Key Decision Points in Federal Budget Debate

August 30, 2013

As Congress returns to work after a long August recess, the debate over the federal budget deficit is returning to the front burner, with several key milestones rapidly approaching over the next several weeks and months. These key "decision points" will significantly shape *how* Congress tries to reduce the national debt. Each one of these decision points will offer an important choice—whether to take a balanced approach to deficit reduction that includes new revenues and strengthens our economy, or to persist in making harmful spending cuts to key public investments.

DECISION POINT #1—Start of the new Fiscal Year and possible government shutdown

- **What's at stake**: The new federal Fiscal year begins on October 1, but Congress has yet to agree on any of the 13 appropriations bills that will fund federal government operations for the next year. Since Congress will not pass these bills prior to October 1, the House and Senate are expected to take up a stop-gap funding measure (a "continuing resolution") that temporarily continues spending levels into the next fiscal year—but only if Congress and the White House can agree on what those levels should be. Currently, the House is proposing temporary spending levels for 2014 far below the levels proposed by the Senate, largely due to differences over whether to continue automatic sequestration spending cuts into 2014. If no agreement is reached before the deadline, the federal government will "shut down" and suspend operations.
- **Bottom Line**: Unless an agreement on temporary funding levels is reached or the 2014 appropriations bill rolled into some kind of large-scale budget deal, the federal government will shut down—seniors will not receive social security checks, workers will lose access to community college training programs, national parks will close, and even some military operations will cease. But at this point, it appears that leaders of both parties are working hard to avoid this. Finally, given that sequestration is a major sticking point in any budget agreement for 2014, new revenue options remain an important part of any final deal.

DECISION POINT #2—The 2014 round of sequestration begins.

- **What's at stake:** On October 1, the impact of the 2014 round of automatic sequestration spending cuts begins to take effect, reducing federal spending by $120 billion over the next year on military programs and key domestic initiatives like Head Start, research and development, K-12 education, and food safety. First passed by Congress in 2011, these sequestration cuts come on top of nearly $2 trillion in spending cuts to the portion of the budget that funds these types of domestic discretionary initiatives—already the smallest area of the budget—leaving this category of spending at the lowest levels since the 1950s.
- **Bottom line:** The budget debate for 2014 opens the door to replacing sequestration (for a year or more) with a balanced package of new revenues and smarter spending cuts that don't increase poverty or inequality. Sequestration has already generated significant economic hardship for many North Carolinians in 2013, through reduced access to critical services, damage to the state's defense contracting base, and by reducing overall economic growth and job creation. Another round in 2014 will only harm the state further. As a result, a key consideration in the upcoming debate over sequestration will involve raising new revenues.

DECISION POINT #3—Federal debt ceiling reached.

- **What's at stake**: The federal debt limit is the statutory maximum the U.S. Treasury can legally borrow in order to pay its bills—and to cover the costs of commitments previously made to the nation's borrowers. For most of the 20th century, Congress raised the debt ceiling when necessary with little or no controversy, a practice that came to an end in 2011, when the House of Representatives agreed to lift the debt ceiling only in exchange for deep spending cuts—which ultimately resulted in sequestration. As the Treasury approaches the current debt ceiling, it is clear that Congress will need to act sometime in October in order to lift the limit and ensure that the country can pay its bills. Failure to do so would be catastrophic, resulting in default by the U.S. Government and a likely global financial crisis. Unfortunately, the House is again considering holding the debt limit hostage in exchange for more deficit reduction based on additional entitlement spending cuts.

- **The bottom line**. Nothing less than the future of the global economy rests on the decision to raise the federal debt ceiling. At the same time, the rationale for deep spending cuts has greatly diminished. The short-term federal budget deficit is now more than half what it was in 2009, rendering additional deep spending cuts both unnecessary and economically counterproductive, as seen in sequestration's negative consequences. Instead, Congress should take a balanced approach to remaining rounds of deficit reduction that includes new revenues and smart spending cuts that spares the most vulnerable. Almost 75 percent of deficit reduction savings have come through spending cuts that have hurt working North Carolinians. Now is not the time to ask them to bare an even greater share of the burden at a time when so many unnecessary tax expenditures allow so many corporations to avoid paying their own contribution.

DECISION POINT #4—Tax Reform

- **What's at stake**: The chairmen of the two tax-writing committees in Congress, Sen. Max Baucus (D-Mont.) and Rep. Dave Camp (R-Mich.), have joined forces to attempt a bipartisan compromise on overhauling the federal tax code. At stake is the largest portion of the federal budget, corporate and personal tax expenditures—the special tax breaks, loopholes, deductions, and credits that cost more than $1 trillion in foregone revenue every year and $10 trillion every decade. This cost surpasses every other major function of the budget, including Medicare, Social Security, and national defense, and is almost double the cost of domestic discretionary programs. [1]
- **Bottom Line**: While many of these tax expenditures represent tax breaks are genuinely beneficial to working and middle class families and should be preserved, [2] a significant portion constitute special tax loopholes available almost exclusively to corporations and the wealthiest Americans. Even those tax expenditures that should be preserved for middle income families can be reformed to reduce the tax break for the wealthiest taxpayers. Most economists believe such credits to be ineffective at promoting economic growth.[3] As a result, tax expenditures represent a far better place to achieve balanced deficit savings than the domestic discretionary programs targeted for spending cuts in the past.

As Congress debates these four decision points in the federal budget process, it is clear that North Carolina needs a balanced approach to deficit reduction that doesn't increase poverty and asks the wealthy and corporations to pay their fair share so that together all North Carolinians can contribute to a stronger economy for all.

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[1] Chuck Marr, Chye-Ching Huang, and Joel Friedman. (2013). Tax Expenditure Reform: An Essential Ingredient of Needed Deficit Reduction. The Center on Budget and Policy Priorities. Washington, DC

[2] These include credits like the EITC, Child Tax Credit, American Opportunity Credit, the home mortgage interest deduction, the charitable giving deduction, retirement savings deductions, and others.

[3] For a good review of this literature, see Peters, Alan and Fisher, Peter. (2004). "The Failures of Economic Development Incentives." Journal of the American Planning Association. Vol. 70, Number 1, Winter 2004. Chicago, IL: American Planning Association