Addendum:
Decision Time: The Fiscal Effects of Extending the 2001 and 2003 Tax Cuts

September 2, 2010

In May 2010, the Pew Fiscal Analysis Initiative released *Decision Time: The Fiscal Effects of Extending the 2001 and 2003 Tax Cuts*, which examined four options for extending the tax cuts. Since then, another option has attracted attention: extending the tax cuts for only two years to individuals making less than $200,000 and married couples earning less than $250,000. Pew's analysis of the latest proposal finds that it would cost $387 billion, including interest costs, over the next decade. In contrast, a permanent extension of these tax cuts for the "middle class" (as defined in the President's fiscal 2011 budget) would cost $2.2 trillion over the next decade, while extending the cuts for everybody would cost $3.3 trillion over the same period.

Pew's original analysis was based on the Congressional Budget Office (CBO) March 2010 budget projections for fiscal years 2010-2020, which assumed that Congress would make no changes to current law. Pew used this current law baseline in order to isolate the fiscal effects of extending the tax cuts. Other analyses of deficit and debt projections use a current policy baseline that assumes the extension of certain expiring policies that are regularly or widely expected to be extended by Congress. These include adjustments to Medicare physician payments, indexing of the Alternative Minimum Tax, and extension of the 2001 and 2003 tax cuts.

CBO released a new current law baseline in the August 2010 Budget and Economic Outlook for FYs 2010-2020. The analysis below provides updated cost estimates based on this new CBO baseline for the four options included in *Decision Time*, as well as the fifth option of extending the tax cuts for middle-class taxpayers for two years.

No Extension

With no extension of the tax cuts, the August 2010 current law baseline for fiscal years 2010-2020 projects that deficits will be 7 percent of GDP in 2011 but will drop to 4.2 percent of GDP in 2012. By 2014, according to CBO, the deficit would be 2.5 percent of GDP. It would remain at or below 3 percent for the rest of the decade. The CBO also projects that with no extension the debt will continue to rise over the next two years, reaching a level of 68.5 percent of GDP in 2012. It will then decline slightly, reaching 67.3 percent of GDP in 2015, before resuming its upward trajectory, passing 69 percent of GDP in 2020.

Permanent Extension of All Tax Cuts

Extending all of the 2001 and 2003 tax cuts permanently would cost $3.3 trillion over 10 years, including interest payments on the debt. With a full extension of the tax cuts, the deficit would be 4.1 percent of GDP in 2014 and by the end of the decade would reach 5 percent. Under this scenario, public debt would reach 83.5 percent of GDP in 2020.

President Obama's Proposal for a Middle-Class Extension

The cost of a permanent extension to just the middle class as proposed in the President's FY 2011 Budget would be $2.2 trillion over the next decade, including interest payments on the debt. This proposal would cost about $1.1 trillion less over 10 years than a permanent full extension, but would result in deficits of 3.6 percent of GDP in 2014, rising to 4.3 percent in 2020. Debt would rise to 79 percent of GDP by 2020.

Two-Year Extension of All Tax Cuts

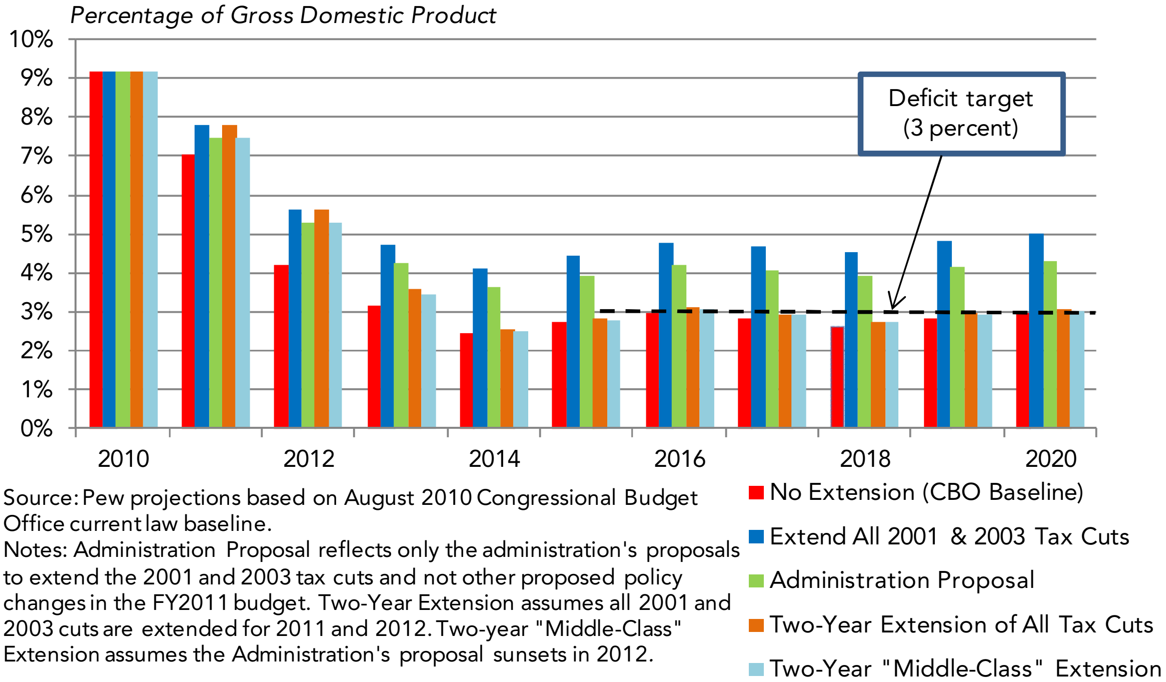
The cost of a temporary two-year extension of all the tax cuts would be $561 billion over the next decade, including interest payments on the debt. Under this scenario, the deficit would be 2.6 percent of GDP in 2014 and would rise to 3.1 percent by 2020. Debt would rise to 71.8 percent by the end of the decade.

Two-Year Middle-Class Extension

A two-year extension of the tax cuts for only the middle class would cost $387 billion including interest costs over the next decade. In 2014, the deficit would be 2.5 percent of GDP and by the end of the decade it would rise to 3.0 percent of GDP. Under this proposal, debt would reach 71.1 percent of GDP by 2020.

The figures and table below show the costs and effects on the deficit and debt of all five options.

Figure 1: Federal Deficits with Extension of 2001 & 2003 Tax Cuts



Source: Pew projections based on August 2010 Congressional Budget Office current law baseline.
Notes: Administration Proposal reflects only the administration's proposals to extend the 2001 and 2003 tax cuts and not other proposed policy changes in the FY2011 budget. Two-Year Extension assumes all 2001 and 2003 cuts are extended for 2011 and 2012. Two-year "Middle-Class" Extension assumes the Administration's proposal sunsets in 2012.

Figure 2: U.S. Debt Under Various Tax Cut Scenarios

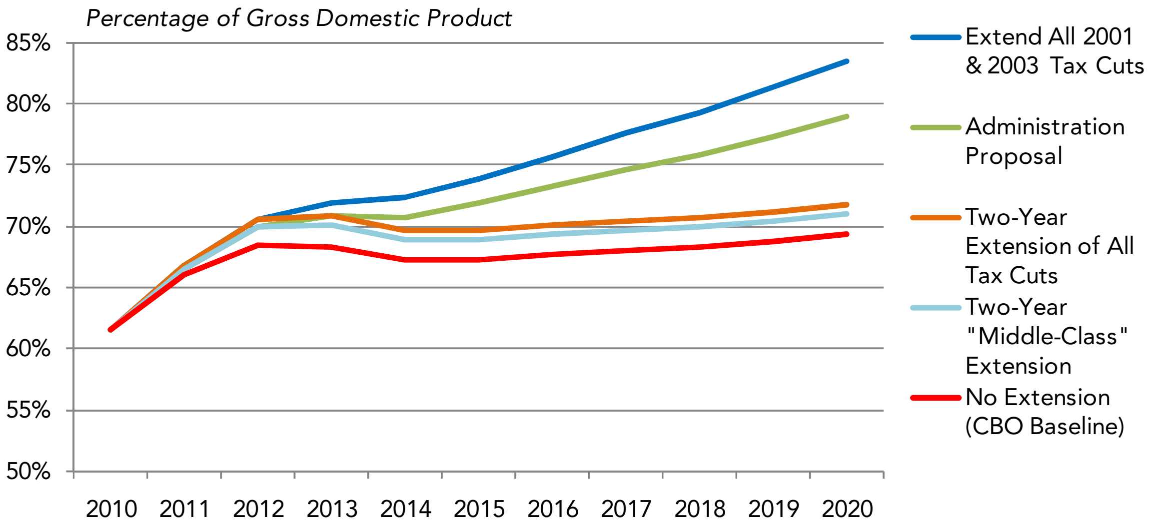


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Table 3: Cost of Tax Cut Extensions (billions of dollars, fiscal years)												
		2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total 2011-20
Extend All 2001-2003 Cuts	Direct Cost	113	218	250	263	278	288	297	305	315	325	2,652
	Interest Cost	1	6	14	26	42	61	80	102	125	150	607
	Total	114	223	264	290	320	348	377	407	440	475	3,259
Obama Proposal	Direct Cost	61	166	177	185	192	196	199	203	206	210	1,795
	Interest Cost	1	4	10	18	29	42	56	70	85	102	417
	Total	62	170	187	203	221	238	255	273	292	312	2,212
Two Year Extension of All Tax Cuts	Direct Cost	113	218	63	-	-	-	-	-	-	-	393
	Interest Cost	1	6	11	15	17	20	22	24	25	27	168
	Total	114	223	74	15	17	20	22	24	25	27	561
Two Year "Middle Class" Extension	Direct Cost	61	166	44	-	-	-	-	-	-	-	271
	Interest Cost	1	4	8	10	12	14	15	16	17	19	115
	Total	62	170	52	10	12	14	15	16	17	19	387

Note: Numbers may not sum to totals due to rounding.