



Federal Deficit Reduction: How It Works and Implications for Minnesota

After months of intense debate, Congress passed and President Obama signed into law an increase in the federal debt ceiling. Votes to increase the federal debt ceiling have historically been relatively uncontroversial. However, this year, as a condition of raising the debt ceiling, some members of Congress insisted on also achieving reductions in future federal deficits, although these issues are not necessarily related.

While the debt ceiling deal may have averted the near-certain economic crisis that would have occurred had the federal government defaulted on its debt, a close look at the details of the deal reveals a package that is unbalanced and unfair, and could have serious consequences for Minnesota.

The deal, known as the Budget Control Act of 2011, ensures over \$2.1 trillion in deficit reduction over ten years through a multi-step process. The deal also requires the House and Senate to vote before the end of 2011 on a joint resolution proposing a Balanced Budget Amendment to the U.S. Constitution, although passage of the amendment is not required in order to raise the debt ceiling.¹

Here's how the process will work:

- Nearly \$1.0 trillion in cuts to discretionary spending will be made over ten years from Federal Fiscal Year 2012 to 2021.
- A new Joint Select Committee on Deficit Reduction is charged with specifying an additional \$1.5 trillion or more in deficit reduction over ten years. These reductions can come from discretionary spending, entitlements, or increases in revenues.
- If policymakers fail to achieve at least \$1.2 trillion in deficit reduction through the Joint Committee process, automatic across-the-board cuts would occur over nine years to discretionary spending (including defense) and mandatory spending, with some exceptions.

Different parts of the federal budget are at stake at each phase of the process.

Federal spending is often described in two broad categories: discretionary spending and mandatory spending. Discretionary spending includes education, environmental protection, low-income housing assistance, defense, and other areas whose budgets are set each year by Congress through the appropriations process. Discretionary spending, including defense, covers 39 percent of all federal spending; non-defense discretionary spending makes up 19 percent of all federal spending.² Mandatory spending, which consists largely of so-called entitlement programs, is not controlled by the annual appropriations process. It makes up 55 percent of federal spending. Some of the best-known entitlements include Social Security, Medicare, Medicaid and Unemployment Insurance.

The first phase of deficit reduction makes almost \$1.0 trillion in cuts over ten years in discretionary spending. The Budget Control Act does not specify where these cuts would be made, but rather puts limits, or "caps," on the annual appropriations bills for ten years beginning in Federal Fiscal Year 2012, which starts on October 1, 2011. The cuts to specific services will be determined as Congress takes up individual annual appropriations bills later this year and in coming years.

The second phase of deficit reduction is not limited to discretionary spending. The Joint Select Committee on Deficit Reduction will recommend at least \$1.5 trillion in additional deficit reduction over ten years (through

2021). The deficit reduction could be achieved through cuts in discretionary spending or entitlements, or through increases in revenues. The Joint Select Committee must vote on its deficit reduction package by November 23, 2011. The package must be voted on in the House and Senate before the end of the year under a fast-track process with no amendments that only requires a simple majority of votes to pass.

Again, the Budget Control Act does not specify where the Joint Select Committee would make changes. But to meet its target, the Committee will likely need to adopt severe cuts in both entitlements and discretionary spending – on top of the nearly \$1.0 trillion in cuts to discretionary spending made through annual spending caps. Some members of the Committee have previously pledged not to raise revenues. Looking at the types of deep cuts that would be required to meet the target without raising revenues, some Congress-watchers have predicted that the Committee will be unable to reach its target. For example, recent budget negotiations that included shifting significant Medicaid health care costs to the states, raising the age at which Americans are eligible for Medicare, modifying cost-of-living increases in Social Security, as well as other entitlement savings and changes in the tax code, would only get the Joint Select Committee *halfway* to its deficit reduction goal.³

If the Joint Select Committee process does not achieve at least \$1.2 trillion in deficit reduction, a third mechanism would make up any difference between what has been passed into law and the \$1.2 trillion target. Across-the-board spending cuts, known as “sequestration,” would occur in a number of discretionary programs, including defense, and in some entitlements, starting in January 2013. Medicare would be subject to cuts of no more than two percent, and those cuts would fall solely on payments to doctors, hospitals and other health care providers. Unlike the Joint Select Committee process, some areas of the budget would be protected from the across-the-board cuts, such as Social Security, Medicaid, veterans’ benefits and pensions, Supplemental Security Income (SSI), refundable tax credits including the Earned Income Tax Credit, and Temporary Assistance to Needy Families. The Center on Budget and Policy Priorities estimates that \$1.2 trillion in across-the-board cuts would result in an approximately nine percent annual cut in affected non-defense discretionary programs and a nine percent cut in defense.

The Debt Ceiling Package Violates Key Principles of Balance and Fairness

The Minnesota Budget Project has argued that long-term deficit reduction should be achieved through a responsible and balanced approach that is equally divided between spending reductions and increases in needed revenue. This approach recognizes that tax cuts have been a significant contributor to the growth in the federal deficit.⁴ In addition, we assert that deficit reduction should not lead to an increase in poverty or inequality.

Unfortunately, the legislation passed by Congress so far largely falls short of meeting these principles.

The legislation is unbalanced because it risks reducing deficits solely through spending cuts. While the Joint Select Committee can use any deficit reduction tools, including raising revenues, some participants in the process have adamantly ruled out increasing revenues. A better approach would be a balanced mix of shared and appropriate reductions in spending along with increases in revenues from, such as from modifications or elimination of certain tax expenditures, including some tax exclusions or deductions that disproportionately benefit wealthy taxpayers and highly profitable businesses.

Under the Budget Control Act, an increase in poverty and inequality appears inevitable. Deep cuts are very likely to be made in federal services that support and provide opportunities for children, students, people with disabilities, seniors, and others. The initial burden will be felt most by those directly impacted, but over time, the nation as a whole will also suffer the consequences. The nation’s economy is stronger when all have the

education and opportunity to reach their greatest potential. And our nation fails to live up to its promise if the elderly and people with disabilities are not able to live in dignity.

The legislation also requires Congress to take a vote in the final three months of this year on a constitutional amendment to require an annual balanced budget. Such an amendment would tie the hands of the President and Congress in responding to future economic emergencies or natural disasters. The American people intend for their elected representatives to debate and make the tough choices about tax and spending policies, not rely on rigid and potentially irresponsible fiscal constraints.

Impact on Minnesota

Given the important relationships between states and the federal government, legislation as sweeping as the Budget Control Act will have a significant impact on Minnesota.

The nearly \$1 trillion in spending cuts from annual appropriations caps, and possibly a portion of future rounds of deficit reduction, come from cuts to discretionary spending. A substantial portion of federal discretionary spending flows to the states, either directly to state and local governments or to state residents.

While the details are not yet determined, some areas of federal discretionary spending where Minnesota could face cuts include:

- Title I Elementary and Secondary Education Act assistance to Minnesota schools serving low-income children.
- Even Start, a literacy project to improve the academic performance of young children.
- Special education grants to the State of Minnesota to help pay for services for children with disabilities.
- Pell Grants that help pay tuition for students pursuing higher education.
- Vocational and adult education.
- Workforce Investment Act (WIA) job training state formula grants for job training, helping dislocated workers and young people find jobs.
- Mental Health and Substance Abuse Block Grants to the State of Minnesota serving adults and children at risk of or experiencing mental illness.
- Substance Abuse Block Grants to help state and local governments to support and expand prevention and treatment for individuals and families at risk of or affected by substance abuse.
- LIHEAP (Low Income Home Energy Assistance Program), which helps low-income Minnesota families meet their energy needs.
- The Public Housing Capital Fund that local Minnesota housing agencies use for repairs.
- The HOME Investment Partnership Program that provides funding to the state and local communities for rental assistance as well as the development, acquisition and rehabilitation of affordable housing.
- Native American and Native Hawaiian Housing Block Grants that help fund affordable housing and related services along with community development on Minnesota reservations and tribal lands.
- Clean Water and Drinking Water State Revolving Funds that help Minnesota communities to provide clean and safe drinking water.
- Byrne Justice Assistance Grants that enable Minnesota communities to improve law enforcement and public safety.

Minnesota could also be harmed by cuts in entitlements that could occur under the Joint Committee process. The federal government could seek to reduce its spending by shifting more funding responsibilities to the states, including funding for health care through Medicaid.

It is impossible to say right now exactly which services will be cut as part of federal deficit reduction over the next ten years. But there is no doubt that the impact of significant cuts in federal spending will eventually be felt in every Minnesota community.

¹ Center on Budget and Policy Priorities, [*How the Potential Across-the-Board Cuts in the Debt Limit Deal Would Occur*](#), August 2011.

² Center on Budget and Policy Priorities, [*Policy Basics: Introduction to the Federal Budget Process*](#), January 2011.

³ Center on Budget and Policy Priorities, [*Statement of Robert Greenstein, President, on New Debt Ceiling Agreement*](#), August 2011.

⁴ Center on Budget and Policy Priorities, [*Economic Downturn and Bush Policies Continue to Drive Large Projected Deficits: Economic Recovery Measures, Financial Rescues Have Only Temporary Impact*](#), May 2011.