



Fiscal Speed Bumps: Challenges, Risks, and Opportunities January 8, 2015

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Executive Summary

In the coming months and years, lawmakers will face a number of important budget related deadlines, or **Fiscal Speed Bumps**, that will require legislative action. These Fiscal Speed Bumps will present challenges, risks, and opportunities. Addressed irresponsibly, they could cause serious disruptions and/or add as much as \$3 trillion to the debt over the next decade above what current law would allow. But if dealt with thoughtfully, they offer an opportunity to pursue reforms that would grow the economy, improve the policy landscape, and reduce the risk of an uncontrollably growing national debt.

We have identified six major speed bumps this year and one next year that is significant enough that it should be dealt with in 2015. These speed bumps include:

- Expiration of the **CR funding Homeland Security** (*February 27, 2015*)
- Reinstatement of the **debt ceiling** (*March 16, 2015/Fall 2015*)
- Expiration of the “**doc fix**” and return of the SGR (*March 31, 2015*)
- Expiration of the **highway bill**, insolvency of the **Highway Trust Fund** (*May 31, 2015*)
- Expiration of **2015 appropriations**, return of **sequestration** (*October 1, 2015*)
- Deadline to renew **tax extenders retroactively** (*December 31, 2015*)
- Insolvency of the **Social Security Disability Insurance Trust Fund** (*late 2016*)

In *Fiscal Speed Bumps: Challenges, Risks, and Opportunities* we discuss each of these moments in detail, put them into historical context, and explain the options available to policymakers as they navigate these speed bumps.

Each of these Fiscal Speed Bumps must be addressed to avoid a major disruption and in each case, unfortunately, addressing the issue irresponsibly could substantially worsen an already unsustainable fiscal situation.

Instead, policymakers should use these speed bumps as opportunity to pursue responsible changes that result in better policy, a stronger economy, and a more sustainable long-term debt path.



Introduction

The temporary decline in [short-term deficits](#) and fatigue over recent budget fights has drawn attention away from very real long-term fiscal challenges. Despite record-high debt levels that are projected to grow unsustainably in future years, neither the President nor Congress are focused on how to fix our debt situation. Indeed, last year lawmakers *added* roughly \$100 billion to the medium-term debt.

Despite the apparent desire to ignore fiscal responsibility, policymakers will be forced to focus on these issues as various **Fiscal Speed Bumps** demand attention.

Fiscal Speed Bumps represent moments where budget-related legislation is needed to maintain the status quo and/or avoid a major change in policy. The upcoming Fiscal Speed Bumps include:

- Expiration of the **CR funding Homeland Security** (*February 27, 2015*)
- Reinstatement of the **debt ceiling** (*March 16, 2015/Fall 2015*)
- Expiration of the “**doc fix**” and return of the SGR (*March 31, 2015*)
- Expiration of the **highway bill**, insolvency of the **Highway Trust Fund** (*May 31, 2015*)
- Expiration of **2015 appropriations**, return of **sequestration** (*October 1, 2015*)
- Deadline to renew **tax extenders** *retroactively* (*December 31, 2015*)
- Insolvency of the **Social Security Disability Insurance Trust Fund** (*late 2016*)

These Fiscal Speed Bumps represent challenges and risks, but also opportunities. Specifically, they present a challenge of needing to reach consensus on how to move forward without major disruptions and a risk that decisions to navigate these speed bumps will dramatically increase deficits and debt. But they also offer an opportunity to take stock of our fiscal situation and enact reforms which improve the fiscal, economic, and broader policy outlook.

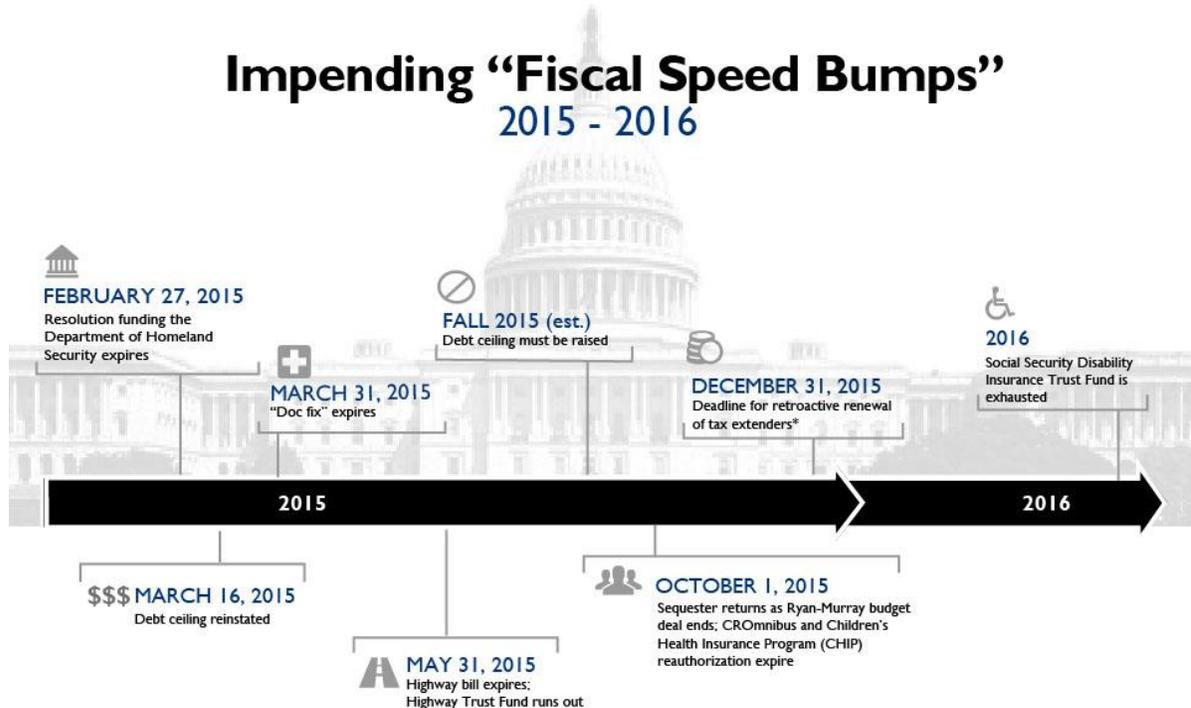
If policymakers act irresponsibly at each of these bumps, they could increase debt levels by nearly \$3 trillion above what current law allows by 2025. If they seize the opportunity to act responsibly, on the other hand, they could accelerate economic growth, slow the growth of federal health spending, secure various federal trust funds, and stabilize the debt over at least the next decade as a share of GDP.

CRFB strongly urges policymakers to take the responsible route.



What Are the Impending Fiscal Speed Bumps?

CRFB has identified six major Speed Bumps in calendar year 2015, and one bump in 2016 so significant that it should be addressed this year. Some of these bumps have multiple parts, and all must be addressed in some fashion.



*The tax extenders officially expire at the end of 2014, but can be restored retroactively until this point.

Below, we discuss each of these Fiscal Speed Bumps.

Department of Homeland Security Funding Expires (February 27, 2015)

The “CROmnibus” legislation passed in December included full year (FY2015) appropriations bills for every area except Homeland Security, which was funded by a continuing resolution (CR) through the end of February (The decision to fund Homeland Security temporarily was the result of a disagreement over executive action on immigration, which falls under the purview of Homeland Security).

When the CR expires, policymakers could come to an agreement over how to fund and set policy for the Department of Homeland Security for the remainder of the year, or they could pass another CR to further defer these decisions. Failure to do either would result in a partial government shutdown, though existing exemptions for “essential” personal could keep as much as 85 percent of the Department of Homeland Security working during the partial shutdown. Notably, any continued funding to the Department of Homeland Security must be near or below the current level of \$39 billion



for FY2015 to avoid breaching current law budget caps and triggering an across-the-board cut.

Federal Debt Ceiling is Reinstated (March 16, 2015 / Fall 2015)

The Temporary Debt Limit Extension Act that passed in February of last year suspended the debt ceiling through March 15th to be re-instated on the 16th at the level of debt that day. Although this theoretically prohibits any further borrowing at a time when the federal government is borrowing roughly \$2 billion per day, the Treasury Department can use a number of extraordinary measures (see [Debt Ceiling Watch 2014](#)) to buy time before the debt ceiling is breached. Indeed, experts believe Treasury could delay this “X date” into the fall of 2015, though the actual X date is still highly uncertain.

While the X date can be delayed through extraordinary measures, policymakers will ultimately need to increase or suspend the debt ceiling. No plausible set of policy changes could reduce immediate borrowing needs enough to keep the federal debt below the nominal ceiling, and failure to raise (or suspend) the debt ceiling before it is breached could force the government to default on some of its obligations, with potentially disastrous consequences. Even waiting until the 11th hour could have negative economic consequences.

While the debt ceiling **must** be increased (or suspended) in a timely manner, such an increase could be accompanied with measures that improve the long-term fiscal situation. In 2011, for example, the debt ceiling was accompanied by the Budget Control Act which imposed discretionary spending caps and established the “Super Committee,” and was scored at the time as achieving \$2.1 trillion of ten year deficit reduction.

To learn more about the debt ceiling, read [Q&A: Everything You Should Know About the Debt Ceiling](#).

“Doc Fix” Expires (March 31, 2015)

At the end of March, most physicians will experience a 21 percent cut in their Medicare payment under the Sustainable Growth Rate (SGR) formula. Originally designed to help control Medicare spending growth, the SGR has been waived continuously since 2003 through regular “doc fixes” that maintain stable physician payments but often increase the size of the subsequent scheduled cut. Most recently, Congress enacted a one-year doc fix in March of 2014.

While allowing the doc fix to expire would result in a 21 percent cut, freezing payments for just one year would cost roughly \$15 billion, and freezing them for ten years would cost \$135 billion. Replacing the SGR with a more sensible system could cost even more –



last year the Senate proposed a version of a bipartisan tri-committee fix that would cost about \$180 billion through 2025.

In the past, nearly all doc fixes [have been offset](#) over ten years, generally with alternative health savings, to avoid adding to the deficit. In March, policymakers will have an opportunity to not only replace the SGR formula, but also enact offsetting changes that help to slow health care cost growth and promote value-based care.

In CRFB's [PREP Plan](#), we outline one possible plan to fully pay for an SGR replacement with health care cost curve-bending reforms.

Highway Bill Expires and Trust Fund Runs Low (May 31, 2015)

Currently, highway spending is authorized through the end of May and the Highway Trust Fund (HTF) includes enough reserves to finance projects over that time period. When the highway bill expires, no new funds may be obligated to new transportation projects. At the same time, revenue will prove insufficient for current spending, and the HTF will run out of money.

Gas and other dedicated taxes raise about \$38 billion per year but transportation spending costs the trust fund \$53 billion per year. The \$15 billion gap in 2015 is projected to grow, resulting in a \$180 billion shortfall through 2025. Since 2008, lawmakers have plugged this gap with roughly \$65 billion worth of general revenue transfers, most not paid for or paid for with budget gimmicks.

Instead, policymakers could use the expiration of the highway bill as an opportunity to both better prioritize transportation spending and make sure it is fully funded. Eliminating the HTF's structural imbalance would require about a 15 cent per gallon gas tax increase, a one-third cut in spending, the introduction of new funding sources, or some combination. For the transition, lawmakers could fully offset temporary general revenue transfers with real offsets elsewhere in the budget.

To learn more about the HTF and options to make it solvent, read [Trust or Bust: Fixing the Highway Trust Fund](#)

CROmnibus Expires, Sequester Returns (October 1, 2015)

When the new fiscal year begins on October 1st, appropriations bills from the CROmnibus will expire, requiring lawmakers to pass new appropriations (or extend existing appropriations through a continuing resolution) to avoid a government shutdown. With the spending caps agreed to in the Ryan-Murray Bipartisan Budget Act (BBA) expiring, total spending levels will be dictated by the "sequester" triggered by the



failure of the 2011 Super Committee, and any spending above these levels would lead to across-the-board cuts.

Importantly, even at post-sequester levels, nominal discretionary caps would be allowed to rise by about \$2 billion relative to this year. However, this represents \$17 billion less than if spending increased with inflation, \$44 billion less than if spending increased with GDP, and about \$90 billion less than the pre-sequester caps set in the Budget Control Act. At a time when defense and non-defense discretionary limits are already quite strict, policymakers might have trouble agreeing to spend within those limits.

A full repeal of sequestration would be quite expensive, adding roughly \$100 billion to the deficit if enacted for FY2016 alone, or nearly \$1 trillion if enacted permanently. Instead, policymakers could follow the example set in the [Ryan-Murray BBA](#) and replace a portion of the sequester for one or two years with more thoughtful long-term deficit reduction. A more ambitious alternative would follow the model of the Simpson-Bowles [Bipartisan Path Forward](#) and permanently replace a portion of the sequester cuts with a new set of caps and finance the cost with structural tax and entitlement reforms.

To learn more about the appropriations process, read [Appropriations 101](#). For more about the sequester, read [Understanding the Sequester](#).

“Tax Extenders” Reach Reinstatement Deadline (December 31, 2015)

At the end of last year, over 50 temporary tax provisions known as the “tax extenders” expired. These include a number of popular individual and business tax breaks such as the research and experimentation tax credit, the production tax credit for wind energy, and the state and local sales tax deduction. Most of these provisions are renewed regularly, and can be reinstated retroactively any time in 2015, as they were in 2014 just a few weeks before the end of the year.

Continuing all these expired tax provisions through the end of 2015, including bonus depreciation, would cost more than \$40 billion. Continuing them permanently would cost over \$750 billion through 2025. A wiser alternative would use the need to address the tax extenders as an opportunity to pursue comprehensive tax reform. Such reform could promote economic growth and competitiveness by broadening the tax base and lowering rates. Tax reform could also make thoughtful choices about whether to continue, eliminate, phase out, or reform each tax extender and fully pay for any costs incurred.

Last year, former Ways & Means Chairman Dave Camp (R-MI) released the [Tax Reform Act of 2014](#) which responsibly addressed the tax extenders on a permanent basis. CRFB’s [PREP Plan](#) combined a temporary extension with a fast-track process for tax reform and offset the cost with measures to improve tax compliance.



To read more about the tax extenders, see [Tax Break-Down: The Tax Extenders](#)

Social Security Disability Insurance (SSDI) Becomes Insolvent (Late 2016)

This year, the Social Security Disability Insurance (SSDI) Trust Fund will spend about \$35 billion more than it will collect in payroll taxes, and sometime in the last quarter of calendar year 2016, it will run out of reserves. At that point, without legislative change, the program's 11 million beneficiaries will see their benefits cut across-the-board by roughly 20 percent.

One option to avoid this cut would be to “reallocate” revenues currently dedicated to Social Security's retirement program, so they instead flow into the SSDI Trust Fund. But while this would avoid SSDI insolvency, it would modestly worsen the financial state of the retirement program and as the Social Security Trustees explain, “such a response might serve to delay DI reforms and much needed financial corrections for [Social Security] as a whole.”

Policymakers could instead use this deadline to pursue comprehensive Social Security reform which makes both trust funds sustainably solvent, or more incremental reforms to improve the SSDI program for its beneficiaries and contributors. (In either case, at least a temporary reallocation or interfund borrowing would be necessary during the transition). The recently-launched [McCrery-Pomeroy SSDI Solutions Initiative](#) is currently working to identify improvements to various aspects of the SSDI program.

To learn more about Social Security, see [our analysis of the 2014 Social Security Trustees' report](#).

The Need to Act Responsibly

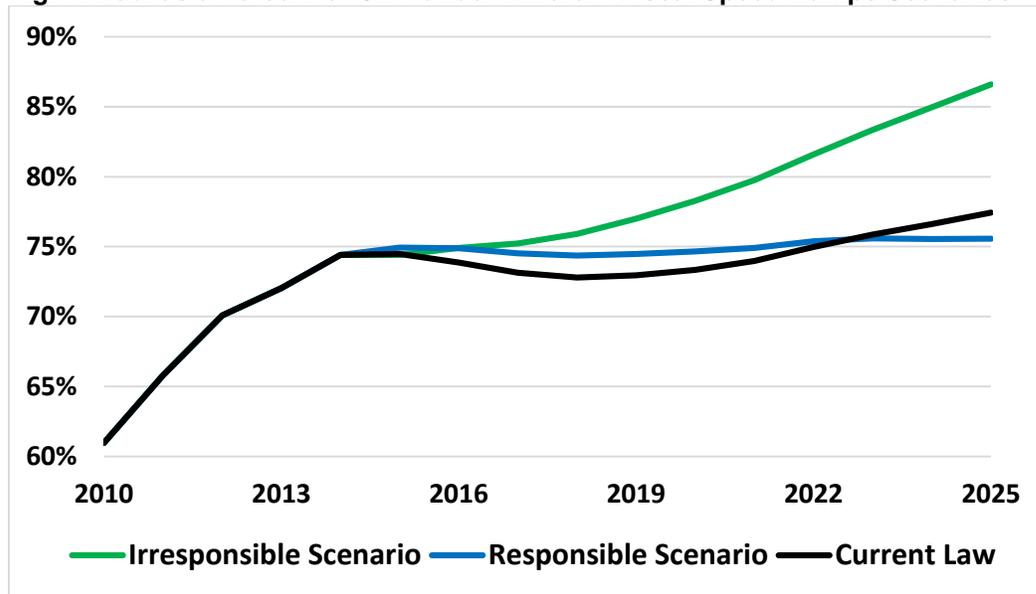
Nearly all upcoming Fiscal Speed Bumps will require some form of legislative action. In some cases, ignoring the speed bumps would cause harmful disruptions – such as an immediate 21 percent cut in physician payments or an abrupt hiatus on all new transportation projects. The consequences of hitting other speed bumps could be far more severe – leading to a full government shutdown or even a catastrophic default. Regardless, policymakers have plenty of advanced warning to be able to address each of these issues before going over a speed bump.

Yet it matters not only when policymakers address these bumps, but how. In many cases, policymakers might be tempted to opt for the politically easier, but fiscally irresponsible solutions – replacing the SGR without offsets, relying on unpaid for intragovernmental transfers to shore up insolvent trust funds, ignoring or circumventing sequestration-level caps, and permanently reinstating expired tax extenders on a deficit-financed basis.



Taken together, these changes could increase the debt by as much as \$3 trillion by 2025 relative to what current law allows, allowing debt levels to grow from 74 percent of GDP today to 87 percent by 2025, compared to 77 percent under CBO's baseline. The irresponsible approach would also waste an opportunity for policymakers to enact much-needed policy improvements.

Fig. 1: Debt as a Percent of GDP under Different Fiscal Speed Bumps Scenarios



Current law is CBO's August 2014 current law baseline adjusted by CRFB for subsequent legislation. Irresponsible Scenario includes permanent doc fix, extension of tax extenders, sequester repeal, and implicit general revenue transfers for the Highway and SSDI Trust Funds. Responsible Scenario assumes permanent doc fix, tax extenders, and partial sequester repeal with illustrative offsets and an illustrative solvency package for the Highway and SSDI Trust Funds.

Yet, if policymakers act responsibly they can use these Fiscal Speed Bumps as moments to enact important and thoughtful reforms. The expiration of the “doc fix” offers an opportunity to produce Medicare changes that would improve the value of care and slow the growth of health care costs. The expiration of the highway bill offers a chance to establish stable funding for more wisely selected infrastructure projects. Addressing the return of the sequester would allow a portion of mindless front-loaded discretionary cuts to be replaced with thoughtful long-term reforms. The need to address the “tax extenders” could be an opening to pursue comprehensive pro-growth tax reform. And the exhaustion of the SSDI Trust Fund could offer an opportunity to begin making improvements to that program and improving the financial state of Social Security as a whole.

Addressing the Fiscal Speed Bumps responsibly could dramatically improve the policy landscape and the prospects for economic growth. While they would not solve our fiscal problems, they would likely help prevent the debt from rising further over the next decade or so; an important first step. Lawmakers should take these first steps, and then build on them to put the country on a more sustainable and prosperous long-term path.