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# THE SENATE'S BALANCED BUDGET AMENDMENT WOULD REQUIRE EXTREME BUDGET CUTS

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The constitutional balanced budget amendment (BBA) that the Senate is expected to consider this month would, like any version of a BBA, risk serious harm to the economy by requiring that the budget be balanced even during an economic downturn. But this BBA, in particular, would do far more damage because it also would prevent the federal government from meeting the nation's basic needs even when the economy is healthy.

That's because the amendment would enshrine a severe cap on total federal spending in the Constitution, forcing Congress to cut all programs by an average of *one-fourth* by 2018. If lawmakers were to cut all programs by the same percentage to fit within the cap, Social Security would be cut $266 billion in 2018 alone and almost $1.7 trillion through 2021; Medicare would be cut $169 billion in 2018 and almost $1.1 trillion through 2021; Medicaid and the Children's Health Insurance Program (CHIP) would be cut $115 billion in 2018 and more than $700 billion through 2021; and veterans disability, pension, and other benefits would be cut $19 billion in 2018 and $123 billion through 2021, in addition to cuts that would be made in veterans' health care.

Defense would be cut almost $900 billion over this period, with these cuts coming on top of the defense cuts that will occur under the caps on discretionary spending enacted this August and the sequestration scheduled to start in January 2013. The result would be that defense spending would fall by 2021 to its lowest level as a share of the economy *since before World War II*. And the cuts also would be severe in non-defense discretionary programs; by 2021, spending for those programs would plummet to its lowest level as a share of the economy *since 1930*.

Policymakers could, of course, limit the cuts in some programs. But to do so, they would have to cut other programs even more severely. For instance, if they exempted Social Security from cuts, they would have to cut other programs by more than one-third on average.

Strikingly, even the budget plan that House Budget Committee Chairman Paul Ryan designed and the House passed in April would not come close to passing muster under the Senate BBA. The Ryan plan, with its $4.5 trillion in spending cuts over 10 years, would not achieve balance until sometime in the 2030s, according to the Congressional Budget Office. And the spending levels in the Ryan budget resolution would breach the Senate BBA's cap by $2.8 trillion over the four-year period 2018-2021. Even the more draconian House Republican Study Committee budget[1] — which, by 2021, would cut funding for non-defense discretionary programs by *70 percent* and cut basic low-income programs like Medicaid, SNAP, and Supplemental Security Income for the elderly and disabled poor *in half* — would breach the Senate's BBA cap by almost $300 billion in 2018 and $1.1 trillion from 2018 through 2021.

## Proposal Would Impose Severe Budget Caps in Addition to Zero-Deficit Requirement

Under the proposed balanced budget amendment, the first year in which the federal budget would have to be balanced could be fiscal year 2018.[2] But the Senate's version of the BBA goes well beyond requiring annual deficits of zero by 2018, as difficult as that would be. In addition to requiring budget balance or surplus in every year, the Senate's BBA – introduced by Minority Leader Mitch McConnell (R-KY) and Sen. Orrin Hatch (R-UT) – would prohibit tax increases and limit federal spending to about 16.6 percent of the U.S. economy.[3] These three requirements could be waived only by a two-thirds vote of the Senate and the House.

The proposed limit on the size of the budget is so low that it would produce budget surpluses of about $300 billion in 2018 and growing surpluses in subsequent years even if Congress permanently extended all of President Bush's tax cuts, the current very low level of the estate tax, relief from the alternative minimum tax (AMT), and all the "normal tax extenders." Beyond those extensions, in fact, the low budget limit would leave room for an additional *$1.9 trillion* in tax cuts through 2021 alongside the severe budget cuts the amendment would require. That would produce significantly lower federal revenues than under the Ryan and House Republican Study Committee budget plans.

The budget limit is so low, in fact, that:

- President Reagan would have breached the Senate's 2018 spending limit by 5.7 percent of GDP, equivalent to "excess" spending of almost $1.2 trillion. Federal spending averaged 22.3 percent of GDP under Reagan.

- The Ryan budget, as well, would far exceed the spending limit. The spending levels in the Ryan budget resolution would exceed the Senate BBA's limit by $643 billion in 2018, and by more than $2.8 trillion over the four-year period 2018-2021. Moreover, CBO estimates that under the Ryan budget's spending policies, federal spending would equal about 20¾ percent of GDP in 2030, meaning that the Ryan budget would be over the cap by more than 4 percent of GDP

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

[2] Both the Senate and House versions of the BBA specify that its requirements would take effect in the fifth fiscal year after its ratification. If Congress approved the amendment this year, ratification by three quarters of the states could conceivably be completed during the first nine months of calendar year 2013. If so, the amendment would take effect for fiscal year 2018.

[3] Senate Joint Resolution 10 was introduced by Senator Hatch on March 31, 2011; Senate Joint Resolution 23, which is identical, was introduced by Senator McConnell on June 29, 2011. These constitutional amendments set a spending cap for each fiscal year equal to 18 percent of the Gross Domestic Product in the prior *calendar* year. The spending cap will therefore be less than 18 percent of GDP whenever nominal GDP is growing. Under CBO's most recent economic assumptions, the spending cap would vary from year to year and would be 16.6 percent of GDP in fiscal year 2018.

in that year — the equivalent of $845 billion in 2018 terms. The proposed constitutional budget limit thus would require massive cuts *on top of* the cuts in the Ryan budget itself, which converts Medicare to vouchers and cuts the program deeply, cuts Medicaid by 49 percent by 2030, cuts other programs for low-income Americans like SNAP (food stamps) and Pell Grants by unprecedented amounts, and shrinks non-defense discretionary programs by another 21 percent by 2021 on top of the steep cuts that will occur in discretionary programs under the caps enacted as part of the debt-ceiling deal and the sequestration scheduled to start in January 2013.

It may also be noted that legitimate demands on the federal government have increased significantly since the Reagan period. The percentage of Americans who are 65 or older will grow by more than half over the next 25 years. In addition, increases in per-person costs across the U.S. health care system — both public and private — will raise the cost of providing health coverage to seniors, people with disabilities, and people with low incomes, among others. Overall health care costs in the United States already are more than 60 percent higher as a share of GDP than they averaged in the Reagan years. Furthermore, the government incurs costs it did not face in the 1970s, 1980s, or 1990s for homeland security (after the September 11 terrorist attacks), for health care and other benefits and services to veterans of the Iraq and Afghanistan wars, and for the Medicare prescription drug benefit enacted in 2003. These factors and the costly 2001 and 2003 tax cuts also drive up interest payments on the federal debt.

## How Deep Are the Required Budget Cuts?

The figures below illustrate the depth of the spending cuts that would be required under the spending cap in the Senate Republican BBA proposal. (Note: the figures assume that revenues are reduced by the amount that would place the budget in balance each year from 2018 on, rather than in surplus.[4]) The spending cuts are measured relative to CBO's current policy projections, including adherence to the new discretionary caps enacted in the Budget Control Act (BCA) in August 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, federal spending would be almost $1.1 trillion above the proposed constitutional spending cap in 2018, and would equal 21.8 percent of GDP. (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 and meet the spending cap in the Senate's BBA in 2018 and subsequent years:

- Programs would need to be cut almost $6.2 trillion through 2021. (Counting the interest savings that would be generated by the lower deficits and ultimately a balanced budget, total spending over this period would be $7.1 trillion lower.)

- By 2018, programs would have to be cut by an average of 25 percent. If the cuts are spread

[4] Assuming a balanced budget rather than surpluses makes a very small difference — 3 percent in 2018 — in the required amount of spending cuts because balanced budgets leave higher levels of debt than a policy of permanent surpluses, and therefore higher levels of interest payments on the debt, which count against the spending ceiling. The assumption of permanent substantial surpluses seems unrealistic as a matter of policy.

proportionally over all programs:

- Social Security would be cut $266 billion in 2018 alone and almost $1.7 trillion through 2021.
- Medicare would be cut $169 billion in 2018 and almost $1.1 trillion through 2021.
- Medicaid and CHIP would be cut $115 billion in 2018 and more than $700 billion through 2021.
- Veterans' disability payments, pensions, and other entitlement benefits would be cut $19 billion in 2018 and $123 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 $59 billion in 2018 and almost $370 billion through 2021.
- Defense would be cut more than $140 billion in 2018 and almost $900 billion through 2021. These cuts would be in addition to the constraints of the new appropriations caps and the scheduled sequestration. As a result, defense spending would fall to 2.0 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.*
- Appropriations for non-defense discretionary (i.e., non-entitlement) programs would likewise be cut more than $140 billion in 2018 and almost $900 billion through 2021 (in addition to the cuts made to meet the BCA's appropriations caps and the cuts slated to occur under sequestration). Funding for these programs would fall to 2.0 percent of GDP from its current 4.3 percent of GDP, *reaching the smallest percentage for this part of the budget since 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 percentage cuts would be even deeper than those shown here if Congress chose to spare certain large programs.
  - For example, if Social Security were not cut, the average cut to all remaining programs would rise by more than one-third, from 25 percent to 34.4 percent. The Medicare cuts alone would grow to $1.5 trillion through 2021, for instance, and the Medicaid and CHIP cuts would grow to almost $1.0 trillion through 2021.
  - If Social Security, Medicare, and Medicaid/CHIP were spared from cuts, the cuts on all remaining programs would average an astounding 57.1 percent: veterans' benefit programs would be cut almost $300 billion through 2021, the key safety-net programs mentioned above would be cut more than $800 billion through 2021, and defense and non-defense discretionary programs would fall to no more than 1.2 percent of GDP each.

- Some policymakers, defense analysts, and pundits have argued that cutting defense spending would threaten national security. Some — for example, Republican presidential candidate Mitt Romney — have called for *increasing* the defense budget, excluding war costs, to 4 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 after the sequestration required by the Budget Control Act. If defense spending were placed at 4 percent of GDP, then even if no other program were spared from budget cuts, all other programs would have to be cut an average of 38.4 percent in 2018: on this basis, Social Security would be cut by more than $400 billion in that year alone and more than $2.5 trillion through 2021, and Medicare would be cut by more than $260 billion in 2018 and almost $1.7 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.

**S. J. Res. 23: Additional Budget Cuts Required to Balance the Budget and Adhere to the Spending Cap in 2018**
In billions of dollars

| | No program spared from cuts. | | Social Security spared from cuts. | | Social Security, Medicare, and Medicaid/CHIP spared from cuts. | | Defense funding (except war) increased to 4.0% of GDP; nothing else spared from cuts. | |
|---|---|---|---|---|---|---|---|---|
| | **in 2018** | **thru '21** | **in 2018** | **thru '21** | **in 2018** | **thru '21** | **in 2018** | **thru '21** |
| Percent cut for unprotected programs | 25.0% | | 34.4% | | 57.1% | | 38.4% | |
| Total required program cuts | 981 | 6,183 | 981 | 6,183 | 981 | 6,183 | 1,287 | **8,099** |
| **Cuts to Selected Programs** | | | | | | | | |
| Social Security | 266 | 1,671 | 0 | 0 | 0 | 0 | 408 | 2,555 |
| Medicare | 169 | 1,096 | 233 | 1,502 | 0 | 0 | 260 | 1,675 |
| Medicaid/CHIP | 115 | 728 | 158 | 998 | 0 | 0 | 177 | 1,113 |
| SSI, SNAP, child nutrition, & refundable parts of CTC and EITC | 59 | 366 | 81 | 502 | 134 | 841 | 90 | 560 |
| Federal retirement | 42 | 268 | 58 | 367 | 97 | 617 | 65 | 410 |
| Veterans' disability compensation & other entitlement benefits | 19 | 123 | 26 | 168 | 43 | 283 | 29 | 188 |
| Defense (including war costs) [resulting level as a % of GDP] | 142 [2.0%] | 886 | 195 [1.8%] | 1,214 | 324 [1.2%] | 2,037 | 0 [4.2%] | 0 |
| Non-defense discretionary [resulting level as a % of GDP] | 143 [2.0%] | 883 | 196 [1.8%] | 1,209 | 327 [1.2%] | 2,030 | 220 [1.7%] | 1,350 |

Assumes revenues equal the spending cap. Program cuts are relative to a baseline that complies with the BCA caps and the sequestration that the BCA requires as a result of the supercommittee's failure to produce $1.2 trillion in deficit reduction. Program cuts do not include associated interest savings. Cuts are assumed to be distributed equally across-the-board except to those programs specified as spared from cuts.

Source: CBPP calculations based on Congressional Budget Office.

## 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 both tax cuts and spending cuts will be phased in over the five-year period 2014-2018 sufficient to balance the budget in FY 2018 at the level of the spending caps specified in the Senate BBA proposal and keep it balanced through 2021. There are both economic and budgetary advantages to phasing in the necessary budget cuts starting in 2014 rather than instituting them all at once in 2018.

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

- If the budget 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 a modest part of the way to balancing the budget and therefore reduces the degree to which programs would otherwise need to be cut in 2018. This advantage is partly offset, however, by the higher interest costs generated by phasing in tax cuts over this period.

- 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 here. In that respect, our figures slightly understate the severity of the proposed balanced budget amendment and outlay cap.

**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. 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. Finally, as noted, we assume that additional tax cuts start in 2014 and phase in over the next five years so that revenues equal the spending caps for 2018 and thereafter that are included in the Senate BBA proposal.

It should be noted that CBO's August baseline assumes adherences to the discretionary caps put in place by the Budget Control Act of 2011, but does not distribute the necessary cuts between defense and non-defense programs because the Budget Control Act did not initially impose separate caps on defense and non-defense funding. Now that the Joint Select Committee on Deficit Reduction has failed to produce a deficit-reduction plan, however, the Budget Control Act does impose separate caps on defense and non-defense funding. Our figures therefore start with the resulting, separate defense and non-defense discretionary funding levels.

Finally, the CBO August baseline assumes that $1.2 trillion in savings, including interest, will come from the Joint Select Committee process, but it 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 and the Joint Select Committee process has failed to produce a deficit-reduction plan, we adjust the pre-sequestration baseline by the sequestration specified under the Budget Control Act. We 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 both 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 plus the additional tax cuts allowed by the Senate BBA proposal, the deficit in 2018 would be $1,089 billion or 5.2 percent of GDP.

**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 at the specified outlay cap levels in 2018.

After 2018, the cuts grow only as needed to keep the budget balanced at the specified cap levels. That growth after 2018 is close to the growth rate of GDP; in this analysis, the required policy cuts reach $981 billion, or 4.7 percent of GDP, in 2018 and rise to 5.0 percent of GDP by 2021. The $981 billion in policy cuts in 2018 is accompanied by $108 billion in interest savings in that year, which together remove the $1,089 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 a level in 2017 very similar as a percentage of GDP to the cuts for 2018 that we model. Similarly, if the budget did not need to be balanced until 2019 or later years, the cuts could be smaller at first (because they would have more years to stair-step up) but would eventually reach a slightly larger size as a share of GDP in the year in which the budget is first balanced than under our model. In short, balancing the budget by 2018 happens to require the same or 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.