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ENTITLEMENT CAP PROPOSAL WOULD REQUIRE CUTS OF $1.8 TRILLION OVER THE NEXT TEN YEARS

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Proposals are now emerging to "cap" expenditures for entitlement programs at levels far below the cost of those programs under current law — and to require automatic across-the-board cuts in entitlements if the caps would be breached. The leading such proposal is an entitlement cap included in legislation recently introduced by four conservative House Republicans (the "Family Budget Protection Act," introduced by Reps. Jeb Hensarling, Paul Ryan, Chris Chocola, and Christopher Cox).

If enacted, the Family Budget Protection Act would trigger the most severe budget cuts in modern U.S. history, requiring entitlement cuts of *$1.8 trillion* over the next ten years. If the required cuts were made proportionally across all entitlements other than Social Security (which is outside the caps), the cumulative ten-year cuts would reach almost $800 billion in Medicare and nearly $400 billion in Medicaid. Numerous other entitlement programs, including veterans benefits, military retirement, farm programs, student loans, the school lunch program, the Earned Income Tax Credit, and virtually all basic assistance programs for the poor also would be hit (see table).

Table 1
Total Entitlement Cuts Over 10 Years Under H.R. 3800, If All Entitlements Are Cut Proportionately
(in billions of dollars)

Medicare	-797
Medicaid	-392
Federal civilian retirement and disability	-117
Unemployment Compensation	-69
Military retirement and disability	-67
Supplemental Security Income	-63
Earned Income Tax and Child Tax Credits	-54
Veterans benefits'	-53
Food Stamps	-43
TANF, child care, child support enforcement	-37
Child Nutrition	-23
Commodity Credit Corporation	-21
Other federal retirement and disability	-14
TRICARE for Life	-13
Foster Care and Adoption Assistance	-13
Student loans	-11
Universal Service Fund	-10
State Children's Health Insurance	-8
Social services	-7
Other miscellaneous	-23
TOTAL	**-1,834**

By 2010, the required entitlement cuts would reduce these programs by nearly one-fifth, compared with current-law levels, cutting the programs by $226 billion in that year alone. By 2014, the cuts would reach almost $300 billion a year. State governments would likely be among those heavily affected, with possibly hundreds of billions of dollars in costs for programs such as Medicaid shifted to the states.

In addition to requiring deep cuts, the proposed entitlement cap mechanism would generate an array of disturbing anomalies that raise crucial questions about the cap's fundamental fairness and integrity.

- Many entitlements programs would likely be cut regardless of whether their costs are rising significantly or whether the programs have contributed to the return of deficits. Virtually the entire $1.8 trillion amount by which entitlement spending would have to be cut below the levels projected under current law is the result of two factors that cause entitlement costs to rise faster than the caps would allow — increases in health care entitlements and increases in interest payments on the national debt. (Interest payments are treated as an entitlement program under the proposed cap.) The Congressional Budget Office projects that the overall cost of all entitlement programs *other than* Medicare, Medicaid, and interest payments actually will *decline* as a share of the economy between 2005 and 2014. Nevertheless, these other programs would likely be subject to large cuts under the proposal.

- The cost of the new Medicare drug benefit that was enacted last year is one of the principal reasons that entitlement costs would exceed the caps. The caps are based on entitlement spending in *2005*, while the major costs of the drug benefit do not begin until *2006*. As a result, virtually all of the costs of the drug benefit would be considered "excess costs," requiring offsetting cuts in Medicare or other entitlements. This would be the case even if spending on the drug benefit turns out to be at or below the levels originally projected.

- Because interest payments would be counted as an entitlement under this proposal, the enactment of tax cuts — including the extension of expiring tax cuts — would trigger *deeper* entitlement cutbacks. By adding to deficits and thereby increasing the debt, tax cuts cause interest payments on the debt to rise. Thus, the more that taxes are cut and interest payments consequently increase, the deeper the entitlement cuts would have to be to avoid a breach of the entitlement cap.

- Under the proposed entitlement cap, the deepest cuts could occur in years when the economy is weak, even though that could push a faltering economy into recession and cause existing recessions to become deeper and more protracted. When the economy slows, incomes decline, causing families eligible for programs such as food stamps to qualify for larger benefits on average, and causing entitlement spending to rise. The increased spending on these programs helps to stabilize the economy when it is weak. Cutting entitlements when the economy slows, however, as would be required under the proposal, would have the *opposite* effect, aggravating economic downturns.

Fundamentally, the proposed entitlement cap would cause deep and disruptive cuts in entitlement programs as a result of events that have little to do with possible defects in the programs or the actions of policymakers. For instance, the increase in the cost of health care is a principal reason that entitlement costs would exceed the caps. Yet the rising costs of Medicare and Medicaid are due not to some flaw in those programs but to the aging of the population, advances in medical technology that improve health and prolong life — especially in old age — but raise health care costs, and to other factors in the U.S. health care system that impact on both public- and private-sector health costs. Indeed, the per-beneficiary costs in Medicare and Medicaid are rising a bit more slowly than health care costs in the private sector.

Similarly, the single biggest reason that entitlement costs would exceed the caps and require $1.8 trillion in cuts is that interest payments on the debt are projected to rise substantially over the coming decade. Yet interest payments will increase in part because interest *rates* are expected to rise from their current, unusually low levels, reflecting economic trends over which policymakers have little or no control.

Interest payments also are projected to rise because the deficits we are now running increase the national debt each year and thereby raise the principal on which interest must be paid. A portion of the current deficit can be attributed to the current state of the economy. To the extent that actions by policymakers have contributed to the dramatic shift from budget surpluses to deficits (and hence to increases in interest payments), CBO data show that tax cuts and increased spending on defense and homeland security are by far the largest factors, dwarfing the impact attributable to changes in the entitlement programs that would be the target of the proposed caps. Over the ten-year period from 2002 to 2011, the cost of the tax cuts enacted since January 2001 will be four times the cost of the entitlement increases enacted since 2001, assuming the tax cuts are extended.

Finally, despite the wide-ranging nature of this entitlement cap proposal, it exempts an entire class of entitlement programs that Federal Reserve Board Chairman Alan Greenspan has called “tax entitlements” and the Joint Committee on Taxation refers to as “tax expenditures.” These are the many hundreds of billions of dollars of entitlement-style subsidies that are delivered through the tax code, via special tax breaks, write-offs, shelters, and the like. Whereas middle-class and low-income Americans receive the bulk of their government benefits through spending entitlements, wealthy individuals and corporations receive the majority of their government benefits and subsidies through tax entitlements. By exempting tax entitlements from the cap, the proposal effectively favors affluent individuals and powerful corporations over ordinary Americans.

The following analysis examines the entitlement cap provisions of the Family Budget Protection Act.

How the Entitlement Cap Would Work

Starting in 2006, a ceiling would be placed each year on total “mandatory” (or entitlement) spending outside of Social Security. The ceiling or cap would be set each year by taking spending for each entitlement program in the prior fiscal year, adjusting the spending levels for certain entitlements (the specific adjustments that would be made are described below), and adding up the resulting amounts for each entitlement program. The total amount would be the level at which the cap is set.

The caps would be binding. If total entitlement spending outside Social Security for a fiscal year would exceed the cap for that year and Congress did not pass legislation cutting entitlements enough to fit within the cap, entitlement cuts would automatically be triggered. The automatic cuts would have to be of sufficient magnitude to shrink entitlement spending so it fits within the cap. Once a program is cut by such an automatic reduction — such as by cutting benefit levels or reducing the federal share of the costs of a joint federal-state program — the reduction would be *permanent.*

OMB would determine, when Congress adjourned each fall, whether automatic entitlement cuts were needed that year. OMB would estimate whether the cost of entitlements in the fiscal year that had just started (on October 1) would breach the entitlement cap. If so, the President would be required to order the automatic entitlement cuts.

A few entitlements would be exempt from these automatic cuts, and the magnitude of the cuts in some other programs would be limited. All other entitlements would be cut across-the-board as deeply as needed to shrink total entitlement spending enough to fit within the cap. Except for Social Security, the costs of entitlements exempt from the automatic cuts would still be counted in determining whether the cap would be breached, and Congress could cut such entitlements as part of efforts to reduce entitlement programs enough to hit the cap without triggering the automatic cuts.

If some Members of Congress sought to raise the entitlement cap for a year or otherwise to prevent the across-the-board cuts from being implemented, they would likely find it difficult to pass legislation to accomplish those ends. Such legislation would require 67 votes in the Senate.

As noted, the entitlement cap for each year would equal total entitlement spending for the prior year, outside Social Security, with some adjustments. Two adjustments would be made.

- First, if a statute governing an entitlement program mandates an inflation adjustment in the program — such as the annual cost-of-living adjustments in civil service and military retirement programs or the annual “cost-of-food” adjustments in the school lunch and food stamp programs — the cost of these entitlements in the prior year would be assumed to increase by the amount of the inflation adjustments.[1] In programs for which there is no statutory inflation adjustment — such as Medicaid, Medicare (outside of certain provider reimbursement payments), and interest payments on the debt — no such adjustment apparently would be made.

- Second, the cost of an entitlement program in the prior year would be adjusted to reflect changes in the estimated size of the population eligible for the program, where such an adjustment is applicable.

[1] The specific wording of H.R. 3800**,** the Family Budget Protection Act, calculates the cap by assuming that the cost of an entitlement in the prior year will be “increased by the inflator (if any) applicable to that program.”

Factors Beyond Policymakers' Control that Could Cause the Entitlement Cap to be Breached and Cuts to be Required

The following are a few of the unforeseen and uncontrollable factors that could boost entitlement costs and consequently require cuts (or require deeper cuts) in entitlement programs. Most of these factors would increase costs only on a temporary basis. But all of the entitlement reductions made as a result of the across-the-board cuts would be permanent.

Entitlement costs would rise — and cuts consequently would be required — if:

- *Interest rates increased*, because that would make interest payments on the debt and student loan subsidies more expensive;
- *The federal government ran a deficit of any size*, because that would increase the debt and thereby result in an increase in interest payments;
- *International harvests improved*, because farm prices would fall as a result and price support costs would rise;
- *Unforeseen weather conditions damaged some crops,* because that could cause crop insurance costs to increase;
- *A flu epidemic occurred or some other disease spread*, raising health-care costs, or a new treatment were developed for a major illness that improved patients' health but increased costs;
- *Taxes were cut or revenues rose more slowly than expected for other reasons,* such as because of more widespread use of a tax shelter, because that would cause deficits to increase and interest payments on the debt to rise;
- *Incomes fell during an economic slump*, especially for low-wage working families, because that would make them eligible for larger benefits in programs such as food stamps and the Earned Income Tax Credit.

These adjustments would be highly inadequate. They ignore the factors that cause health care costs in the United States to rise each year in the private and public sectors alike. They also ignore an array of other factors that raise entitlement costs — usually on a temporary basis — for reasons beyond policymakers' control, such as declines in income during a recession, weather conditions and other factors that affect the prices of agricultural commodities, and increases in interest rates that raise the cost of interest payments on the debt. (See box above.)

Proposal Would Lead to Severe Cuts

The Congressional Budget Office publishes data on the projected growth of mandatory spending over the coming decade. CBO breaks out the components of entitlement spending growth, showing how much is due to inflation adjustments required by law, how much is due to projected increases in caseloads, and how much is due to other factors.[2]

[2] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2005 to 2014*, January 2004, Table 3-7. We have updated the figures in the CBO table to reflect CBO's revision to its baseline, issued February 27, 2004. We assume that the minor increases in estimated entitlement growth shown in the February CBO report

The CBO data show more than $1.6 trillion in increases in entitlement expenditures over the coming decade (between 2006 and 2014) for reasons *other than* statutory inflation adjustments or caseload growth. (We exclude 2005 because the proposed entitlement cap would not take effect until 2006.) This would seem to mean that the proposed entitlement cap would require $1.6 trillion in entitlement cuts.

The required cuts, however, would be even deeper than that. Not included in this CBO table are two other forms of mandatory spending — "offsetting receipts" and interest payments on the debt. Under the Family Budget Protection Act, both of these forms of mandatory spending are counted as entitlement costs. The inclusion of interest payments under the entitlement cap has especially large effects. As noted, no statutory inflation adjustment applies to interest payments, nor is the concept of "growth in the eligible population" relevant. As a result, all increases in interest payments — above the level of interest payments made in 2005 — would count as "excess" spending and would push entitlement spending further above the caps, necessitating deeper cuts.

Interest payments on the debt in 2006-2014 are projected to be a total of $1.1 trillion above the 2005 level, if the 2001 and 2003 tax cuts are *not* extended and relief from the Alternative Minimum Tax is allowed to end. If, as is more likely, the tax cuts are extended and AMT relief is continued, interest costs will rise even more. We use here the very conservative $1.1 trillion figure. This means that another $1.1 trillion (at a minimum) must be added to the amount by which overall entitlement costs would exceed the caps.

The growth in offsetting receipts (such as Medicare premiums) works in the other direction, partly offsetting the growth of gross entitlement spending. Together, the inclusion of interest payments and offsetting receipts brings the total amount by which entitlements under current law would exceed the proposed caps to at least $2.2 trillion over the period 2006-2014.

Cuts in entitlements that save at least $2.2 trillion consequently would have to be made. Since cuts made in entitlement programs would produce some savings in interest costs, the actual program cuts that would be needed would amount to at least $1.8 trillion. These $1.8 trillion in entitlement program reductions would generate total savings — including savings in interest payments — of $2.2 trillion and thereby could shrink overall entitlement spending enough to fit within the caps.

Rising Health Care Costs and Interest Payments Account for *All* of the "Overage"

The CBO data show that two factors account for *all* of the $2.2 trillion amount by which entitlement costs would rise for reasons other than statutory inflation adjustments and changes in the size of eligible populations.[3] These two factors are:

are not related to indexing or the number of eligible participants because CBO did not alter its economic assumptions between January and March and because virtually all of the changes occurred in Medicare, Medicaid, interest, and offsetting receipts, programs whose costs are frequently re-estimated for reasons unrelated to changes in caseload.

[3] Increases in the cost of Medicare, Medicaid, and interest payments account for more than 100 percent of the "excess" entitlement growth. The growth of offsetting receipts such as Medicare premiums reduces the figure, so

Development of New Colon Cancer Drug Illustrates How Medical Advances Can Raise Costs

In February, the Food and Drug Administration approved a new drug, Avastin, for use in standard chemotherapy treatments of colon cancer that has metastasized. In an indication of the importance that cancer-care professionals assign to approval of this drug, FDA Commissioner Mark McClellan personally made the announcement. Avastin, the first drug of its kind that the FDA has approved, works by restricting blood vessels that supply cancerous tumors with oxygen and nutrients.

Private insurers, Medicare (under its new prescription drug benefit), and state Medicaid programs are expected to cover the drug. Genetech, the manufacturer of Avastin, expects the drug to cost $4,400 per patient per month.

- *Increases in Medicare and Medicaid costs for reasons other than caseload growth*. These increases reflect both rising health care costs in the United States and the cost of the new prescription drug benefit.

- *Increases in interest payments on the national debt*. CBO projects that interest payments will rise both because interest rates are expected to climb in coming years from their current, very low levels and because tax cuts, defense and domestic spending increases, the recent economic slump, and the retirement of the baby-boom generation are resulting in deficits and hence in increases in the national debt.

The CBO data also show that after offsetting receipts are taken into account, 100 percent of the $2.2 trillion "excess cost" (i.e., of the increase in cost for reasons other than statutory inflation adjustments or caseload growth) is found to stem from growth in Medicare, Medicaid, and interest payments on the debt. (See footnote 3.) In other words, the *other* entitlements do not contribute to "excess costs." Moreover, the CBO data show that the total cost of entitlements other than Social Security, Medicare, Medicaid, and interest payments will *decline* significantly as a share of the economy over the coming decade, falling from 3.3 percent of GDP in 2004 to 2.7 percent in 2014.

In short, the other entitlements are not contributing to projected increases in the deficit. Yet many of them would likely be hit hard under the proposed entitlement cap.

Implications of These Findings

Outside of growing interest payments on the debt, all of the "excess" entitlement expenditures that the Family Budget Protection Act seeks to eliminate stem from the rapid rate at

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that Medicare, Medicaid, interest, and offsetting receipts together explain exactly 100 percent of the "excess" entitlement growth.

Note that we assume here that CBO's projections of the cost of caseload growth in the entitlement programs is equal to increases in costs that will occur as a result of "growth in eligible population," which is the term used in the Family Budget Protection Act. Although the two are not identical, caseload growth generally reflects increases in the size of the eligible population, such as increases in the number of people who will be eligible for Medicare, Medicaid, and SSI as the U. S. population ages.

which health care costs are rising. That health care costs in the United States are rising rapidly is not due to flaws in Medicare and Medicaid. Health care costs in the private sector are rising just as fast, if not faster. These cost increases generally reflect advances in medical technology, as well as other factors endemic to the U.S. health care system.

This fact is highly significant. It means that sharply reducing the rates of growth in Medicare and Medicaid costs *without* achieving equivalent reductions in the rate of growth in health care costs system-wide — i.e., in the private sector as well as in the public sector — can generally be accomplished only in one or more of five ways:

- by curtailing eligibility for Medicare and Medicaid and thereby pushing large numbers of low-income or elderly and disabled Americans into the ranks of the uninsured;

- by substantially scaling back the types of health care services and treatments covered by Medicare and Medicaid, with the result that major ailments or illnesses could go untreated and Medicaid and Medicare could end up offering second-class health care;

- by shifting a significant share of the costs of these programs (or at least of Medicaid) to the states;

- by shifting costs from Medicare and Medicaid to the private sector and making health care providers raise their charges to private-sector payers (such as employers and insurance companies, and ultimately the people whom they insure) to make up for their losses in treating Medicare and Medicaid patients; or

- by increasing Medicare premiums, deductibles, and co-payments substantially and thereby shifting more costs directly onto the elderly and people with disabilities.

The proposed entitlement caps would inevitably lead to deep cuts in Medicare and Medicaid that result in millions of vulnerable Americans becoming uninsured or underinsured (and/or in costs being shifted on a large scale to states, the private sector, or beneficiaries), to deep cuts in an array of *other* basic programs that are well-behaved and whose costs are *not* rising faster than inflation and growth in the number of people eligible for these programs, or to both types of actions.

Other Basic Problems With the Proposal

1. The Proposal Would Represent Extremely Unwise Economic Policy that Could Make Recessions More Frequent and Deeper

Under the proposal, entitlements would have to be cut deeply regardless of whether the economy was weak in a particular year and in need of stimulus. In fact, the proposal would cause the cuts to deepen when the economy turns down.

This is because the per-beneficiary costs of some entitlements, such as food stamps and the Earned Income Tax Credit, increase when family incomes fall and people who already receive these benefits qualify for larger average benefits as a result. Incomes typically fall when the economy sours, thereby raising the costs of these programs. As a result, the amount by which entitlement spending would exceed the cap — and hence the magnitude of the cuts that would be required to fit within the caps — would grow when the economy weakens.

The deeper cuts that would have to be instituted during recessions would aggravate the nation's economic problems. Such cuts would weaken consumer demand and consumer spending further and cause the economy to slow even more, causing the loss of additional jobs.[4]

2. Proposal Raises Serious Equity Concerns

As noted, the entitlement expenditures that would be considered excess expenditures under the proposal are almost entirely the result of increases in health care costs and interest payments on the debt. The required cuts are so large, however, that it is likely most entitlement programs would be cut.

Indeed, if Congress and the President could not agree on cuts deep enough to fit within the cap in any year, across-the-board entitlement reductions would be triggered automatically, and all but a few programs would be hit. Social Security, civil service retirement, regular, state-funded unemployment benefits, and interest payments on the debt would be the only major entitlement programs exempt from the across-the-board reductions. All other entitlements would be cut. (See the box on page 11.)

It also may be noted that the entitlement cap would essentially require cuts in other entitlements to pay for the cost of the new Medicare drug benefit, since the drug benefit is one of the principal reasons that entitlement costs would exceed the cap. The cap would be based on entitlement expenditures in 2005. Since the drug benefit would not be instituted until 2006, virtually all of the costs of the drug benefit would be considered excess costs.

In unveiling his tax cut in 2001, President Bush declared there would be plenty of money left over after his large tax cut to finance a drug benefit without pushing the budget into deficit. He turned out to be seriously mistaken. But rather than consider scaling back (or not extending) some parts of the 2001 tax cut to help pay for the drug benefit, proponents of the entitlement cap favor making permanent both the 2001 and the 2003 tax cuts — including tax-cut provisions that confer very large tax benefits on the wealthiest Americans — while cutting an array of basic benefit programs for poor and middle-income families and elderly and disabled people to offset the cost of the drug benefit.

Moreover, the high cost of health care and the rapid rate of increase in health care costs stem in substantial part from problems in the structure of health care in the United States, as compared to other western industrialized countries where health care consumes a significantly

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[4] The Family Budget Protection Act includes an adjustment to cover increases in entitlement costs that result from more people becoming eligible for programs during a recession. But the bill makes no adjustment to cover the increased costs of various benefits for *already eligible* households who qualify for larger benefits during a downturn because an earner in the family is laid off or has his or her work-hours cut back. Nor does it reflect that during recessions, the share of eligible people who choose to apply for benefits may rise because eligible people are in worse financial shape than during more normal times.

smaller share of the economy. Since the demise of the Clinton health care plan in 1994, however, policymakers have been afraid to tackle the restructuring of the U.S. health care system. Indeed, the recent Medicare drug bill was replete with dubious subsidies for HMOs, PPOs, and some other providers — and kid glove treatment for the pharmaceutical industry — despite the fact that those features of the legislation increased its cost.

The high cost of health care in the United States is not due primarily to irresponsible behavior by elderly and disabled Medicare beneficiaries or by low-income families and elderly and disabled people insured through Medicaid. Under the proposed entitlement cap, however, Medicare and Medicaid beneficiaries would likely be among the principal victims. A feature of the entitlement cap proposal that stands out is the high probability that it would heavily punish the innocent.

3. Favoring the Wealthy and Powerful Over Ordinary Americans

The proposal would favor affluent individuals and powerful corporations over ordinary Americans. Middle-class and low-income Americans receive the bulk of their government benefits and subsidies through entitlement programs — Medicare, Medicaid, student loans, veterans benefits, school lunches, Supplemental Security Income for the elderly and disabled poor, and the like. By contrast, affluent Americans and corporations receive the bulk of their government subsidies through the tax code.

Each year, both OMB and the Congressional Joint Committee on Taxation, Congress' official scorekeeper on tax matters, publish a list of what they term the "tax expenditures" in the federal tax code. As this term implies, these items are akin to spending programs, except that they are embedded in the tax code. Tax expenditures are measures through which the tax code is used to provide subsidies to various individuals and businesses.

These tax expenditures effectively operate as entitlements. They are not limited by a fixed amount that Congress appropriates each year. In most cases, their cost is open-ended. This is why, in testimony before the Bipartisan Commission on Entitlement and Tax Reform in 1994, Federal Reserve Chairman Alan Greenspan explicitly called these measures "tax entitlements" and urged that deficit reduction efforts consider both spending entitlements and tax entitlements.

These tax entitlements are costly. OMB estimates that tax expenditures cost many hundreds of billions of dollars a year.[5]

But the entitlement cap proposed in the Family Budget Protection Act protects these tax entitlements. It exempts them from the entitlement cap. It even goes one step farther: it would bar restraining a tax entitlement, such as an abusive corporate tax shelter, as a way to reduce entitlement costs so they fit within the entitlement cap.

[5] President's 2005 Budget, Analytical Perspectives. Although OMB estimates the cost of each individual tax expenditure, it does not provide an estimate of the combined cost of all tax expenditures because it does not measure the interaction effects among tax expenditures.

How the Across-the-Board Cuts Would Work

Under the Family Budget Protection Act, if across-the-board entitlement cuts are triggered because the entitlement caps would otherwise be exceeded, almost all entitlement programs would be treated in one of three ways. They would be exempt from the across-the-board cuts, cut no more than two percent, or cut by whatever percentage is needed to shrink overall entitlement spending enough so it fits within the cap.

Only a few programs would be exempt from the across-the-board cuts. These include Social Security, Medicare Part A (hospital services) and Part C (Medicare "Choice" plans), civil service retirement, and regular (state-funded) unemployment benefits. It should be noted that Congress could cut any of these programs except Social Security if it sought to enact legislation to reduce entitlement spending in order to avert the across-the-board cuts.

Programs that would be cut no more than 2 percent include Medicare Part B (physician services) and Part D (the new drug benefit), some (but not all) low-income benefit programs (such as Medicaid), the military retirement program, and veterans pensions and veterans disability compensation. These programs could be cut two percent each time an across-the-board cut is triggered. If across-the-board cuts were triggered in five years, these programs could be cut close to 10 percent by the fifth time such a cut was instituted. In addition, if Congress sought to pass legislation to reach the caps *without* triggering the across-the-board cuts, there would be no limit on the magnitude of the cuts that could be made in these programs.

Finally, there are the programs in which there would be no limit on the depth of the across-the-board cuts. These programs include, among others:

- The refundable portion of the Earned Income Tax Credit and the Child Tax Credit
- Student loans
- Extended unemployment benefits, which are paid during economic downturns in especially hart-hit states
- Farm-price supports and crop insurance
- Trade adjustment assistance
- Child care
- Vocational rehabilitation
- The Social Services Block Grant
- Child support enforcement
- Tricare-for-life, which provides health benefits to military retirees age 65 or older
- The Universal Service Fund, which makes payments to telecommunications carriers to subsidize universal coverage in high-cost or low-income areas.

The entitlement cap thus is highly imbalanced. New tax entitlements could be created, and existing ones could be expanded. No limit or restraint would be placed on such activity. But program entitlements for the middle class and the poor would be cut deeply.

An example may help illustrate the imbalanced nature of this approach. The federal government provides child care subsidies to households at all income levels. The child care subsidies provided to low- and moderate-income households are provided through spending programs. Funding for those programs is tightly controlled, with the result that only about one in seven low- or moderate-income families that meet the eligibility criteria for these child care subsidies actually receives a subsidy. Child care subsidies also are provided to higher-income families, with those subsidies being provided through several tax expenditure provisions, including a provision under which the child care subsidies are worth the most to people in the highest income-tax brackets. Furthermore, unlike the child care subsides for the lower-income families, which are limited to about one-seventh of the families that qualify, the child care tax subsidies for the high-income families are available to *every* family that meets the criteria for these tax subsidies.

Under the proposed entitlement cap, the child care subsidies for the lower-income working families could — and likely would — be cut. The subsidies for the higher-income families would not be touched. Moreover, any effort to even this out — by modestly scaling back the child-care tax subsidies for higher-income families so that the subsidies for the lower-income families would not be cut as deeply — would be prohibited.

Another example involves the Earned Income Tax Credit, a key tax benefit for the working poor. EITC payments that exceed a family's income tax liability are technically considered "mandatory spending." Such payments, however, often simply offset the payroll and federal excise taxes the family pays. Under the proposed entitlement cap, the EITC would be counted as an entitlement and subject to the across-the-board cuts. The proposed entitlement cap thus could — and in all likelihood, would — lead to tax increases on the working poor even as it protected tax breaks and tax cuts for the well-to-do and left the door open to more such tax cuts.

4. Cost Shifts to States

State governments likely would be hit hard under the entitlement cap. The proposed cap could lead the federal government to comply with the cap partly by shifting billions of dollars in costs to the states.

If across-the-board reductions were triggered, Medicaid would be cut. Those Medicaid cuts would be instituted by reducing the federal share of state Medicaid costs and thereby saddling states with costs that the federal government is supposed to cover. The reduction in the federal share of state Medicaid costs would be permanent. Grants to states for child care, social services, and vocational rehabilitation, among other areas, also would be cut.

The end result would likely be an unfunded mandate of extremely large proportions, with states subject to various federal requirements regarding these programs but with a significant amount of federal funding having been withdrawn. We have already seen during the current state fiscal crisis that pressure on state budgets can result in large cuts in programs in various areas, including education and health care, along with increases in taxes and fees that many middle-class and low-income families pay, such as increases in tuition at state universities and colleges.

5. Incentives for Budget Gimmicks

Finally, the entitlement cap would create powerful incentives for policymakers to resort to rosy economic forecasts and other budget gimmicks to make it appear as though entitlement caps were being met. The pressure to resort to such devices would likely become intense in election years. As occurred in response to the Gramm-Rudman-Hollings law in the late 1980s, the proposed entitlement cap would likely spawn maneuvers to shove entitlement costs into the following year, to accelerate offsetting receipts into the current year, and to use highly optimistic economic and technical assumptions to make it appear as though entitlement costs would be lower than they actually will be.

Conclusion

Efforts to restore fiscal discipline should cover all parts of the budget — entitlements, taxes, and discretionary (i.e., non-entitlement) programs. But an “entitlement cap” is an exceedingly ill-advised way to approach this matter. It represents unsound economic policy, requiring the deepest cuts when the economy weakens and thereby risking making recessions more frequent and deeper. Entitlement caps also raise severe equity problems: they would likely lead to large cuts in important programs that are not rising rapidly in cost or contributing to deficits, and would tend strongly to favor the well-to-do over middle- and low-income families and state governments. Entitlement caps also could disrupt the delivery of health care in the United States.

The entitlement cap proposal in the Family Budget Protection Act would do substantial damage, requiring $1.8 trillion in cuts over ten years. Under this legislation, these massive reductions would be implemented at the same time that the large tax reductions for the nation’s wealthiest individuals enacted in recent years were continuing to phase in, untouched by fiscal constraints.