Budget Control Act of 2011

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September 02, 2011

After much debate and brinkmanship, on August 2, 2011 President Obama signed the "Budget Control Act of 2011". The Act increases the federal government's debt limit by $900 billion and provides for $917 billion of spending cuts, which is achieved through the reduction of discretionary government spending over a ten year period (fiscal years 2012-2021, with the government's fiscal year 2012 beginning on October 1, 2011).

In addition, the Act establishes a Joint Select Committee on Deficit Reduction, which will consist of twelve members of Congress (six members of the Democratic party and six members of the Republican party). The purpose of the Joint Committee is to propose legislation by November 23, 2011 that will reduce the federal budget deficit by $1.5 trillion over fiscal years 2012-2021. If a proposal is made, the House and the Senate must each vote on the proposal "as-is" by December 23, 2011. If the Joint Committee's proposal is enacted, then the President would be authorized to request a debt limit increase of $1.5 trillion. If, however, the Joint Committee fails to produce a proposal or if its proposal is not enacted, then an additional $1.2 trillion of spending cuts will automatically occur and the debt limit increase is limited to $1.2 trillion. The automatic spending cuts apply to both mandatory and discretionary spending, but certain spending is exempt, such as social security, military and government employee retirement benefits, Medicaid and other welfare programs, and interest payments on debt.

A reduction in some government spending is inevitable based on the structure of the Joint Committee and the make-up of its membership. The unknown variable is whether the federal tax laws will change. The Republican members of the Joint Committee have vowed not to raise taxes while the President opposes any proposal that does not include tax increases. Possible changes to the tax laws include:

- Elimination of accelerated depreciation and bonus depreciation for businesses;
- Elimination of the LIFO method of accounting for inventory;
- Elimination of tax credits for certain industries or activities, such as oil and gas production and alternative energy;
- A reduction or elimination of deductions for individuals, such as the deduction for mortgage interest; and

- Changes in individual income tax brackets (most likely lower rates and less brackets in exchange for the reduction or elimination of deductions).

A few noteworthy issues with the Act and the Joint Committee:

- The automatic spending cuts will not occur until fiscal year 2013, which begins shortly before the next election cycle, so the impact of the cuts should not impede the re-election of the members of Congress.
- Comprehensive reform to the federal tax laws is an unlikely result of the Committee given the deadline for the Committee's proposal.
- Although the Committee proposal may include tax increases, any proposal may be rejected by either the House or the Senate or vetoed by the President.
- Whether the House or the Senate will reject tax increases is hard to gauge because the automatic spending cuts affect both Republican and Democratic priorities.
- The current Congress cannot bind any future Congress, so the proposal of the Joint Committee, if enacted into law, may only enjoy a short existence.
- If the Joint Committee fails to act or if Congress fails to adopt its proposal, then the President likely will let the "Bush" tax cuts enacted in 2001 expire (recall that these tax cuts were set to expire in 2010, but were extended until December 31, 2012).
- If the "Bush" tax cuts are allowed to expire as part of a Joint Committee proposal, any increase in revenue that results does not count against the $1.5 trillion of deficit reduction that is the mandate of the Joint Committee (current laws are not factored into the equation).
- There are several favorable tax laws, such as the AMT patch, that are set to expire this year and must be addressed (either as part of a Joint Committee proposal or otherwise).