage Foundation calculations based on Congressional Budget Office, "Estimate of the Budgetary Effects of H.R. 8, the American Taxpayers Relief Act of 2012, As Passed By The Senate on January 1, 2013," January 1, 2013, http://www.cbo.gov/sites/default/files/cbofiles/attachments/American%20Taxpayer%20Relief%20Act.pdf (accessed January 9, 2013).

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Impact on Spending. The agreement then incorporates a range of spending provisions that add a net of $47 billion in spending over 10 years, based on estimates by the Congressional Budget Office (CBO).[2]

Extended Unemployment Benefits. The agreement extends for another year 47 weeks of federally financed emergency unemployment benefits, at a 10-year cost of $30 billion. These payments are in addition to up to 26 weeks of benefits paid by state governments, providing a maximum of 73 weeks—a year and a half—of benefits. Although seemingly reasonable on humanitarian grounds in the current sluggish economy, these extensions come with an economic cost. They encourage the unemployed to delay their job searches or spend too much time searching for jobs they are less likely to find, remaining out of work longer than they would otherwise. A maximum of 50–60 weeks of unemployment benefits would be more appropriate given the state of the economy.[3]

Another "Doc Fix." The fiscal cliff deal prevented a 27 percent reduction in payments to Medicare physicians in 2013 at a cost of $25 billion over 10 years. Commendably, the cliff agreement did offset this "doc fix" elsewhere in Medicare. For example, it reduced payments for disproportionate-share hospitals—institutions that receive high numbers of low-income patients. It also revised certain Medicare payment and coding systems to achieve additional savings. These and other health care program reductions prevented what would have been a significant spending increase.[4]

Farm Bill Extension. The agreement extended, through September 30, price and income support programs to certain farmers that had expired, at a cost of $5 billion. The program subsidizes—at taxpayers' expense—producers of certain commodities based on historical yields, rather than production. Farm bills adopted by the House and Senate would have eliminated these outdated subsidies, which made more sense considering recent record levels of net farm income and high crop prices. This temporary extension only puts off much needed reforms, such as

1. Patrick Louis Knudsen, "Why Budget 'Reconciliation' Matters," Heritage Foundation *Issue Brief* No. 3593, May 7, 2012, http://www.heritage.org/research/reports/2012/05/why-budget-reconciliation-matters.
2. Congressional Budget Office, "Estimate of the Budgetary Effects of H.R. 8, the American Taxpayers Relief Act of 2012, As Passed by the Senate on January 1, 2013," January 1, 2013, http://www.cbo.gov/sites/default/files/cbofiles/attachments/American%20Taxpayer%20Relief%20Act.pdf (accessed January 9, 2013).
3. Romina Boccia, James Sherk, and Katie Tubb, "What's in the Fiscal Cliff?," Heritage Foundation *Issue Brief* No. 3787, November 28, 2012, http://www.heritage.org/research/reports/2012/11/what-is-in-the-fiscal-cliff.
4. Congressional Budget Office, "Detail on Estimated Budgetary Effects of Title VI (Medicare and Other Health Extensions) of H.R. 8, the American Taxpayer Relief Act of 2012, as passed by the Senate on January 1, 2013," January 1, 2013, http://www.cbo.gov/sites/default/files/cbofiles/attachments/SenateHR8-TitleVI_0.pdf (accessed January 9, 2013).

eliminating all farm subsidies and decoupling the food stamps program from farm programs, which lawmakers should include when they next take up agriculture policy.

CLASS Act Repeal. One significant victory in the fiscal cliff agreement was the elimination of Obamacare's Community Living Assistance Services and Supports (CLASS) Act, a long-term care program so poorly designed that even the Administration admitted it would not work. CLASS gave the illusion of building a surplus by collecting premiums for five years before paying out benefits. The phantom surplus would eventually become a deficit, however, as premiums rose and healthier participants dropped out. The repeal of CLASS is a welcome policy choice.[5]

Contradictory Estimating Practices. The CBO analysis also demonstrates the bizarre double-standard in congressional bookkeeping that promotes higher spending and higher taxes.[6]

The estimate shows a spending increase of $276.5 billion over 10 years as a product of extending most tax policies enacted in 2001, 2003, and 2009, including about $78 billion from the 2009 stimulus bill. This figure reflects the refundable portion of certain extended tax credits, which are paid out to taxpayers with too little tax liability to deduct them from their tax bills.

Appropriately, these payouts are presented as spending. Not so suitably, however, the CBO shows them as spending *increases* even though they result simply from extending the same policies that existed in 2012. This is because those tax policies were scheduled to expire, and the CBO's "baseline"—the supposedly policy-neutral yardstick it uses to evaluate budget proposals—assumes they would. Consequently, extending them appears, in the CBO's estimate, to be a new tax cut.

When it comes to spending, however, the principle is reversed. The CBO spending baseline assumes the farm programs cited above continue even though they have expired—exactly the opposite of how the CBO treats tax law. Consequently, the $5 billion cost of extending these provisions is reflected as zero.[7]

These misleading and inconsistent estimating practices are required by law. Although the CBO could arguably present alternative estimates, the real problem lies with Congress. Lawmakers could, and should, rewrite the applicable laws to make budgetary estimates clearer and more realistic—but they refuse to do so.

Time to Cut Spending. The fiscal cliff agreement has a few benefits and many flaws. One trait it does not suffer, however, is "balance": The agreement allowed for large tax hikes with no spending reductions. Indeed, the measure yields a small but real net spending *increase*.

Today's trillion-dollar deficits and rising debt are the product of excessive spending. Until Congress and the President take substantial steps toward reining in spending, especially in the government's entitlement programs, debt will be a constant drain on the country's prosperity. Having squandered this opportunity, lawmakers need to focus on substantive spending reductions in forthcoming budget debates.

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5. Alyene Senger, "Fiscal Cliff Deal Undoes Part of Obamacare," The Heritage Foundation, *The Foundry*, January 4, 2013, http://blog.heritage.org/2013/01/04/obamacare-is-officially-class-less/.
6. Congressional Budget Office, "Estimate of the Budgetary Effects of H.R. 8"
7. Ibid.