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2017 Debt Limit Should Trigger Spending Limit—with Enforcement

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Abstract

The U.S. budget is unsustainable. As the U.S. fiscal situation grows further out of control, and as entitlement spending on health care and old-age programs is projected to consume a growing share of the budget, lawmakers should take action this year, while economic growth is steady, to implement a medium-term and long-term budget agreement that controls spending and debt. The 2017 debt limit offers an ideal action-forcing moment for President Trump and Congress to implement key measures to control spending and debt, and put the budget on a path to balance before the end of the decade. To enshrine their commitment to fiscal responsibility in the long term, Congress and the President should adopt a statutory spending limit to help them achieve their budgetary goals with action-motivating deadlines and enforcement measures. Congress and the President should enact spending controls before considering any increase in the debt limit.

The U.S. budget is unsustainable. Spending and debt are growing to catastrophic levels. With the national debt at $20 trillion as deficits grow rapidly, the President and Congress must address the nation's fiscal situation without delay. Congress and President Trump will be confronted with the expiration of the current debt limit suspension on March 16, 2017. Lawmakers should respond by putting the U.S. budget on a path to balance before raising the debt limit, only authorizing such borrowing as is necessary to realize this path to fiscal sustainability. A statutory spending cap can help to rein in fiscal profligacy by imposing penalties if lawmakers breach their commitment to balance the budget. Several legislative approaches, including the Penny Plan[1]—introduced by House

Key Points

- The U.S. budget is unsustainable. With the national debt at $20 trillion as deficits grow rapidly, the President and Congress must address the nation's fiscal situation now.
- Congress and President Trump will be confronted with the expiration of the current debt-limit suspension on March 16, 2017. Lawmakers should respond by putting the U.S. budget on a path toward balance before raising the debt limit, only authorizing such borrowing as is necessary to realize this path to fiscal sustainability.
- Instead of focusing on the risk of default, Congress should avoid a real fiscal crisis by implementing reforms to rein in uncontrolled spending and debt.
- Lawmakers must acknowledge the magnitude of the looming U.S. fiscal crisis and develop a serious commitment to a sustainable fiscal path. A spending limit can enshrine such commitment and facilitate enforcement—if there is political will.

This paper, in its entirety, can be found at **http://report.heritage.org/bg3190**

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Budget Committee Member Representative Mark Sanford (R–SC) and the Senate Budget Committee Chairman Senator Mike Enzi (R–WY)—and the Maximizing America's Prosperity Act, introduced by Representative Kevin Brady (R–TX), promise to focus necessary budget discussions on the key drivers of spending and debt: unsustainable health care and old-age programs.

The Debt Limit: A Critical Fiscal Policy Tool

This spring, Congress and the executive will run up against the statutory debt limit: Treasury's authorization to borrow on the credit of the U.S. government expires on March 16, 2017. Due to the existence of various debt limit loopholes, Treasury will be able to borrow from other governmental accounts for a few months, possibly until mid-summer, but eventually the debt limit will threaten to become binding.

The debt limit is the statutory limit on the amount of national debt that the U.S. Treasury may issue to meet federal payment obligations. Congress last lifted the debt limit in November 2015 as part of the Bipartisan Budget Act (BBA), commonly known as the Obama–Boehner budget deal. The BBA reinstates the debt limit on March 16, 2017.[2] At $20 trillion, debt subject to the limit exceeds what the U.S. economy produces in goods and services as measured by gross domestic product (GDP) annually. Moreover, debt is growing rapidly, primarily driven by spending on health care and old-age entitlement programs, including Medicare, Medicaid, Obamacare, and Social Security.[3]

A vote to increase the debt limit is a highly public affair and an opportunity to revisit how current policies affect spending, deficits, and debt. Without a rule imposing a periodic routine examination of finances on Congress and the executive, there is a real risk that lawmakers will delay corrective fiscal action until a crisis forces drastic and needlessly painful changes. Just as an occasional check on blood pressure can lead to a course correction in eating and exercise habits to avoid a life-threatening heart attack, the debt limit serves to motivate lawmakers to check on and correct the nation's fiscal path before a crisis hits.

Hitting the debt limit confronts Congress and the Administration with the results of unsustainable budget decisions: massive and growing amounts of debt. In response, lawmakers should adopt spending cuts and critical reforms to stop out-of-control spending and debt. A fiscal crisis that forces lawmakers to take action when investors lose confidence in the U.S. government would have far worse consequences than deliberate congressional action to ensure that government programs are sustainable.

Just as an occasional check on blood pressure can lead to a course correction in eating and exercise habits to avoid a life-threatening heart attack, the debt limit motivates lawmakers to check on and correct the nation's fiscal path before a crisis hits.

It is not uncommon for lawmakers to use the statutory debt limit as leverage to enact deficit-reduction legislation. Examples include the Budget Control Act (BCA) of 2011, which raised the debt limit in exchange for dollar-for-dollar cuts in spending, and the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm–Rudman–Hollings), which raised the debt limit in exchange for a five-year plan to balance the budget.[4] Indeed, the prudent choice pairs any increase in the debt limit with spending reforms to control debt in the future.

Before agreeing to consider any increase in the debt limit, Congress and the President should enact these spending controls:

1. Justin Bogie and Romina Boccia, "How the Federal Government Can Get Its Spending Under Control," The Daily Signal, July 12, 2016, http://dailysignal.com/2016/07/12/how-the-federal-government-can-get-its-spending-under-control/.
2. Paul Winfree et al., "Analysis of the Bipartisan Budget Act of 2015," Heritage Foundation *Issue Brief* No. 4477, October 28, 2015, http://www.heritage.org/research/reports/2015/10/analysis-of-the-bipartisan-budget-act-of-2015.
3. Paul Winfree, "Causes of the Federal Government's Unsustainable Spending," Heritage Foundation *Backgrounder* No. 3133, July 7, 2016, http://www.heritage.org/research/reports/2016/07/causes-of-the-federal-governments-unsustainable-spending.
4. University of California, Berkeley, Bancroft Library, Oral History Center, "1985 Balanced Budget and Emergency Deficit Control Act," http://bancroft.berkeley.edu/ROHO/projects/debt/1985grammrudmanhollings.html (accessed August 5, 2016).

Stop Suspensions. Since passage of the BCA, Congress has failed to put a current-dollar limit on the debt, opting instead to repeatedly suspend the debt limit. A debt-limit suspension technically renders the debt-limit statute inoperative. It allows unlimited borrowing by the Treasury through a certain date.

Debt-limit suspensions are a convenient way for Congress to mask the consequences of their action. Taxpayers will not know until after the debt-limit suspension ends and Treasury has exhausted its extraordinary measures how much the debt increased as a result of Congress's vote.

When the debt-limit suspension ends, the debt limit is automatically increased to reflect the amount of borrowing that occurred since the last debt limit last bound the Treasury. In many ways, a debt-limit suspension is like giving the Treasury a credit card with no limit, or a blank check to be cashed against younger and future generations, valid until a certain date.[5]

Lawmakers often argue that suspensions allow them to schedule a more opportune legislative moment at which to enact spending control. Recent history, though, shows that Congress does not, in fact, enact spending control following suspensions of the debt limit. Clearly, this argument is just another smokescreen to cover for lawmakers' fiscal profligacy and lack of budget discipline. Moreover, given unpredictable cash-flow operations and the Treasury's authority to resort to extraordinary measures, or authorized debt-limit loopholes, Congress has very little control over when Treasury's borrowing authority is fully exhausted and the debt limit will bind.

Debt-limit suspensions pave the way to eliminate the debt limit altogether. Congress should not allow any more debt-limit suspensions. Congress should commit to limiting the debt to either a specific dollar amount or to a percentage of GDP. The debt limit itself, however, is not sufficient to control the growth in the debt. Congress must act on its commitment to limit debt by controlling its key driver: out-of-control spending.

Focus on the Real Fiscal Crisis. Spending, deficits, and debt are rising at an unsustainable rate that is leading the nation down the path to fiscal disaster. The Congressional Budget Office projects that spending will grow from $3.9 trillion in 2016 to more than $6 trillion by the end of the decade. More than half of this projected growth in spending is driven by major health care programs and Social Security. Debt subject to the limit is projected to grow from more than $20 trillion in 2017 to more than $28 trillion by 2026.

Economic growth alone cannot make the budget sustainable.

Whether a fiscal path is sustainable depends on projected spending and revenues, not only on current debt.[6] Since spending, especially on health care programs, is outpacing growth in revenues and in the economy, immediately and over the long run, the federal budget is on a fiscally unsustainable path that requires policy changes. Economic growth alone cannot make the budget sustainable. Congress should not delay action to return the U.S. budget to a fiscally sustainable path.[7]

Too often, when the government approaches the debt limit, public debate is focused on the risk of default due to a debt-limit impasse. We now know that the Obama Administration intentionally misled Congress about contingency plans in the event of a debt-limit impasse to pressure Congress into raising the debt limit without spending reforms. A House Financial Services Committee investigation revealed that the Administration was technologically capable of prioritization and it had been preparing to prioritize debt-service payments in the event of a debt-limit impasse to avoid default.[8]

Instead of focusing on the risk of default, Congress should avoid a real fiscal crisis with reforms to rein in out-of-control spending and debt. That

5. Romina Boccia, "Blank Check: What it Means to Suspend the Debt Limit," Heritage Foundation *Issue Brief* No. 4149, February 14, 2014, http://www.heritage.org/research/reports/2014/02/blank-check-what-it-means-to-suspend-the-debt-limit.
6. Paul Winfree, "Causes of the Federal Government's Unsustainable Spending," Heritage Foundation *Backgrounder* No. 3133, July 7, 2016, http://www.heritage.org/research/reports/2016/07/causes-of-the-federal-governments-unsustainable-spending.
7. Congressional Budget Office, "Budget and Economic Data: 10-Year Budget Projections," March 2016, https://www.cbo.gov/about/products/budget_economic_data (accessed on January 27, 2017).
8. Romina Boccia, "At the Debt Limit: Congress Should Focus on the Real Budget Crisis," Heritage Foundation *Commentary*, February 26, 2016, http://www.heritage.org/research/commentary/2016/2/at-the-debt-limit-congress-should-focus-on-the-real-budget-crisis.

means reforming the key drivers of spending and debt—Medicare, Medicaid, and Social Security—before increasing the debt limit yet again.

Congress should also cut unnecessary domestic spending, especially in areas that are better managed at the state, local, and private level. Corporate welfare that distorts the economy and picks winners and losers in the marketplace should be eliminated. Individual and economic freedoms must be restored by reducing the sphere of federal politics to its constitutionally appropriate size and scope.

Discretionary budget caps are not enough. Two-thirds of the federal budget is not subject to the BCA caps. The much larger "mandatory" budget grows on autopilot without regular congressional control or oversight.

By better prioritizing federal spending programs, Congress can fully provide for the nation's defense needs and reduce the national debt—without further raising taxes. The Heritage Foundation's three-part blueprint series includes the specific policy reforms to accomplish these goals.[9]

Building on the Budget Control Act: Capping Federal Spending

Fiscal discipline is politically difficult. Special interests and legitimate government purposes vie for scarce federal dollars. Prioritizing competing demands is hard work, but it is necessary. Lawmakers in several countries, including in the United States, have laudably imposed restrictions on themselves in order to tie their own hands for the greater good of fiscal discipline.

The debt limit represents one such self-imposed restriction. It seeks to limit the issuance of debt. One key shortcoming of the statutory debt limit is that it seeks to restrain borrowing without first restraining the key source of the need for borrowing: spending. By the time the Treasury runs up against the debt limit, spending commitments have already been made, and bills will be coming due. And while spending is a key driver of rising debt, economic crises and other factors outside of Congress's control can drive debt up without Congress's active doing. Though lawmakers should react to the debt limit by viewing it as an action-forcing wake-up call to motivate a change in budget policies, it is easy to argue that the limit must be raised or else payments will be delayed.

Restrictions on spending focus lawmakers on what they can more effectively control, and on the key source of growing debt. Research shows that spending restrictions or expenditure rules tend to be more effective at accomplishing fiscal discipline than restrictions on debt or deficits alone. Four researchers with the International Monetary Fund reviewed expenditure rules in all countries where such rules exist at the national or supranational level and compared them with other rules:

> Our findings suggest that expenditure rules are associated with spending control, countercyclical fiscal policy, and improved fiscal discipline. We find that fiscal performance is better in countries where an expenditure rule exists. This appears to be related to the properties of expenditure rules as compliance rates are generally higher than with other types of rules (on the budget balance or debt, for example). In particular, we find that compliance with expenditure rules is higher if the expenditure target is directly under the control of the government and if the rule is not a mere political commitment, but enshrined in law or in a coalition agreement.[10]

Congress did impose spending limits on part of the federal budget in 2011. The BCA caps discretionary budget authority through 2021. These caps have helped to control discretionary spending, and they have spurred other budget changes to offset automatic cuts or sequestration. The overall discretionary cap should be maintained and lowered.

However, discretionary caps alone are not enough. Discretionary spending makes up a small and declining share of the overall federal budget.

9. The Heritage Foundation, "Blueprint for Reform: A Comprehensive Policy Agenda for a New Administration in 2017," July 14, 2016, http://www.heritage.org/research/reports/2016/07/blueprint-for-reform.

10. Till Cordes et al., "Expenditure Rules: Effective Tools for Sound Fiscal Policy?" International Monetary Fund, *IMF Working Paper* No. 15/29, February 2015, http://www.imf.org/external/pubs/ft/wp/2015/wp1529.pdf (accessed December 29, 2016).

Two-thirds of the federal budget is not subject to the BCA caps. The much larger "mandatory" budget grows on autopilot without regular congressional control or oversight.

Political will is a necessary component of political success.

Congress has thus far been unable to advance the important reforms that are necessary to control entitlement spending. An overall cap on government spending, including on entitlements, promises to advance the important discussion of which changes, and of which magnitude, are needed to address growing spending. Such a spending cap or limit would act as a constraint on the budgetary process and therefore on those who decide on the budget: lawmakers in Congress. A broader spending limit that encompasses the entirety of the federal budget is needed to rein in growing spending.

Expenditure Limits with Enforcement

Several approaches can establish effective expenditure limits. This section reviews several legislative approaches to limit spending that were recently introduced in the U.S. It explores the expenditure or spending limit, called the "debt brake," in Switzerland. It also discusses a new fiscal rule proposed by John Merrifield and Barry Poulson.[11]

A spending limit is not a silver bullet. Its effectiveness requires commitment to fiscal responsibility; a spending limit can enshrine such commitment and facilitate enforcement. Only when lawmakers recognize the magnitude of the looming U.S. fiscal crisis and develop a serious commitment to changing budgetary policy, can a spending limit and its enforcement be effectively sustained. Political will is a necessary component for success.

The Penny Plan. Representative Sanford and Senator Enzi introduced the "Penny Plan," which would implement an aggregate spending cap beginning in 2017 and "would cut a single penny from every dollar the federal government spends."

This plan would impose a spending cap or limit of $3.6 trillion for total non-interest outlays minus 1 percent for 2017. For each subsequent year through 2021, outlays would be capped at the previous year's level (not including net interest payments) minus 1 percent. Starting in fiscal year 2022, and all subsequent years, total spending would be capped at 18 percent of GDP, in line with the historical revenue average. Sequestration would enforce the spending cap in the absence of more deliberate congressional reforms to achieve the spending target.

Unlike the current form of sequestration applied to the BCA spending caps, the Penny Plan would not exempt any of the programs listed under the Balanced Budget and Emergency Deficit Control Act of 1985, except payments for net interest.

Automatic spending cuts are a blunt tool. The main drivers of debt—Medicare, Medicaid (including Obamacare), and Social Security—are best reformed with targeted structural reforms that secure benefits for the most vulnerable in society.

Automatic spending cuts are a blunt tool to rein in growing spending, and the main drivers of the debt—Medicare, Medicaid (including Obamacare), and Social Security—are best reformed with targeted structural reforms that secure benefits for those most vulnerable in society, while protecting working Americans from undue debt and tax burdens. By not exempting any programs, Congress is more likely to consider deliberate reforms to entitlement and welfare programs, rather than let sequestration cut them indiscriminately.

The Maximizing America's Prosperity (MAP) Act. The MAP Act[12] introduced by Representative Brady would cap federal non-interest spending as a percentage of full-employment GDP or potential GDP for cyclical adjustment. Lawmakers would be able to spend more during periods when the econo-

11. John D. Merrifield and Barry W. Poulson, *Can the Debt Growth Be Stopped? Rules-Based Policy Options for Addressing the Federal Fiscal Crisis* (Lanham, MD: Lexington Books, 2016).

12. H.R. 2471, Maximizing America's Prosperity Act of 2015, https://www.congress.gov/bill/114th-congress/house-bill/2471 (accessed January 5, 2017).

my is weak, and deficits incurred to smooth out business cycles would be offset with surplus revenues when the economy is at full employment.

Sequestration would be limited in size and scope, affecting only those programs not exempt from sequestration under the Balanced Budget and Emergency Deficit Control Act of 1985. One theory holds that, as discretionary programs financing domestic and defense priorities get squeezed, this will bring about the political consensus to address the key drivers of spending growth: health care and Social Security.

The Business Cycle Balanced Budget Amendment. The Business Cycle Balanced Budget Amendment,[13] introduced by Representative Justin Amash (R–MI) would cap federal non-interest spending based on the average annual revenue collected over the three prior years, adjusted for inflation and population. Congress would need to pass implementing legislation to carry out the necessary spending changes to achieve the savings determined by the outlay cap. Public humiliation for breaching the caps is expected to motivate spending reforms.

The Debt Brake. A "debt brake," such as employed in Switzerland and then in Germany, is an expenditure-based rule that limits spending—except on social insurance—in accordance with revenues and a business-cycle adjustment factor. The adjustment factor is determined by the difference between trend potential GDP and real GDP. The Swiss debt brake is a countercyclical expenditure rule that allows deficit spending during economically weak periods, and that limits spending more tightly during economically strong periods. The goal is to achieve a stable revenue-to-spending ratio. The rules, adopted in 2003, have led to a budget that tends toward surpluses or balance. The rule is widely lauded as a success story, worthy of emulation by other nations.[14]

The Merrifield/Poulson (MP) Rule. The MP rule would limit all federal spending with automatic enforcement sequestration, except for interest, Social Security, and Medicare Part A (due to their trust-fund financing). A second-layer debt-and-deficit brake would include all spending, except interest, and is expected to exert indirect pressure on entitlement spending by squeezing other parts of the budget more tightly without Medicare and Social Security reform. The spending limit would be adjusted upwards with population growth and inflation, similar to Colorado's Taxpayer's Bill of Rights (TABOR), which is recognized as one of the most effective budget limits in the U.S.[15] The second-layer debt brake follows the Swiss model for achieving countercyclical budget balance.[16] As such, the MP rule seeks to adapt the most effective features of expenditure limits to the U.S. context.

Adopting a Fiscal Rule in the U.S.

As the U.S. fiscal situation grows further out of control and as entitlement spending on health care and retirement programs is projected to consume a growing share of federal resources, lawmakers should take action this year, while economic growth is steady, to implement a medium-term and long-term budget agreement that controls spending and debt. The 2017 debt limit offers an ideal action-forcing moment for the President and Congress to implement key measures to control spending and debt and put the budget on a path toward balance before the end of the decade.

Congressional budget plans introduced in recent years,[17] and alternative proposals, such as the Republican Study Committee's Blueprint for a Balanced Budget 2017[18] and the Heritage Foundation's

13. Merrifield and Poulson, *Can the Debt Growth Be Stopped?*

14. Daniel J. Mitchell, "How the Swiss 'Debt Brake' Tamed Government," *The Wall Street Journal*, April 25, 2012, http://www.ncpa.org/sub/dpd/index.php?Article_ID=21869#sthash.clbEF660.dpuf (accessed January 24, 2017).

15. Benjamyn Zycher, "State and Local Spending: Do Tax and Expenditure Limits Work?" American Enterprise Institute, May 2013, http://www.aei.org/wp-content/uploads/2013/05/-state-and-local-spending-do-tax-and-expenditure-limits-work_152855963641.pdf (accessed January 24, 2017).

16. Merrifield and Poulson, *Can the Debt Growth Be Stopped?*

17. U.S. House Committee on the Budget, "A Balanced Budget for a Stronger America," April 2017, http://budget.house.gov/fy2017/ (accessed January 5, 2017).

18. Republican Study Committee, "Blueprint for a Balanced Budget 2017," April 2017, http://rsc-walker.house.gov/files/uploads/RSC_2017_Blueprint_for_a_Balanced_Budget_2.0.pdf (accessed January 5, 2017).

three-part Mandate series,[19] all propose specific, detailed reforms to control the key drivers of the federal debt. Congress should pursue a budget that balances before the end of the decade with repeal of Obamacare, tax reform, and key reforms to Medicare, Medicaid, Social Security, and prioritization of other government programs such that the nation's defense is strong, and improper, crony, and unnecessary federal domestic programs are devolved to the states, localities, and the private sector, or eliminated altogether.

Moreover, Congress and the President should enshrine their commitment to fiscal responsibility in the long term by adopting a statutory spending limit, enforced by sequestration when necessary, to help them achieve their budgetary goals with action-motivating deadlines and enforcement measures. Congress should build on the successes of the Budget Control Act with a broader spending cap that motivates deliberate reforms of the key drivers of spending and debt by putting all government programs on the table for discussion—with the threat of automatic cuts should lawmakers fail to reach agreement.

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19. The Heritage Foundation, "Mandate for Leadership: A Comprehensive Policy Agenda for a New Administration," *Executive Summary*, August 26, 2016, http://www.heritage.org/research/reports/2016/07/mandate-for-leadership.