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PROGRAM CUTS UNDER A BALANCED BUDGET AMENDMENT: HOW SEVERE MIGHT THEY BE?

By Richard Kogan

The constitutional balanced budget amendment that the House is expected to consider this week could force Congress to cut all programs by an average of 17.3 percent by 2018. If revenues are not raised (the House-passed budget resolution assumes no increase above current-policy levels) and all programs are cut by the same percentage, Social Security would be cut $184 billion in 2018 alone and almost $1.2 trillion through 2021; Medicare would be cut $117 billion in 2018 and about $750 billion through 2021; and Medicaid and the Children's Health Insurance Program (CHIP) would be cut $80 billion in 2018 and about $500 billion through 2021.

If policymakers limit cuts to some programs, other programs would have to be cut more deeply. For instance, if Social Security is exempted from cuts needed to meet the balanced budget mandate, other programs would have to be cut by nearly one-fourth, on average.

In essence, Congress could well have to enact the extreme budget plan of the Republican Study Committee or something similar to it. True, Congress could balance the budget by raising revenues. But if the votes to raise revenues cannot be found, then even the House-passed budget plan of House Budget Committee Chairman Paul Ryan would not pass muster under the balanced budget amendment. Rather, the more draconian Republican Study Committee (RSC) budget[1] or a close equivalent would be required.

Under the proposed balanced budget amendment, the first year in which the federal budget would have to be balanced would likely be fiscal year 2018.[2] The Congressional Budget Office estimates that the Ryan plan, even with its deep cuts, would not achieve balance until sometime *in the 2030s*. When asked at a hearing in May what steps he would recommend beyond the House-passed budget to meet the amendment's time frame, the amendment's chief sponsor, Rep. Bob Goodlatte (R-VA), pointed

[1] Republican Study Committee materials on the proposal are available at http://rsc.jordan.house.gov/Solutions/rscfy2012budget.htm.

[2] The amendment specifies that the balanced budget requirement would take effect in the fifth fiscal year after its ratification. If Congress approved the amendment this year and three-quarters of the states ratified it, ratification could conceivably be completed during calendar year 2013. If so, the amendment would take effect for fiscal year 2018.

to the RSC budget.[3] The RSC says its plan would achieve balance in 2020. The RSC budget secures all of its deficit reduction through spending cuts and none through revenues.

This analysis illustrates the depth of the spending cuts that would be required if a balanced budget were to be achieved entirely through program cuts. Revenues are assumed to continue as under current policy, with expiring provisions extended. The current-policy level of revenues is almost identical to those in the House-passed Ryan and RSC budget plans. Spending is assumed to adhere to current policy, based on CBO's projections, including adherence to the new discretionary caps enacted in August in the Budget Control Act (BCA), *plus* another $1.2 trillion in spending reductions through the sequestration provisions of the BCA. Even with adherence to the provisions of the Budget Control Act, the deficit would be $752 billion or 3.6 percent of GDP in 2018, and would be rising. (For a more detailed discussion of the methods and budgetary assumptions used in this report, see the Appendix.)

Given these projections, we find that to balance the budget in 2018 and subsequent years:

- Programs would need to be cut almost $4.3 trillion through 2021 (with interest savings that would be generated by the lower deficits and ultimately a balanced budget starting in 2018, total spending would be $4.9 trillion lower).

- By 2018, programs would have to be cut by an average of 17.3 percent. If the cuts are spread proportionally over all programs:

    - Social Security would be cut $184 billion in 2018 alone, and almost $1.2 trillion through 2021;

    - Medicare would be cut $117 billion in 2018 and about $750 billion though 2021;

    - Medicaid and CHIP would be cut $80 billion in 2018 and about $500 billion through 2021;

    - Veterans' disability payments, compensation, and other entitlement benefits would be cut $13 billion in 2018 and $85 billion through 2021;

    - Key safety-net programs — Supplemental Security Income (SSI) for the elderly and disabled poor, the Supplemental Nutrition Assistance Program (SNAP, formerly known as the Food Stamp Program), the school lunch and other child nutrition programs, and the refundable portions of the Child Tax Credit and the Earned Income Tax Credit — would be cut $41 billion in 2018 and more than $250 billion through 2021;

    - Defense would be cut almost $100 billion in 2018 and more than $600 billion through 2021; since these cuts would be in addition to the constraints of the new caps and the potential across-the-board sequestration, defense spending would fall to 2.2 percent of GDP in 2018 (assuming sequestration), from its current level of 4.7 percent of GDP, *a level not seen since before World War II*; and

    - Appropriations for non-defense discretionary (i.e., non-entitlement) programs would likewise be cut almost $100 billion in 2018 and more than $600 billion through 2021, and would fall

[3] See transcript of the May 13 hearing on the Balanced Budget Amendment conducted by the Subcommittee on the Constitution of the House Judiciary Committee.

Republican Study Committee Budget Would Slash Wide Range of Programs

The RSC budget features its own set of budget cuts, including the following:

- It cuts total funding for non-defense discretionary programs by approximately *70 percent* in 2021, and by more than $3 trillion over the next ten years, relative to the funding levels that Congress approved in April for fiscal year 2011, adjusted for inflation. (Relative to the discretionary caps set by the BCA, the RSC's cuts in discretionary programs would be smaller, but still enormous.)
- It contains deeper Medicare cuts than the Ryan budget — it includes the Ryan proposals to convert Medicare to vouchers and raise the Medicare eligibility age from 65 to 67, but raises the eligibility age sooner than the Ryan budget would.
- It raises the Social Security retirement age to 70.
- It contains cuts of almost unimaginable depth in the core programs for the poorest and most disadvantaged Americans. In 2021, Medicaid, SNAP, and Supplemental Security Income would all be cut in half.

to 2.3 percent of GDP from their current levels of 4.3 percent of GDP, *reaching their smallest percentage since approximately 1930*. This area of the budget includes education, housing, veterans' medical care, transportation, law enforcement, biomedical and other scientific research, job training, natural resources and environmental protection, and the Treasury.

- The cuts would be far deeper than those shown if Congress chooses to spare large programs.
  - For example, if Social Security is not cut, then the average cut to all remaining programs would rise by more than one-third, from 17.3 percent to 23.8 percent. The Medicare cuts would grow to $160 billion in 2018 and more than $1 trillion through 2021, for instance, and the Medicaid and CHIP cuts would grow to $110 billion in 2018 and almost $700 billion through 2021.
  - If Social Security, Medicare, and Medicaid/CHIP were spared from cuts, the cuts on all remaining programs would average 39.5 percent: veterans' benefit programs would be cut almost $200 billion through 2021, the key safety-net programs mentioned above would be cut almost $600 billion through 2021, and defense and non-defense discretionary programs would fall to no more than 1.7 percent of GDP each.
- Republican presidential candidate Mitt Romney has recently called for increasing the defense budget, excluding war costs, to 4.0 percent of GDP and keeping it there. This is above the level set in the new BCA caps, and even further above the level that would occur under the sequestration modeled in this analysis. With defense at this level, then even if no other program is spared budget cuts, all other programs would be cut an average of 29.4 percent in 2018: on this basis, Social Security would be cut by more than $300 billion in that year alone and almost $2 trillion through 2021, for instance, and Medicare would be cut by almost $200 billion in 2018 and almost $1.3 trillion through 2021.

The cuts highlighted above are displayed in the following table, in each case under the assumption that all cuts are in strict proportion unless a program is explicitly spared from budget cuts.

Additional Budget Cuts Required to Balance the Budget in 2018 Assuming revenues at current policy, compliance with the BCA caps, and a BCA sequestration In billions of dollars								
	No program spared from cuts; 17.3% cut for all programs in 2018		Social Security spared; 23.8% cut for all other programs in 2018		Social Security, Medicare, and Medicaid/CHIP spared; 39.5% cut for all other programs in 2018		Defense funding (except war) at 4.0% of GDP; nothing else spared; 29.4% cut for all other programs in 2018	
	in 2018	**thru '21**	**in 2018**	**thru '21**	**in 2018**	**thru '21**	**in 2018**	**thru '21**
2018 deficit	752		752		752		1,092	
Required program cuts (interest savings will also occur)	677		677		677		984	
Cuts to Selected Programs								
Social Security	184	1,156	0	0	0	0	312	1,955
Medicare	117	754	160	1,034	0	0	198	1,275
Medicaid/CHIP	80	503	110	690	0	0	136	851
SSI, SNAP, child nutrition, & refundable parts of CTC and EITC	40	251	55	357	92	582	69	429
Federal retirement	29	185	40	254	67	427	50	314
Veterans' disability compensation & other entitlement benefits	13	85	18	117	30	196	22	144
Defense (including war costs) [resulting level as a % of GDP]	98 [2.2%]	613	135 [2.1%]	838	224 [1.6%]	1,405	0 [4.2%]	0
Non-defense discretionary [resulting level as a % of GDP]	99 [2.3%]	610	136 [2.1%]	836	225 [1.7%]	1,402	168 [1.9%]	1,033
Grand Total, all cuts (including cuts in other programs not mentioned in this table, except interest)	**677**	**4,270**	**677**	**4,270**	**677**	**4,270**	**984**	**6,190**

Appendix:
Methods and Assumptions

Approach. The analysis in this paper starts from the baseline projection that the Congressional Budget Office (CBO) issued on August 24, 2011, (http://www.cbo.gov/doc.cfm?index=12316) and adjusts those figures to reflect current budget policy, as explained below. From there, it assumes that spending cuts will be phased in over the five-year period 2014-2018 sufficient to balance the budget in FY 2018 and keep it balanced through 2021. There are both economic and budgetary advantages to phasing in the necessary cuts starting in 2014 rather than waiting until 2018 to institute them all at once.

- Phased in over time, the cuts are less likely to drag the economy into an immediate recession than if they occurred precipitously.

- If the cuts start in 2014, deficits and debt will be lower in the years 2014-2017 than they would otherwise have been. This lower debt in 2017 will mean that interest costs will be lower in 2018, which goes part of the way to balancing the budget and therefore diminishes the degree to which programs would otherwise need to be cut in 2018.

- In this analysis, we make the simplifying assumption that the percentage cut in discretionary 2018 *outlays* that is shown in the table can be achieved by the same percentage cut in 2018 *funding*. Yet many programs, especially procurement, construction, and education programs, disburse one year's funding over two or more years. For those programs, even eliminating funding in one year does not stop all expenditures in that year because funds appropriated in prior years are still being disbursed to fulfill obligations validly incurred in those prior years. As a result, cutting the expenditures of discretionary appropriations is best accomplished if the program cuts start in earlier years. Even with this earlier start, it is almost certain that the discretionary outlay savings shown in our table for 2018 would require percentage cuts slightly higher than those indicated. In that respect, our figures slightly understate the severity of the balanced budget amendment.

Baseline assumptions. We adjust CBO's August baseline, which is based on scheduled requirements under current law, to reflect the extension of all expiring tax cuts (both middle-class and upper-income, plus AMT relief through indexing, estate tax relief under current parameters, and the "normal tax extenders") as estimated by CBO in Table 1-8 of its August report, "Budgetary Effect of Selected Policy Alternatives." These CBO estimates do not assume extension of the temporary payroll-tax reduction. In addition, we assume that the costs of overseas wars are phased down as CBO describes in Table 1-8, in which the number of troops engaged in Afghanistan and Iraq is reduced to 45,000 by 2015. Finally, we assume that relief from the scheduled steep reduction in physician reimbursements under Medicare's "sustainable growth rate" (SGR) is granted by freezing those rates.

It should be noted that CBO's baseline assumes adherences to the discretionary caps put in place by the Budget Control Act of 2011. But those caps do not divide discretionary appropriations between defense and non-defense programs; in 2012 and 2013, they divide funding between security and non-security programs, and thereafter the caps apply to aggregate discretionary funding. In contrast, we assume that those caps morph into caps that apply separately to defense and non-defense in all years, at the backup levels specified in the BCA. The BCA specifies separate defense and non-defense caps that apply only if a sequestration is ordered because the process involving the Joint Select Committee on Deficit Reduction has not led to the enactment of $1.2 trillion in deficit reduction. We use these backup levels in order to have a defense and non-defense starting point.

Finally, the CBO August baseline assumes that $1.2 trillion in savings, including interest, will come from the Joint Select Committee process, but does not guess at the division of those savings among programs or between program cuts and revenue increases. Since we need a programmatic starting point in order to make our calculations, we assume the required savings will come entirely from the sequestration specified under the BCA and use CBO's estimates of that sequestration — its dollar division of the savings among defense, non-defense discretionary, Medicare, and other non-exempt entitlements — laid out in its September 12, 2011, analysis of the budgetary effects of sequestration. (http://www.cbo.gov/ftpdocs/124xx/doc12414/09-12-BudgetControlAct.pdf). Therefore, our starting deficits reflect those sequestrations in total and within the starting program levels for Medicare, defense, and non-defense discretionary funding. (The other programs shown in our calculations are exempt from sequestration, so their program levels equal the levels in CBO's August baseline.) Under these current policy assumptions, the deficit would be $752 billion or 3.6 percent of GDP in 2018.

Calculations of cuts. In calculating the spending cuts need to balance the budget, we assume they start in 2014 and grow with the economy each subsequent year. In addition to that growth in the size of the 2014 cuts, we "stair-step" them upwards until 2018, so that the cuts in 2015 are twice the size of the 2014 cuts (plus an increment for the growth of GDP); the cuts in 2016 are three times the cuts in 2014 (plus an increment for GDP growth), and so on through 2018. We fix the nominal value of the starting program cuts in 2014 at the level that, with interest savings also accounted for, produces a balanced budget in 2018.

After 2018, the cuts grow only as needed to keep the budget balanced. That growth after 2018 is very close to the growth rate of GDP; in this analysis, the required policy cuts reach $677 billion or 3.2 percent of GDP in 2018 and rise to 3.4 percent of GDP by 2021. The $677 billion in policy cuts in 2018 is accompanied by $75 billion in interest savings in that year, which together remove the $752 billion deficit projected for that year.

Finally, it should be noted that the ultimate magnitude of the budget cuts that would be needed is not affected much by the precise year in which the budget must first be balanced. If the budget were required to be balanced in 2017 rather than 2018, the necessary program cuts would have to start bigger in 2014. But the size of the program cuts would reach 3.3 percent of GDP in 2017, very similar to the cuts of 3.2 percent of GDP for 2018 that we model. Similarly, if the budget did not need to be balanced until 2019 or later years, the size of the starting cuts could be smaller because they would have more years to stair-step up, but would eventually reach about 3.6 percent of GDP in the year in which the budget is first balanced. In short, balancing the budget by 2018 happens to require slightly smaller program cuts in that year than balancing either earlier or later, and there is no ultimate relief to be gained either by accelerating or delaying the BBA's effective date.