

January 7, 2013

Commentary

Next Round on the Deficit: Big Dangers Ahead for the Economy, the Budget, and Low-Income People

By Robert Greenstein

In recent days, policymakers, pundits, and the media have debated whether the “fiscal cliff” budget deal was a victory or defeat for the President or congressional Republicans, progressives or conservatives, rich or poor, the economy or the deficit — you name it. Most of the commentary is unpersuasive, however, for one basic reason: the fiscal cliff deal is only one stage in a broader budget battle, and you can’t render a legitimate judgment on that effort until the next stage — which includes the scheduled across-the-board spending cuts known as “sequestration” and, especially, the need to raise the debt limit — is completed.

What’s important at this point is not assessing winners or losers but, instead, understanding what lies ahead. That’s because what lies ahead is truly frightening. Indeed, it could (though it doesn’t have to) produce outcomes that are far more damaging to the economy, sound fiscal policy, and low-income and vulnerable Americans than anything that policymakers and experts feared from the fiscal cliff.

So, let’s look ahead to the next 60 days and their potentially monumental ramifications for our country, our economy, and our people.

The Big Challenges and Threats

As many fiscal policy analysts agree, policymakers must generate sufficient deficit reduction to achieve the key economic goal of stabilizing the debt over the coming decade so that it stops rising faster than the economy grows. Policymakers generated about \$1.7 trillion in deficit reduction in 2011 (\$1.5 trillion in discretionary spending cuts, plus the associated interest savings, primarily

through the Budget Control Act, or BCA).¹ That left a need for another \$2 trillion in deficit reduction to stabilize the debt.²

Entering the fiscal cliff negotiations, there were two main barriers to achieving deficit reduction in an equitable and balanced manner that honors the principle, as enunciated by the National Commission on Fiscal Responsibility and Reform (“Bowles-Simpson”) and reflected in major deficit-reduction deals of recent decades, that deficit reduction shouldn’t harm low-income and vulnerable Americans or increase poverty — and that doesn’t disrupt the economy:

1. Apparent Republican unwillingness to raise taxes; and
2. The destructive notion, sometimes called the “Boehner rule” (for House Speaker John Boehner), that Congress should only raise the debt ceiling if it’s accompanied by at least a dollar in new spending cuts for each dollar that the debt limit is raised.³ Under this rigid formula, cuts in programs that are critical for future economic growth or that serve the nation’s poorest people count, while savings from curbing unproductive, special-interest tax subsidies do not.

Moreover, the Boehner rule would require the most radical transformation of government in nearly a century; if policymakers enacted all of the cuts in the severe, House-passed budget of House Budget Committee Chairman Paul Ryan, they would still eventually fall short of adhering to the Boehner rule. They would have to eliminate more and more of the basic functions of government over time.

The Lost Opportunity

The fiscal cliff negotiations appeared to offer a singular opportunity for more rational, balanced, and comprehensive deficit reduction.

Republicans needed the agreement of President Obama and the Democratic-run Senate in order (1) to extend President Bush’s tax cuts (which were scheduled to expire at the end of 2012), including any tax cuts that Republicans could salvage for people who were making over \$250,000 a year, and (2) to preserve as much as they could of the estate-tax break for the nation’s wealthiest estates that Republican leaders extracted from the President in their negotiations over the year-end tax bill of 2010.

The White House’s challenge was to use this leverage to broker a larger deal that contained enough deficit reduction to stabilize the debt over the coming decade, secured an adequate revenue contribution toward that goal (one that extended well beyond the revenues generated just from

¹ Richard Kogan, “Congress Has Cut Discretionary Funding By \$1.5 Trillion Over Ten Years,” Center on Budget and Policy Priorities, November 8, 2012, <http://www.cbpp.org/files/9-25-12bud.pdf>.

² Richard Kogan, “\$2 Trillion in Deficit Savings Would Achieve Key Goal: Stabilizing the Debt Over the Next Decade,” Center on Budget and Policy Priorities, November 1, 2012, <http://www.cbpp.org/files/11-1-12bud.pdf>.

³ “Statement by Robert Greenstein, President, on Speaker Boehner’s Recent Remarks Concerning the Debt Limit,” Center on Budget and Policy Priorities, May 16, 2012, <http://www.cbpp.org/files/5-16-12bud-stmt.pdf>.

letting the Bush tax cuts expire for people making over \$250,000), and raised the debt limit for at least several years. That's what the President tried to achieve in his December negotiations with Speaker Boehner.

At one point, Obama and Boehner appeared close to agreement, with Obama close to achieving his goals. But then Boehner, pressured by other House Republicans, blew up the negotiations and opted for "Plan B."

After Plan B's demise, negotiations resumed — but on a very different playing field. Gone was any discussion of raising the debt ceiling or of a larger deficit-reduction package. Instead, the two sides opted for a deal that raises income, capital gains, and dividend taxes only on couples making over \$450,000 (\$400,000 for singles); limits itemized deductions and phases out personal exemptions for couples making over \$300,000 (\$250,000 for singles); makes permanent most of the estate-tax break originally enacted in 2010; extends improvements in the Child Tax Credit and the Earned Income Tax Credit for low-income working Americans, and in the American Opportunity Tax Credit for middle- and lower-income college students, for five years;⁴ extends federal emergency unemployment insurance benefits for a year; and delays sequestration for two months. All told, the deal makes permanent 82 percent of the Bush tax cuts.⁵

Consequently, the playing field for the next round is very different. It's a terrain filled with land mines and enormous danger.

The Next Round

The nation faces three related and very daunting challenges in the next round, all of which will play out over the next two months.

- *Achieving further deficit reduction.* The President and Republican congressional leaders both seek more deficit reduction, but they are miles apart on how to get it. The White House notes that policymakers have already enacted large cuts in discretionary spending, which amount to \$1.5 trillion over the next ten years (as compared to the fiscal cliff deal's approximately \$600 billion in revenue increases). Quite reasonably, the White House calls for a dollar in additional revenue increases for each dollar in additional spending cuts.⁶

Republicans, however, have already declared that they flatly reject this concept. Although Speaker Boehner offered \$800 billion in revenue increases in his 2011 negotiations with President Obama and indicated that he'd go somewhere close to \$1 trillion in the recent

⁴ Robert Greenstein, "Disparate Treatment: Permanent, Million-Dollar Estate-Tax Breaks for Wealthy Heirs Vs. Temporary Tax Credit Improvements for Low-Income Working Families," Center on Budget and Policy Priorities, *Off the Charts* blog, January 4, 2013, <http://www.offthechartsblog.org/disparate-treatment-permanent-million-dollar-estate-tax-breaks-for-wealthy-heirs-vs-temporary-tax-credit-improvements-for-low-income-working-families/>.

⁵ Chye-Ching Huang, "Budget Deal Makes Permanent 82 Percent of President Bush's Tax Cuts," Center on Budget and Policy Priorities, January 3, 2013, <http://www.cbpp.org/files/1-3-13tax.pdf>.

⁶ Robert Greenstein, "The Next Act: Further Deficit Reduction Must Include a Mix of Revenues and Spending Cuts," Center on Budget and Policy Priorities, *Off the Charts* blog, January 2, 2013, <http://www.offthechartsblog.org/the-next-act-further-deficit-reduction-must-include-a-mix-of-revenues-and-spending-cuts/>.

negotiations, Republican leaders now insist that “the tax issue is off the table,”⁷ “the tax issue is finished, over, completed,”⁸ and they won’t agree to a dollar more in tax increases beyond the roughly \$600 billion just enacted. They insist that *all* of the additional deficit reduction must come from budget cuts. They say that, with the bulk of the Bush tax cuts now permanent, President Obama no longer has any leverage over them in the tax-raising arena.

- *Averting sequestration:* Sequestration will hit March 1 unless the President and Congress delay it further or replace it with something else. Republicans are insisting that policymakers must replace every dollar of across-the-board cuts that’s cancelled with a dollar of spending cuts. The White House, consistent with its dollar-in-taxes-for-a-dollar-in-spending principle, wants to replace sequestration with a package that includes equal amounts of revenue increases and spending cuts.
- *Raising the debt limit:* Most important, many Republicans insist that they won’t raise the debt limit unless legislation to do so is accompanied by massive spending cuts. To raise the debt limit by, say, \$1 trillion — enough for about one year — would require \$1 trillion in spending cuts under their “Boehner rule.” To raise the debt limit to last two years would require about \$2 trillion in spending cuts.

The debt limit fight is key — key to the future of the economy, the budget, and programs for low-income and disadvantaged Americans. The White House and some Democratic congressional leaders signaled a willingness to “go over the fiscal cliff” and into January if they could not reach a satisfactory budget agreement with congressional Republicans by December 31. They believed that, if in place a few weeks and then cancelled, the tax increases and spending cuts that the fiscal cliff would trigger would not harm the economy in a substantial, lasting way.

But, Administration pronouncements on the dangers posed by failing to raise the debt limit suggest that the White House appropriately views those consequences as far more dire, for failure to raise the debt limit so that the federal government can pay its bills would eventually trigger a default, potentially sending interest rates on U.S. securities permanently higher and possibly even causing a global financial crisis. Moreover, the President has said that he lacks authority, as some constitutional scholars have proposed, to invoke the Constitution’s 14th Amendment and essentially ignore the debt limit.

All of this greatly emboldens Republicans, who appear to believe that they are in a much stronger position in this evolving fiscal contest. They believe that by holding the needed debt-limit increase hostage and threatening economic chaos if their demands aren’t met, they can bring Obama and Democrats to their knees — forcing them to accept very big spending cuts without any revenue increases, as they did in the debt-limit crisis during the summer of 2011.

⁷ Russell Berman, “Boehner tells GOP he’s through negotiating one-on-one with Obama,” *The Hill*, January 2, 2013, <http://thehill.com/homenews/house/275295-boehner-tells-gop-hes-done-with-one-on-one-obama-talks>.

⁸ Senate Minority Leader Mitch McConnell on ABC’s “This Week with George Stephanopoulos,” Sunday, January 6, 2013, <http://abcnews.go.com/Politics/week-transcript-senate-minority-leader-mitch-mcconnell/story?id=18134125&page=2#.UOsLeG AeSo>.

The President has said that he will not negotiate fiscal policy as a condition for raising the debt limit, a very well-justified stance if you believe — as I do — that it’s grossly irresponsible for legislators of either party to hold the debt limit hostage and threaten economic chaos if they don’t get their way.⁹ But whether the President can secure a debt limit increase — which will require 218 votes in the House and 60 in the Senate — without acceding to huge spending cuts is unclear at this point. Tea Party Republicans think this is their best chance in ages to secure big cuts in core New Deal and Great Society programs. And with Republicans seemingly committed to this course (and nursing their wounds over the fiscal cliff deal) and the President maintaining that he won’t be blackmailed, the likelihood of a harrowing showdown — one that threatens the economy far more than the fiscal cliff ever did — is very high.

Why Low-Income People Are at Heightened Risk

Some Democrats dismiss the threat that the Boehner rule poses, saying that Republicans ultimately will back off of it because they won’t publicly identify the specific program cuts they would make to produce the savings that would raise the debt ceiling for a reasonable period of time. That view, alas, is mistaken.

To be sure, Republican congressional leaders seem unwilling to propose specific cuts in the two main, popular middle-class entitlement programs — Medicare and Social Security — that would produce large savings over the next ten years. They want Democrats to propose such cuts, or at a minimum, they want to find a way to put some Democratic fingerprints on them.

But, Republican leaders appear more than willing to specify deep cuts in two other parts of the budget — core entitlements for low-income Americans, like Medicaid and SNAP (formerly known as food stamps), and the annual caps on funding for non-defense discretionary programs.¹⁰ The Ryan budget featured trillions of dollars of cuts in these two areas.¹¹ House Republicans may well try to pass legislation in February to raise the debt limit for a year or so, accompanied by cuts primarily in low-income assistance programs and in the caps on non-defense discretionary programs. They will likely re-pass, in the new Congress, the legislation that they passed twice in the last Congress (most recently on December 20) to cancel the first year of sequestration and replace it with spending cuts that hit low-income programs disproportionately.¹²

⁹ Paul Van de Water, “Don’t Play Politics with the Debt Ceiling,” Center on Budget and Policy Priorities, *Off the Charts* blog, January 4, 2013, <http://www.offthchartsblog.org/dont-play-politics-with-the-debt-ceiling/>.

¹⁰ Richard Kogan, “Non-Defense Discretionary Programs Will Face Serious Pressures Under Current Funding Caps,” Center on Budget and Policy Priorities, December 6, 2012, <http://www.cbpp.org/files/12-4-12bud.pdf>.

¹¹ Kelsey Merrick and Jim Horney, “Chairman Ryan Gets 62 Percent of His Huge Budget Cuts from Programs for Lower-Income Americans,” Center on Budget and Policy Priorities, March 23, 2012, <http://www.cbpp.org/cms/index.cfm?fa=view&id=3723>.

¹² Robert Greenstein and Richard Kogan, “House Budget Bills Would Target Programs for Lower-Income Families While Breaking Last Summer’s Bipartisan Deal,” Center on Budget and Policy Priorities, May 10, 2012, <http://www.cbpp.org/files/5-7-12bud.pdf>.

These battles, just starting, will be brutal. Attacks that disparage or demonize programs for low-income and vulnerable Americans may escalate in the weeks ahead in an effort to help lay the groundwork for this strategy.

It's not clear how policymakers will resolve these showdowns. The President's ability to tie an extension of various Republican-backed tax cuts to an agreement on a larger balanced package — one that also raises the debt limit and averts sequestration — now is gone. How the President can secure needed Republican votes in the Senate and House for measures that raise additional revenues — and for measures that raise the debt limit outside of the harsh and regressive confines of the Boehner rule — is very unclear.

But facile assumptions that President Obama will simply roll over in the face of these pressures seem quite unrealistic. So, an extremely high-stakes confrontation — one that could culminate in an actual default, a government shutdown, or even a constitutional crisis — is definitely not out of the question.

What lies ahead will likely dwarf the fiscal-cliff dramatics that the nation has just witnessed. Our leaders, our system of government, and the patience and wisdom of the American people will be severely tested. And, for no one will the stakes — and the risks — be higher than for the tens of millions of our least fortunate citizens, those who lack the luxury of well-connected lobbyists and the access that big campaign contributions bring to help protect them on Capitol Hill in the dangerous weeks ahead.