Center on Budget and Policy Priorities

820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

Revised August 10, 2005

WOULD AN ENTITLEMENT CAP BE A WISE IDEA?

By Robert Greenstein, Richard Kogan, Sharon Parrott, and James Horney

Later this year, Congress may consider proposals that would place an overall cap on the cost of entitlement programs. The House considered (and rejected) two entitlement cap proposals in 2004. One of these proposals, by Rep. Mark Kirk, would have covered all entitlement programs except Medicare and Social Security. The other proposal, by Rep. Jeb Hensarling, would have covered all entitlements except Social Security.[1] Rep. Hensarling has reintroduced his proposal this year in nearly identical form. All current or recent entitlement-cap proposals would establish an overall spending limit for entitlement programs (except for programs outside the cap) for each year; if the total cost of entitlements was estimated to exceed the cap for the coming year, Congress would have to enact legislation to cut the programs enough to bring their overall cost down to the cap. If Congress failed to do so, automatic cuts would be instituted in many entitlement programs.

1. Entitlement cap proposals could lead to deep cuts over time.

An entitlement cap is designed to force cuts in entitlement programs. The Kirk proposal of last year (which excluded Medicare) would have required $445 billion in cuts over the next ten years. The current Hensarling proposal would force $2.1 trillion in cuts over ten years.[2] The cuts required by entitlement cap proposals generally grow much deeper over time.

Entitlement cap proposals can be designed to appear to make only modest cuts even when a proposal's long-term impact would be harsh. For example, an entitlement cap proposal can be designed so the cuts are modest in the first five years and grow much deeper after that. Because Congress wrote a five-year budget this year, proponents of entitlement cap proposals may try to

---

[1] Senator Orrin Hatch introduced a bill in 2004 that included an entitlement cap proposal identical to the Hensarling proposal.

[2] We calculated these figures for the Kirk proposal in 2004, based on the effective dates in the Kirk proposal and on CBO projections issued in 2004. Last year, we estimated that the proposal Rep. Hensarling offered at the time would require $1.55 trillion in cuts over ten years. This year, we estimate that the new Hensarling proposal would require $2.1 trillion in cuts; the increased severity relative to last year's estimate occurs in part because CBO's projection of health care cost growth has increased and in part because the new Hensarling proposal covers a different ten-year period (2006-2015 rather than 2005-2014). All estimates of the Hensarling proposal in this analysis are based upon the new proposal and CBO's 2005 projections.

The Hensarling proposal requires deeper cuts than the Kirk proposal because Hensarling includes Medicare Part A and interest payments on the debt under its entitlement caps, while Kirk excludes them both. For further discussion of the new Hensarling entitlement cap, see Kogan and Greenstein, *Entitlement Cap Would Require Deep Cuts in Entitlement Programs,* Center on Budget and Policy Priorities, August 10, 2005 limit discussion of the cuts such proposals would require to those that would take place in the first five years. When evaluating entitlement cap proposals, it is important to determine their longer-term impacts on entitlement programs.

Entitlement Cuts Over 10 Years Under 2005 Hensarling Proposal, If All Entitlements Are Cut Proportionately
(in billions of dollars)

Medicare	$919
Medicaid	460
Federal civilian retirement and disability	127
Military retirement and disability	74
Unemployment compensation	73
Earned Income and Child Tax Credits	72
Supplemental Security Income	69
Veterans' benefits	56
Food Stamps	54
TANF and other family support	37
Child Nutrition	25
Commodity Credit Corporation price supports	21
TRICARE for life	16
Other federal retirement and disability	15
Foster Care and Adoption Assistance	13
Student loans	13
Universal Service Fund	11
State Children's Health Insurance Program	8
Social services (Title XX, voc rehab)	7
Other miscellaneous	22
TOTAL	**2,092**

2. Entitlement cap proposals are likely to result in large cuts in programs whose costs are *not* rising significantly in order to cover the costs of medical advances.

The entitlement cap proposals would require large cuts for one principal reason — the formula they use to set each year's overall entitlement spending limit fails to take increases in health care costs into account. Typically, under these proposals, the entitlement cap would be raised from one year to the next to reflect the general inflation rate and increases in the number of people eligible for the programs, but with no allowance for increases in health care costs occurring throughout the U.S. health care system.

Over time, Medicare and Medicaid costs rise roughly in tandem with private-sector health care costs. Health care costs systemwide (i.e., in both the private and public sectors) are rising faster than the general inflation rate, primarily because of advances in medical technology and treatments, which improve health and extend life but carry significant costs. A recent medical advance is illustrative. Last year, the Administration determined that Medicare will pay for implantable cardiovascular-defibrillators. This is a new, credit-card-size electric-shock device that can substantially increase a heart-patient's chances of survival, as demonstrated by a four-year trial published in the *New England Journal of Medicine.* This new technology will increase Medicare costs by an estimated $3 billion to $15 billion a year, depending on how many heart patients are implanted with the device.

None of the entitlement caps that have been proposed take the cost of such medical advances into account. As a result of this failure to take increases in health care costs into account, the caps these proposals would establish would fall farther below the actual cost of entitlement programs with each passing year, forcing steadily deepening cuts in entitlement programs.

Under the entitlement cap proposals, the cost of medical breakthroughs like cardiovascular-defibrillators would have to be offset either through cuts elsewhere in Medicare and Medicaid or through cuts in other entitlements such as food stamps, the Earned Income Tax Credit, veterans' benefits, military retirement benefits, student loans, and school lunches. Other mechanisms for offsetting the cost of life-saving medical advances — such as raising more revenue by curbing abusive tax shelters, reducing tax avoidance, or closing unproductive tax loopholes — would *not* be permitted.

It would be virtually impossible politically — and highly undesirable as a matter of policy — to cut Medicare and Medicaid severely enough to comply with such caps. Cutting Medicare and Medicaid enough so their costs would rise no faster than the entitlements caps would lead over time to large increases in the ranks of the uninsured and underinsured, unless increases in health care costs in general were somehow slowed dramatically at the same time.

As a result, Congress would likely bring overall entitlement spending under the cap *by making wide-ranging cuts across entitlement programs generally*, including many programs whose costs are not rising significantly. Under the Hensarling proposal, if all entitlement programs except Social Security were reduced by the same percentage, every such program would have to be cut by about 25 percent by 2015.

Entitlement Cuts Over 10 Years Under Kirk Proposal, If All Entitlements Are Cut Proportionately
(in billions of dollars)

Medicaid	-175
Federal civilian retirement and disability	-50
Unemployment Compensation	-30
Military retirement and disability	-28
Supplemental Security Income	-27
Veterans' benefits	-22
Earned Income Tax and Child Tax Credits	-21
Food Stamps	-18
Family Support	-15
Child Nutrition	-10
Commodity Credit Corporation	-9
Other federal retirement and disability	-6
TRICARE for Life	-6
Foster Care and Adoption Assistance	-5
Student loans	-4
Universal Service Fund	-4
State Children's Health Insurance	-3
Social services (Title XX, Voc Rehab)	-3
Other miscellaneous	-9
TOTAL	**-445**

3. Unforeseen factors beyond policymakers' control could push entitlement costs above the cap, forcing substantial cuts.

Many unforeseen and uncontrollable factors can lead to increases in the cost of certain entitlements. For example:

- *International harvests can improve*, leading to a decrease in prices for agricultural goods and a corresponding increase in the cost of farm price supports.
- *Severe weather can damage crops* and cause the cost of the crop insurance program to rise.
- *A flu epidemic* or the onset of a new disease can lead to increases in Medicare and Medicaid costs.
- A major bankruptcy could impose significant new costs on the Pension Benefit Guarantee Corporation.

Under an entitlement cap, such increases would force offsetting cuts in entitlement programs. Furthermore, if the offsetting cuts were instituted in whole or in part through automatic cuts (rather than legislative changes), those cuts would be permanent, even if the rise in entitlement costs that precipitated the cuts was temporary.

4. The cuts required by an entitlement cap could shift significant costs to states.

If an entitlement cap forces large cuts in entitlement programs, significant costs incurred in providing needed benefits and services almost certainly would be shifted to states. Cuts in Medicaid or Medicare, for example, could force states to cover more of the health care costs of low-income elderly individuals and people with disabilities. States also could lose a portion of other grants, such as child care, social services funding, and funding for vocational rehabilitation. Some cuts might be accompanied by new discretion that states could use to reduce benefits or curtail eligibility, but states and local communities often would be left "holding the bag" when their residents were unable to secure the health care or other benefits and services they needed.

Moreover, if "automatic" entitlement cuts were instituted (because the Administration projected that entitlement costs would exceed the cap), the cost-shift to states would be immediate. Automatic cuts in Medicaid, for example, would likely be implemented through a reduction in the federal Medicaid matching rate, with every state being required to pay a higher percentage of Medicaid costs (and the federal government paying a lower percentage).

5. Exceptions that protect certain programs from automatic cuts under an entitlement cap are unlikely to work as advertised.

Under the Kirk and Hensarling entitlement cap proposals, some programs would be exempt from the automatic cuts that would be triggered if Congress failed to reduce entitlements enough to fit within the cap. Cuts in some other programs would be limited to two percent per year under the automatic cuts.

During last year's debate, entitlement cap proponents cited these rules as meaning that various entitlement programs would be fully protected from cuts or touched only lightly. Such claims were misleading. It is extremely *unlikely* that the bulk of the cuts made to comply with an entitlement cap would be made through the automatic-cuts process.

To see why, suppose that every year, all of the cuts needed to comply with the Hensarling entitlement cap were made through automatic cuts. All programs *not* partly or entirely exempt from these cuts — including farm subsidies, the EITC, vocational rehabilitation, military retiree health benefits, and even Congress's salaries — would have to be cut *100 percent* by 2010.

It is inconceivable that Congress would stand by and allow these programs — and Members' own salaries — to be eliminated (or, in the case of the Kirk version, cut extremely severely). Instead, Congress almost surely would avert the imposition of such severe automatic cuts by enacting legislation that spread the pain more broadly through cuts in a range of entitlements, including those protected against the *automatic* cuts. As a result, *all* programs included under an entitlement cap would be at risk of deep cuts over time.[3]

---

[3] It also should be noted that even in the extremely unlikely event that entitlement programs were reduced entirely through automatic cuts, the cuts would mount over time in the programs in which the cuts were limited to two percent

6. Entitlement cap proposals exclude "tax entitlements."

The entitlement cap would *exempt* the class of entitlements that has been termed "tax entitlements" by Federal Reserve Board Chairman Alan Greenspan and is referred to as "tax expenditures" by the Congressional Budget Act and the Congressional Joint Committee on Taxation. These are the hundreds of billions of dollars of entitlement-style subsidies delivered through the tax code, via special tax breaks, write-offs, shelters, and the like. In fact, according to some experts, the total cost of tax expenditures is between $600 billion and $800 billion per year, amounts equal to 45 percent to 60 percent of total entitlement program outlays.

Middle-class and low-income Americans receive the bulk of their government benefits through spending entitlements. By contrast, wealthy individuals and corporations receive the majority of their government benefits and subsidies through tax entitlements. By exempting the tax entitlements from the cap, the proposal strongly favors affluent individuals and powerful corporations over ordinary Americans.

For example, the federal government subsidizes the cost of child care for families at various income levels. For low-income families, the federal government provides funding to states to use to provide subsidies to families. This child care block grant funding would be under the entitlement cap and almost surely would face cuts. For middle and high-income families, by contrast, the federal government provides two different types of subsidies *through the tax code* to families with child care costs — subsidies through the Dependent Care Tax Credit and through "cafeteria plans" that allow families to deduct up to $5,000 in child care expenses from their taxable income. These tax subsidies would *not* be subject to the entitlement cap and would not face cuts as a result of entitlement cap proposals.

7. An entitlement cap would likely cause recessions to become deeper and more frequent.

Under entitlement cap proposals, substantial cuts would continue to be required even in years when the economy is weak. This could push a faltering economy into recession and cause existing recessions to become deeper and more protracted.

In addition, Congress often enacts temporary increases in some benefits during economic downturns, such as extensions of unemployment insurance benefits and temporary increases in federal matching payments for Medicaid. This helps to stabilize the economy while also providing relief to families (or states) in distress. An entitlement cap likely would make enactment of such forms of economic stimulus more difficult, because the stimulus measures could breach the cap (or cause it to be breached by an even larger amount). The result could be either that such measures would not be enacted or that Congress would have to offset the cost of these stimulus measures with other entitlement cuts, even though doing so would withdraw funds from the economy in the middle of a downturn and be a self-defeating proposition. An entitlement cap consequently could interfere with sound fiscal and economic policy.

---

each time that the automatic cuts were triggered. This is because these programs would be reduced an *additional* two percent each time the automatic cuts were implemented.

An Entitlement Cap Likely Would Make it Harder to Secure Agreement in Coming Years on a Major Package to Achieve Large-scale Deficit Reduction

The establishment of an entitlement cap could doom chances to reach a "grand bargain," under which all parts of the budget would be placed on the table and major deficit-reduction achieved through a bipartisan agreement. History suggests that unless all parts of the budget — including revenues, entitlements, and discretionary programs — are on the table and a spirit of "shared sacrifice" is invoked, large-scale deficit reduction is unlikely to be achieved. (That achievement of large-scale deficit reduction depends upon putting all parts of the budget on the table is true for two reasons. First, policymakers who fiercely defend particular parts of the budget are much more likely to try to block or limit the degree of savings from the parts of the budget that they champion if other major parts of the budget are being given special protection. Second, unless all parts of the budget are on the table, there will be strong temptation to use savings secured in one part of the budget — such as savings from reductions made in entitlement programs to comply with an entitlement cap — to finance measures adding new costs in another part of the budget, such as new tax cuts.)

If an entitlement cap is imposed, the chances of reaching a "grand bargain" in which all parts of the budget contribute to deficit reduction and large-scale deficit reduction is secured will be materially lessened. Significant *additional* reductions in entitlements will likely be off the table, and policymakers and interest groups that favor continual tax cuts and oppose revenue-raising measures will see little reason to assent to a deficit-reduction agreement that increases revenues without making additional cuts in entitlement programs. Indeed, with the establishment of an entitlement cap, these policymakers and interest groups will have succeeded in securing the adoption of a mechanism designed to force cuts in popular entitlement programs *without* having had to give any ground on tax cuts. Adoption of an entitlement cap consequently risks greatly diminishing the potential for a large bipartisan deficit-reduction agreement.

8. Entitlement cap would not necessarily produce any deficit reduction.

Despite the deep cuts that an entitlement cap could require, it would not necessarily result in deficit reduction. Entitlement cap proposals do not place any limitation or any form of fiscal discipline on tax cuts. As a result, deep cuts in entitlement benefits for the elderly, people with disabilities, veterans, low-income children, and others could be used to make room in the budget for further rounds of tax cuts for affluent Americans and well-connected special interests, rather than to reduce the deficit. (In addition, as the box above explains, the existence of an entitlement cap would likely make it harder to secure bipartisan agreement for major legislative packages to achieve deficit reduction on a large scale.)

9. An entitlement cap could lead to severe cuts that most policymakers would not endorse today.

Twelve years ago, Colorado enacted a constitutional tax and spending cap known as the "Taxpayers Bill of Rights," or TABOR. Similar to entitlement cap proposals, TABOR placed an overall cap on state government expenditures, with the cap allowed to rise only with the general inflation rate and increases in the state's population. Since the adoption of TABOR, Colorado has seen a dramatic decline in the quality of its public services. Although Colorado has the 7th highest per capita income in the country:

- The percentage of low-income children in the state who are uninsured is now 50 percent above the national average;
- The percentage of low-income people covered through Medicaid is lower than in all but five other states;
- The state ranks 50th among states in on-time childhood vaccinations;
- The state pays its K-12 teachers significantly less than the national average; and
- The state now ranks 47th in taxpayer support for colleges and universities.

Prior to the adoption of TABOR, reductions in public services to these levels would have been impossible to enact in Colorado. After the TABOR cap was established, previously unthinkable cuts moved to center stage and were adopted.

In a similar way, a federal entitlement cap would likely force cuts in entitlement programs over time that cannot secure majority support in Congress today.

Conclusion

An entitlement cap is an ill-advised and inequitable way to address deficits. Fiscal discipline needs to be restored, but Congress should take a balanced approach, in which the entire budget is on the table and program reductions and revenue increases both are considered, as was done in the large deficit reduction packages enacted in 1990 and 1993. Furthermore, cuts in entitlements should not be made through a rigid cap based on an arbitrary formula. When deciding whether or how to reduce government-funded services, policymakers should analyze the benefits and costs of each program and determine what specific changes in benefits and services are warranted.