Budget Model

The Fiscal Responsibility Act of 2023: Budget Cost Estimates of the Debt Ceiling Agreement

Summary: We estimate the Fiscal Responsibility Act ("FRA") of 2023 will reduce noninterest spending by $1.3 trillion over the 10-year budget window using standard scoring assumptions. If discretionary spending in Fiscal Year 2026, after sequestration is no longer in effect, deviates from standard scoring assumptions, the spending reduction could be as low as $234 billion or as high as $1.8 trillion.

Key Points

- The Fiscal Responsibility Act of 2023 ("FRA"), the formal legislation included in reported debt ceiling agreements, imposes strict limits on discretionary spending for the next two fiscal years and changes social assistance eligibility rules for a small number of Americans.
- Under standard scoring conventions, discretionary spending is assumed to grow with inflation after the last year that spending caps are explicitly enforced. After Fiscal Year (FY) 2025, therefore, spending is assumed to continue to grow with inflation. But that spending would start from a lower level relative to baseline policy (that is, before FRA) due to spending caps in FY2024 and FY2025. PWBM estimates that the FRA would then reduce noninterest spending by $1.3 trillion over the standard 10-year budget window.
- However, the FRA does not prevent Congress from returning discretionary spending to its FY2026 baseline (pre-FRA) level by FY2026. Under this alternative scoring assumption, the 10-year spending reduction comes only from the cost savings in FY2024 and FY2025. In this case, PWBM estimates a 10-year noninterest spending reduction of $234 billion. Alternatively, if Congress adopts the FRA's discretionary spending limits through FY2029 despite the lack of enforcement via sequestration, PWBM estimates $1.8 trillion in savings.

Introduction

On Saturday, May 27th, President Biden and Speaker Kevin McCarthy announced an agreement to suspend the debt ceiling, just days before the estimated date when Treasury would run out of operating funds. The agreement includes formal legislation titled the Fiscal Responsibility Act of 2023 ("FRA"). The agreement also appears to include informal spending cap commitments to be enacted in non-specified future legislation.

Proposal Details

The FRA includes the following provisions:

- **Temporary suspension of the debt limit.** Suspend the debt limit through January 1, 2025, and automatically reinstate the debt limit to the amount of debt outstanding on January 2, 2025.
- **Discretionary funding caps for FY 2024 and FY 2025.** Defense and nondefense discretionary spending would be subject to caps which would be enforced by sequestration. Under the caps, budget authority for defense programs would increase from its level of $858 billion in FY2023 to $886 billion in FY2024 and $895 billion in FY2025. Budget authority for nondefense discretionary programs would decrease from $767 billion in FY2023 to $704 billion in FY2024 and $711 billion in FY2025. The caps under the proposal would continue to allow exceptions for certain discretionary programs such as disaster relief, and the caps would provide new exceptions for certain programs under the 21st Century Cures Act and the Harbor Maintenance Trust Fund. As a result, while cap-constrained discretionary spending would total $1.590 trillion in FY24 and $1.606 trillion in FY25, exceptions to the caps would bring total discretionary spending in those years to $1.795 trillion in FY24 and $1.818 trillion in FY25.
- **Discretionary spending limits for FY2026 through FY2029.** A single limit on overall discretionary spending in each year would be applied via the Congressional budget process, allowing lawmakers to raise points of order if proposed spending exceeds the limit for that year.
- **Changes to SNAP.** Under current law, the Supplemental Nutrition Assistance Program (SNAP, or colloquially, "Food Stamps") imposes certain work requirements on childless recipients ages 18 to 49, and the proposal would expand that range through age 54. Veterans, people experiencing homelessness, and people ages 18 to 24 who were in foster care at age 18 would all be fully exempt from work requirements. These exemptions are more generous than current law. In total, the changes to SNAP represent a net increase in spending.
- **Changes to TANF.** Under current law, state TANF populations must meet certain thresholds for work activity for the state to receive the full TANF block grant allowed from the federal government. Those thresholds are calculated based on a benchmark year, and the proposal would change that benchmark year from 2005 to 2015. In addition, the proposal would exclude people receiving less than $35 per month from counting toward the work activity thresholds. The result of those changes is that TANF block grants could be slightly reduced.
- **Rescissions.** The proposal would rescind funds provided to the IRS in 2022 that cover enforcement activities through 2031. It would also rescind $27 billion of budget authority from a broad collection of accounts related to the federal government's response to the COVID-19 pandemic.
- **Additional provisions.** The proposal also includes provisions on student loans, energy permitting reform, and pay-as-you-go requirements for the executive branch. In the case of student loans, the proposal includes details similar to an administration announcement from November 2022. The energy permitting reform carries no substantial budgetary effect, and this analysis does not consider the potential economic impact of the Mountain Valley Pipeline. Finally, the pay-as-you-go proposal requires the executive branch to offset any increase in the deficit that arises from an increase in mandatory spending in an administrative action related to discretionary spending, but that requirement can be waived by the Director of the Office of Management and Budget.

Reports of the debt ceiling agreement indicate that, in addition to the formal provisions included in the FRA, Congressional leaders and the White House agreed on several informal spending changes to be implemented

in future legislation. This non-binding informal agreement includes commitments to fund sub-components of nondefense discretionary programs at certain levels. It also repurposes some IRS budget authority towards other spending. PWBM will offer quantitative analysis of these provisions in the future as legislation is formally introduced.[1]

Background: Discretionary Spending Caps

Federal government spending falls into three categories. *Discretionary spending* is provided by appropriations acts. About half of discretionary spending is for national defense, and the other half supports a variety of program areas such as transportation, education, and veterans' benefits. *Mandatory spending* is that which is provided in legislation other than appropriations acts and is often determined by formulas and is the largest of the three categories. Social Security, Medicare, Medicaid, and income security programs such as food and nutrition assistance are examples of mandatory spending. Finally, *net interest* is the government's interest payments on debt held by the public, offset by its interest income.

At various times in history, lawmakers have applied limits on the amount of discretionary spending that can be provided in each fiscal year. The Budget Control Act of 2011 established annual limits on discretionary spending by instituting separate caps for defense and nondefense programs for fiscal years 2012 through 2021. Certain categories of spending were effectively exempt from the caps: various emergency spending, defense-related spending known as overseas contingency operations, disaster relief, wildfire suppression, and program integrity initiatives. In addition, lawmakers amended the levels of those limits several times in subsequent legislation.

Enforcement of budget caps varies based on their legislative origins. The discretionary budget caps proposed for FY2024 and FY2025, like those in effect from FY2012 through FY 2021, would be enforced by a process known as sequestration. A sequester provides for an automatic, across-the-board reduction of spending if lawmakers enact discretionary spending levels that exceed the caps. By contrast, the proposed caps for FY2026 through FY2029 are set as overall discretionary spending limits for the Congressional budget process. Enforcement of those limits would not occur through sequestration, but instead through the ability of lawmakers to raise points of order during the consideration of the annual budget resolutions.

Background: Traditional Discretionary Spending Scorekeeping Convention

To make projections for *mandatory* spending, budget scorekeepers project the number of eligible beneficiaries then apply predetermined benefit formulas. For example, to project Social Security outlays, PWBM simulates the evolution of the retiree population into the future and uses this data as input for a detailed benefit calculator.

But for *discretionary* spending, no such formulaic approach exists. The discretionary appropriations process means that scorekeepers must instead rely on heuristics to project discretionary outlays. The Congressional Budget Office (CBO), per guidelines enacted by Congress, assumes that discretionary spending grows from its most recent appropriations level at the rate of projected inflation. PWBM uses a similar methodology but also adjusts for demographic trends that might change inflation-adjusted per-capita spending by discretionary spending category over time ("traditional scorekeeping").

One implication of growing discretionary spending by inflation after a spending cap has expired is that small changes to near-term discretionary spending will produce larger, permanent changes to spending in future

years.

For example, consider a hypothetical proposal to set next year's (FY2024) top-level discretionary budget authority to be 1 percent below its prior year (FY2023) level, after which point no further discretionary spending caps are specified. Compared with the baseline, under which new budget authority grows by 2 percent in FY2024, the proposal represents a reduction of roughly 3 percent in that year. But the projected path of discretionary budget authority under the proposal does not revert to its baseline trend beginning in FY202025. Instead, it is assumed to resume growing at the rate of projected inflation, but from the lower FY2024 value. In other words, the proposal generates a permanent annual (approximate) 3 percent cut in projected discretionary spending despite only explicitly specifying a single year of cuts.

This scorekeeping convention, therefore, effectively assumes that future Congresses will benchmark future spending to that of recent years when determining budget authority in the appropriations process. Figure 1 offers a visual illustration of this effect.

Figure 1. Hypothetical Discretionary Budget Authority Projections

(Index, 100 = FY2023)

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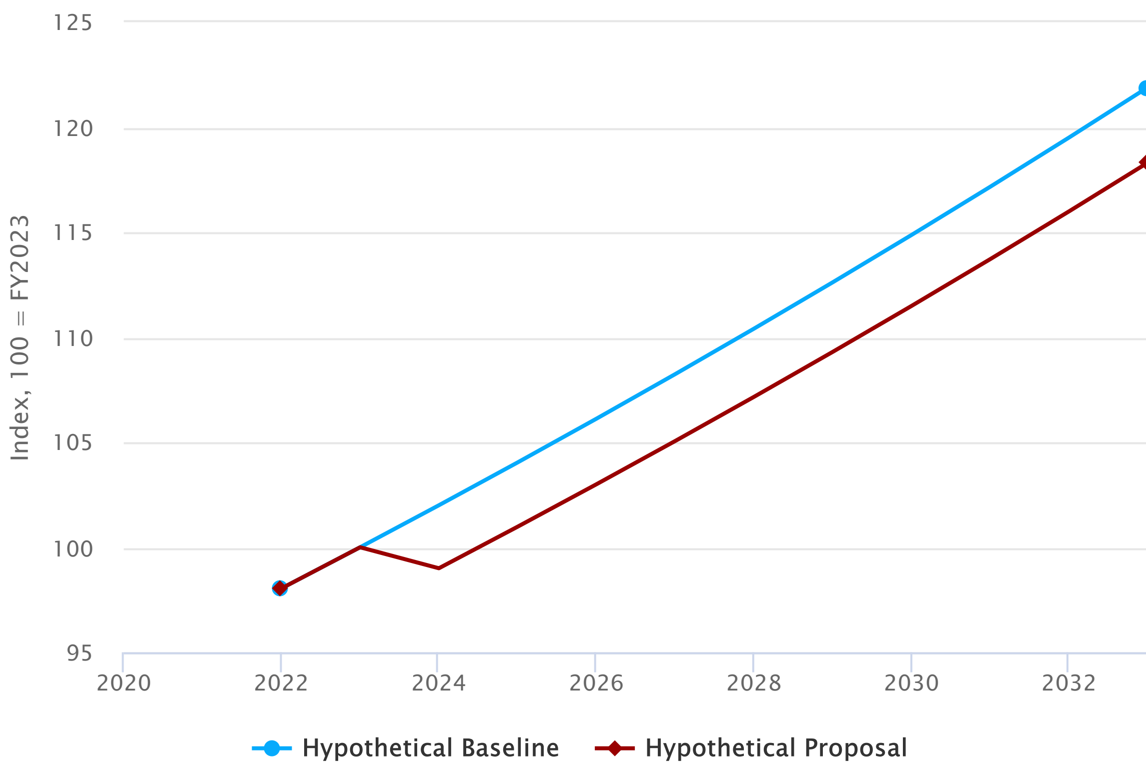

Background: Alternative Scorekeeping Illustrations

An alternative approach is to assume that discretionary spending returns to baseline levels after the explicitly specified years are over ("baseline reversion"). In the context of this brief, baseline reversion assumes that the *level* of spending in FY2026 would return to its baseline value in that year, that is, discretionary spending returns to the same level as projected for FY2026 prior to the passage of FRA. This alternative analysis can be interpreted as Congress "catching up" to pre-FRA levels of spending. More importantly, this scoring provides

an illustrative sensitivity analysis that isolates the component of the budget estimate attributable to the explicitly specified, enforceable discretionary budget caps.

Another alternative scoring approach assumes that discretionary funding continues growing at 1 percent annually through FY2029 as per the FRA's nonbinding top-line caps ("additional caps"). In this scenario, base appropriations in FY2030-FY2033 are set to inflation-adjusted FY2029 levels.

PWBM typically provides these alternative illustrative scoring projections in response to requests from members of Congress. For speed, we include them herein.

Estimated Budget Effects

Table 1 presents PWBM's budget estimates for the FRA under each scoring scenario over the ten-year budget window. As is convention, these estimates do not include any additional savings attributable to lower interest payments since these estimates are not translated to present values.[2] Conventional estimates also do not include potential economic feedback effects.

Table 1. Estimated Budget Effects, FY2024-FY2033 Total

(Billions of dollars)

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Provision	Total
Discretionary caps	1,301
Alternative scenario: baseline reversion	*242*
Alternative scenario: additional caps	*1,855*
Changes to SNAP and TANF	2
Rescissions	-10
Total	**1,293**
Alternative scenario: baseline reversion	*234*
Alternative scenario: additional caps	*1,847*

Under the *traditional* scorekeeping convention discussed above, we estimate that the FRA would reduce noninterest outlays by about $1.3 trillion over ten years, as Congress funds discretionary programs at their inflation-adjusted FY2025 level for the remainder of the 10-year budget window. Under the *baseline reversion* illustrative alternative projection, total estimated savings fall to $234 billion over the budget window, as spending reverts to the FY2026 baseline value in that year. Under the *additional caps* illustrative alternative projection, spending falls by an estimated $1.8 trillion, where Congress adopts the top-line discretionary caps specified through FY2029. In all three scenarios, discretionary spending caps generate almost all of the estimated budget savings; the budgetary effects of changes to social assistance programs are comparatively small on net.

This analysis was produced by John Ricco and Ed Murphy. Mariko Paulson prepared the brief for the website.

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1. For example, the PWBM model of IRS budget authority includes the return to specific mechanisms of IRS enforcement. A PWBM score, therefore, would require knowing the mechanisms subject to funding reductions. ↩

2. An alternative accounting would include interest payments while also discounting future cashflows by the government borrowing rate. ↩