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The U.S. Debt Limit Debate: Consequences of Global Spending Caps & Balanced Budget Amendments

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On August 2nd, the nation will reach its statutory "debt ceiling," the amount of revenue the nation is allowed to borrow to meet its current legal obligations. The U.S. Department of Treasury reports that if Congress does not act to raise the debt ceiling by August 2nd, the nation will be required to suspend a variety of legally required payments, including those for Social Security, Medicare, military salaries, payments on the national debt and more.[1] The failure of the U.S. to meet its obligations would be unprecedented and could trigger a global financial crisis. In fact, since 1960 the Congress has consistently acted to raise the debt ceiling, either temporarily or permanently, including 49 times under Republican presidents and 29 times under Democratic presidents, because there is bipartisan agreement that the move is essential.[2]

However, some policy makers are proposing to use the looming debt ceiling deadline as an opportunity to force inclusion of dangerous fiscal policy proposals in the debt ceiling legislation. These measures include global spending caps and balanced budget amendments. Although they may sound reasonable on the surface, they would have dramatic ramifications for critical federal services including Social Security, Medicare and Medicaid.

While serious attention to stabilizing the national debt and reducing deficits is certainly merited, the proposed global spending caps and balanced budget amendments would have severe long-term consequences.

Background

A recent study by the National Academy of Sciences and the National Academy of Public Administration evaluated a range of policy alternatives that would lead to a federal debt level of 60 percent of gross domestic product (GDP), a level largely considered to be sustainable. The debt level in federal fiscal year 2010 was 62 percent.[3]

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[1] United States Department of the Treasury, "Debt Limit: Myth vs. Fact," http://www.treasury.gov/initiatives/Documents/Debt%20Limit%20Myth%20v%20Fact%20FINAL.pdf, retrieved on 6/25/11

[2] Ibid

[3] Ruffing, K, Cox, K. & Horney, J. "The Right Target: Stabilize the Federal Debt," Center on Budget and Policy Priorities, January, 12, 2010. Retrieved from: www.cbpp.org

At one extreme, the study relied almost solely on spending cuts to reach the 60 percent target; at the other extreme, it relied almost solely on revenues. There were two intermediate scenarios. [4]

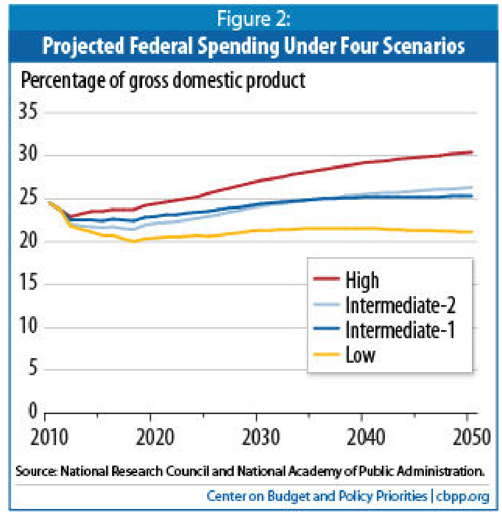

Figure 2:
Projected Federal Spending Under Four Scenarios

Source: National Research Council and National Academy of Public Administration.

Achieving the targeted debt-to-GDP ratio without raising revenues would require that federal spending be restricted to about 21 percent of GDP. However, attaining that level would require large cuts in Social Security benefits, limiting Medicare and Medicaid costs and cutting all other programs by 20 percent.[5]

The report clearly illustrates the national dilemma when addressing the national debt. However, it also provides alternatives and a context for examining policy proposals.

Global Spending Caps

Statutory limits, or "global spending caps," are often proposed as a solution to deficit spending. These caps, which are often based on historical expenditures, limit federal spending to a certain percentage of GDP. By definition, a statutory cap limits the nation's ability to respond in times of crisis or war, when costs increase. They also limit the nation's ability to adjust for changing circumstances or demographics. Because the caps don't allow for flexibility to address changing needs, they often increase risk.

In addition, most cap proposals ignore the option of raising revenues as a strategy for deficit reduction. Instead they focus exclusively on cutting federal spending, requiring significant cuts to both discretionary and entitlement programs.

Caps often fail to consider important contextual factors. For example, the Corker-McCaskill proposal, introduced earlier this year, called for limiting federal spending to 20.6 percent of GDP. This spending limit was calculated based on the average of federal spending from 1970 to 2008. The problem with using historical averages is that these are not average times. In fact, the national context is distinct in ways that would be dangerous to ignore. Key distinctions of the coming decade include:

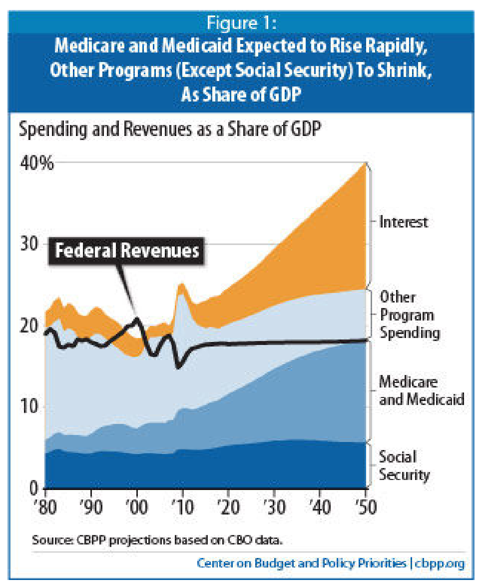

Figure 1:
Medicare and Medicaid Expected to Rise Rapidly, Other Programs (Except Social Security) To Shrink, As Share of GDP

Source: CBPP projections based on CBO data.

- An increasing aging population, which will require increased health care expenditures;
- Increased federal responsibilities and associated costs, including those for homeland security, prescription drug benefits, No Child Left Behind, and care for veterans returning from Afghanistan and Iraq;

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[4] Van de Water, P. (2011). "Corker-McCaskill Spending Cap Doesn't Account for Basic Changes in Society and Government." Center on Budget and Policy Priorities, 2011. Retrieved from: http://www.cbpp.org/cms/index.cfm?fa=view&id=3385,

[5] Ibid.

- Substantially higher spending for the federal debt relative to previous decades.[6]

As context, House Budget Committee Chair Paul Ryan's recent budget proposal included cuts that would bring federal expenditures to around 20 percent of GDP.[7] Nearly two-thirds of the reductions in that budget come from programs that serve low income families, including a $127 million reduction in Supplemental Nutrition Assistance Program (SNAP) benefits over 10 years. Ryan also proposed a block grant of Medicaid. If that block grant had been implemented in 2000, most states would have received 25 percent less in federal Medicaid funding by 2009; some states would have seen reductions of over 40 percent.[8]

While the Corker-McCaskill proposal is given as one example of a cap's potential impact, the Congress is currently considering a variety of proposals, each with its own flaws. For example, some proposed caps include automatic sequesters, or triggers, that would make automatic, across-the-board cuts in non-defense, discretionary spending. This action would disproportionately harm programs that serve low-income Americans. It also allows elected officials to avoid responsibility for budget cuts. Other versions of the cap attempt to address the concerns about lost flexibility by adding time limits to the caps. However, short-term limits, such as 2-3 year caps, may produce very limited savings. Each scenario indicates that cap proposals are flawed, regardless of how the design may be tweaked.

Balanced Budget Amendments

Other policy makers are advocating a constitutional amendment requiring a balanced federal budget. Because Balanced Budget Amendments are constitutional, they would be nearly impossible to adjust, even if significant flaws are later identified.

Balanced Budget Amendments broadly require that spending occur in the same year that revenue is generated. As a result, even past investments for specific budget areas such as Social Security benefits could not be used as intended.

Balanced Budget Amendments also make no provisions for changes in the economy or times of war, when spending would need to increase. Instead, during these times, policymakers would be forced to either cut spending, raise taxes, or both just when the economy is weak or already in recession.

Some versions of the balanced budget amendment currently being proposed would require a 2/3 vote of Congress to raise taxes, and set spending caps of 18 percent of GDP.

A Better Approach

There are better ways to address federal budgetary issues.

- **A balanced approach.** Any sound policy proposal for deficit reduction would require reductions in the deficit that are evenly balanced between revenue increases and spending reductions, including reductions on defense and non-defense spending.

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[6] Van de Water, P. (2011). "Corker-McCaskill spending Cap Doesn't Account for Basic Changes in Society and Government." Center on Budget and Policy Priorities, February 2011. Retrieved from: http://www.cbpp.org/cms/index.cfm?fa=view&id=3385

[7] Greenstein, R., Horney, J. and Merrick, K. "Balanced Budget Amendment Would Require More Extreme Cuts Than Ryan Plan." Center on Budget and Policy Priorities, June 2011. Retrieved from: http://www.cbpp.org/cms/index.cfm?fa=view&id=3508.

[8] Park, E and Broaddus, M. "What if Ryan's Medicaid Block Grant Had Taken Effect in 2000." Center on Budget and Policy Priorities, April 2011. Retrieved from: http://www.cbpp.org/cms/index.cfm?fa=view&id=3466

- **Protection of low-income families**. To date, budget proposals have largely focused on mandatory cuts to non-defense, discretionary programs, which make up less than 14 percent of the federal budget. These are the programs most likely to serve low-income families, including Head Start and Low-Income Home Energy Assistance Program (LIHEAP). Protection of services for low-income families has been included in all previous bipartisan deficit reduction plans.

Global spending caps and Balanced Budget Amendments will not solve the nation's national debt, and are likely to exacerbate struggles.