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PATHS TO DEBT STABILIZATION: A COMPARISON OF DEBT TRIGGERS
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The President's Plan for Economic Growth and Deficit Reduction included a detailed legislative proposal intended to enforce a declining path for the federal debt, beginning in 2013.[i] This "debt trigger" mechanism is similar to a proposal that the Peterson-Pew Commission on Budget Reform (PPC) has developed over the last two years.[ii] The President is to be commended for reinforcing his commitment to lowering the debt by proposing legislation to establish a permanent mechanism to impose automatic reductions in spending and tax expenditures unless the federal debt is on a declining path starting in 2014.

Broadly, the President's proposal is similar in concept to the recommendation for debt reduction guided by a trigger mechanism described in the latest PPC report, ***Getting Back in the Black***[iii] (GBITB). There are differences, however, in a number of details. This paper summarizes some ways in which the two plans are similar and where they differ.

Debt Reduction

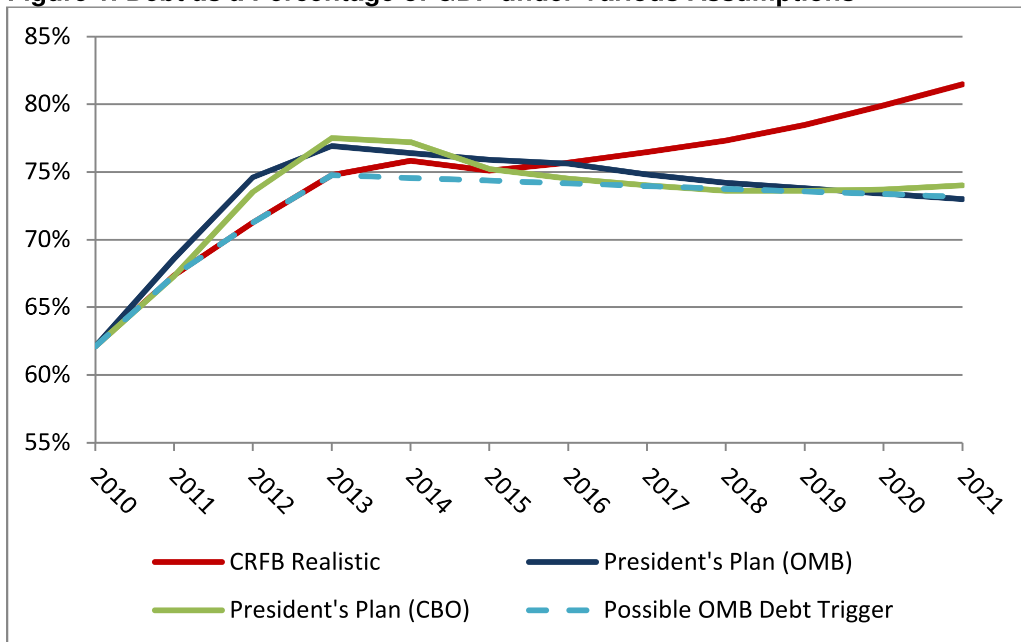
Both the President and the PPC plans make debt reduction an explicit goal. Although there are differences, both plans require that the debt continue to be gradually reduced to a safer level once it is initially stabilized.

- The President's plan does not include a specific debt reduction target. It would direct OMB to set permanent ceilings on debt as a percentage of GDP that declines by 0.2% each year starting from the estimated debt in 2013. OMB would make the calculation setting the debt caps as part of the 2014 sequestration preview report issued next January, but based on current projections (and assuming no legislation affecting the 2013 debt is enacted) the caps would require the debt to decline to approximately 74% of GDP by 2021.

- The PPC plan identifies the specific goal of achieving a medium-term target of a debt to GDP ratio of 60 percent by the end of the decade, with specific annual savings targets calculated for each year on a path to hit the target. It recommends continued debt reduction thereafter, aspiring to budget balance, on average, over the business cycle.

Figure 1 illustrates the debt to GDP ratio if, beginning in 2014, the trigger were to be pulled (dashed line, using CRFB's Realistic Baseline[1]).

Figure 1. Debt as a Percentage of GDP under Various Assumptions



Note: Possible OMB debt trigger scenario based on projected debt level in 2013 under the CRFB Realistic Baseline, falling by 0.2 percentage points each year thereafter.

Enforcement

Both plans include a trigger mechanism intended to enforce their respective goals with a broad sequester if the goals are not being met. In neither case are the triggers intended to force lawmakers into any specific set of policy choices.

- The President's approach would trigger a sequester if insufficient progress was not being made, as estimated by OMB, in reducing debt projected for the budget year and the following four years, on a rolling basis. A trigger would be pulled forcing automatic reductions in non-exempted spending and tax expenditures if debt were

[1] CRFB's realistic baseline assumes that all of the 2001/2003/2010 tax cuts/extensions expire, that a permanent AMT patch is enacted, that the "doc fix" is paid for, and that the troop drawdown in Iraq and Afghanistan proceeds as estimated by CBO. Further, no assumptions are included regarding the President's Joint Select Committee on Deficit Reduction.

estimated to exceed specified targets for the budget year and the last year of the five-year projection period. The amount of triggered reduction is calculated by formula depending on the excess debt amounts, taking into account the budget-year impact of emergency and disaster funding. To discourage "backloading" the savings, at least a minimal amount of debt reduction is required in the budget year. The trigger is to be suspended whenever unemployment levels and trends indicate a recession.

- PPC's plan is a little more straightforward. It calls on Congress and the President to pass a "Sustainable Debt Act" (SDA) that would include the new procedural enforcement requirements, or triggers. The SDA would include the medium-term debt target, as a percentage of GDP, to be reached by a date certain. In our November 2010 report, the Commission recommended a target of debt of 60 percent of GDP by 2018, with annual savings targets that would begin in 2012. The trigger would be pulled if, in any year, the annual or final savings targets were estimated to be missed after Congress and the President had used all their opportunities to stay on or achieve a path to hitting the targets.

If the Trigger is Pulled

Both plans employ a process known as sequestration that requires automatic cuts in spending, as well as revenues to address the amount by which the debt target is missed. Both plans also require an even split between the burden that the cuts and revenues contribute. However, the two plans differ in the make-up of the two sides of that split.

- While the trigger in the President's plan would hit spending and revenues equally in the aggregate, many individual programs would be exempted from the sequester. In addition to exemptions specified in the new act, it generally follows the sequestration procedures of the Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA), including exempting the lengthy list of programs in section 255, as well as provisions exempted in the recently enacted Budget Control Act. Exemptions for certain health programs found in sections 256(d) and 256(e) of BBEDCA are also modified in the President's plan. For purposes of sequestration, emergency and disaster spending would be treated as they are now under BBEDCA. On the revenue side the sequester would limit tax expenditures for taxpayers with incomes above $200K single/ $250K joint, thereby exempting all taxpayers with incomes below that threshold from the revenue sequester.

- The PPC plan also requires that any shortfall that cause the trigger to be pulled be filled equally by 50 percent spending cuts, and 50 percent by a tax surcharge. ***All*** mandatory and discretionary spending, and ***all*** taxes, would be adjusted, including tax expenditures.[iv] Emergency spending is part of a separate recommendation in the PPPC report, which also incorporates disaster spending as a subset of the definition of emergency. The effect of this change would mean no need for a distinct stipulation for the treatment of emergency spending under a sequestration.

Safety Valve

Both plans include suspension of the sequestration provision in the event of poor economic times.

- The President's plan would suspend sequestration in the event that the monthly unemployment rate in any month exceeds 5 percent and is at least 0.5 percentage points above its level six months earlier. Suspension continues until the rate is less than 8.5 percent and less than the rate in the six months prior to the current month, plus an additional three months. At the end of the suspension period, the plan also requires a 12 month phased-in return to implementation of the debt reduction process.

- The PPC plan would suspend the sequestration and tax increases in the event of two consecutive quarters of negative economic growth.

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[i] The major operational section of the President's proposal, the "Debt Reduction Act of 2011" would strike and replace section 253 of The Balanced Budget and Emergency Deficit Control Act of 1985.
[ii] See *Red Ink Rising: A Call to Action to Stem the Mounting Federal Debt* (December 2009), and *Getting Back in the Black* (November 2010), at www.budgetrform.org.
[iii] For a more detailed overview of designing a debt trigger, see *Peterson-Pew Fiscal Targets: Ten Issues in Designing A New Debt Failsafe*, at www.budgetreform.org, in the section, "One-Stop Shop for Budget Reform Tools."
[iv] The Commission recommended that any trigger be applied to the broadest base possible so that there is an incentive for lawmakers to not allow the trigger to be pulled, as all constituencies would be affected. That said, some programs may be legally protected from such cuts, a determination that would need to be made by a careful review of the exempted programs listed in section 255 of The Balanced Budget and Emergency Deficit Control Act of 1985. But many of the exemptions for Social Security, health, certain types of military spending, and certain low-income programs, while perhaps justified, are policy choices that also merit careful consideration.

To modernize an outdated congressional budget process in light of the daunting economic challenges facing the nation, the Peter G. Peterson Foundation, The Pew Charitable Trusts and the Committee for a Responsible Federal Budget have launched a landmark partnership to build bipartisan consensus for a core set of reforms. ***The Peterson-Pew Commission on Budget Reform*** *has convened the nation's preeminent experts to make recommendations for how best to improve the nation's fiscal future and how best to strengthen the federal budget process. The Commission began its work in January 2009 and in December of that year issued its first report, Red Ink Rising.* www.budgetreform.org

Founded by Peter G. Peterson with a commitment of $1billion, the ***Peter G. Peterson Foundation*** *is dedicated to increasing public awareness of the nature and urgency of key fiscal challenges threatening America's future and to accelerating action on them. To address these challenges successfully, we work to bring Americans together to find and implement sensible, long-term solutions that transcend age, party lines and ideological divides in order to achieve real results. To learn more about the Peterson Foundation, please visit* www.PGPF.org.

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