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What's New In Washington

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Looming large in Washington right now is the upcoming debt limit debate. With the United States expected this summer to hit the statutory cap on the amount of money the government can borrow to pay its financial obligations, Republicans led by Speaker of the House Kevin McCarthy (R-CA) and Democrats led by the President are engaged in a public debate over whether and the extent to which to cut federal spending as a condition of raising the debt limit. The failure to raise the debt limit could result in our nation's first ever default and could also put the appropriations process at risk, increasing concern over a government shutdown in late September.

While Democrats continue to insist on a clean debt ceiling bill that raises the national borrowing limit without any other policy conditions, House Republicans this week introduced the Limit, Save, Grow Act of 2023 that raises the debt limit until March 31, 2024, or by $1.5 trillion—whichever occurs sooner—accompanied by policies intended to limit federal spending, save taxpayer dollars and grow the economy. House Republicans contend the proposal would save more than $4.5 trillion in taxpayer dollars. Key components of Speaker McCarthy's debt limit plan are as follows:

- **Limit**: terminate government spending and establish spending levels for fiscal year (FY) 2024 at FY 2022 levels and allow for no more than 1% annual growth over the next 10 years.
- **Save**: reclaim unspent COVID-19 funds; eliminate funding for new Internal Revenue Service (IRS) agents; repeal Inflation Reduction Act (IRA) tax credits; and prohibit student loan forgiveness.
- **Grow**: restore assistance programs; reduce childhood poverty; give Congress oversight over the Biden-Harris administration's spending policies; pass H.R.1 to unleash American-made energy and reduce reliance on foreign adversaries.

This special edition issue of *What's New in Washington* examines the debt limit debate against the backdrop of past debt limit negotiations, highlighting key considerations around federal spending and policies playing a role in the current negotiations.

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A Look Back

As the 118th Congress seeks to address the debt ceiling before the government becomes unable to fully pay its obligations, it is helpful to look back at previous debt limit actions for both context and precedent for how the current process may unfold or impact the U.S. economy. Congress has enacted 48 pieces of legislation to address the statutory debt limit over the past 40 years. Such legislation either increases the debt limit or suspends the debt limit for a particular period of time. Of the prior debt limit legislation, Congress considered roughly 40% as stand-alone bills and nearly 60% as part of larger packages.

In recent years, debt limit debates have grown increasingly contentious, particularly in the wake of the Great Recession and the COVID-19 pandemic, as congressional views on federal spending have become even more polarized. Of note, debt limit discussions in 2011 were particularly heated in the lead-up to the August 2011 passage of the Budget Control Act of 2011 (BCA). Tense negotiations between then-Speaker of the House John Boehner, Senate Republican Leader Mitch McConnell and then-Vice President Joe Biden eventually resulted in the BCA (P.L. 112-25), which required significant Democratic support during final passage to offset disagreement within the GOP majority on the measure. Key provisions of the BCA included:

- Discretionary spending limits for FY 2012 – FY 2021 with two types of spending limits in effect for each of these fiscal years (one for defense spending and one for non-defense discretionary spending).
- A “sequestration” trigger such that if discretionary appropriations were enacted that exceeded a statutory limit for a fiscal year, an automatic across-the-board reduction of non-exempt budgetary resources would apply for the applicable spending category (defense vs. non-defense).
- Certain types of spending did provide for an upward adjustment of the discretionary limits, essentially exempting it from the spending caps (such as emergency spending).
- Annual reductions to the initial discretionary spending limits, which were triggered by the absence of agreement on deficit reduction legislation from the Joint Select Committee on Deficit Reduction, allowing Congress the discretion to develop appropriations legislation within the reduced limits instead of across-the-board cuts.

Notably, the political gridlock and negative economic consequences led Standard and Poor’s (S&P) to downgrade the U.S. government’s credit rating from AAA to AA+ three days after the BCA was signed into law. It is also notable that following the enactment of the BCA, legislation was enacted altering the discretionary spending limits for almost every fiscal year through FY 2021.

More recently, a 2019 suspension of the debt limit expired in mid-2021 before the U.S. Treasury implemented so-called “extraordinary measures”—i.e., fiscal accounting tools that curb certain government investments—to avoid a default. Congress later passed legislation in October 2021 to raise the debt limit by $480 billion and ultimately enacted additional legislation in December 2021 to raise the limit by $2.5 trillion. These measures brought the debt ceiling to nearly $31.4 trillion, which the Treasury reached at the beginning of this year.

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Where Are We Today?

According to the latest data from the Congressional Budget Office (CBO), the federal government's ability to borrow using extraordinary measures will be exhausted between July and September of this year, unless Congress acts to raise the $31.4 trillion debt limit. CBO's projection notes that the final date will ultimately depend on tax revenues received by the IRS in April. Should revenues deviate significantly from the latest estimates, the agency has noted that the Treasury could run out of funds before July.

Prior to release of the debt ceiling plan this week, Speaker McCarthy, who previously indicated he has had no direct contact with the White House on the debt limit since February, exchanged letters with President Biden on the issue at the end of March. Consistent with the contours of his letter to the President, the Speaker's debt ceiling plan proposes to extend a limit on borrowing with provisions to cut and cap discretionary spending, recapture unspent COVID-19 relief funds and establish new work requirements for federal benefits, along with a handful of other policy priorities.

The Speaker continues to flatly reject a clean debt ceiling increase and is now seeking to unify House Republicans around a strategy to force the President to negotiate despite the President's prior statements emphasizing that he will not grant Republicans policy concessions in the context of a debt limit increase. It will be notable if Speaker McCarthy is able to shepherd debt ceiling legislation through the House next week given the narrow Republican majority and will show broad consensus around the Republican terms for a debt limit deal. Nonetheless, any bill advanced along party lines will be a non-starter in the Democratic-controlled Senate. Democratic leaders have continued to back President Biden's position, calling on Congress to pass a "clean" debt limit bill and negotiate spending policy separately in the context of government funding.

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What Happens From Here?

With the country having reached its statutory debt limit early in 2023, the Treasury is currently deploying extraordinary measures to prevent the federal government from defaulting on its debt. While it is unclear precisely when those extraordinary measures will be exhausted, Treasury has estimated they will expire this year, which the nonpartisan CBO estimates will occur sometime this summer.

As of today, the White House and Senate Democratic majority position is clear that a clean extension of the debt limit should be enacted. However, Republicans are in broad agreement that a debt limit extension should come with policies designed to address escalating debt, as reflected in Speaker McCarthy's plan summarized above. Noteworthy policies include current year cuts to spending, long-term caps to spending, work requirements for various federal programs, clawbacks of unused and already appropriated funds, repeal of the President's student loan forgiveness program and permitting reform that would theoretically address the debt by spurring economic growth.

In the absence of an agreement to extend the debt limit and in preparation for hitting the "X date," consideration is being given to how the government will operate at X+1. When faced with a similar situation in 2011, there were efforts to establish a contingency plan that would prioritize payments to avoid default. Based on that plan, Treasury securities, outstanding federal obligations (payments to agencies, for entitlements, etc.) and external obligations would be addressed first. For the Federal Reserve, in the past, the Federal Open Markets Committee (FOMC), a group within the Federal Reserve charged with overseeing the nation's open market operations that makes key decisions about interest rates and money supply, suggested that the Fed would (1) make plans for payments and roll forward the scheduled payment of principal and interest in one-day increments; (2) treat Treasury obligations the same as non-defaulted obligations; and (3) develop structured plans for monetary policy, attempting to avoid the subservience of monetary policy objectives to the Treasury's financing needs.

The U.S. has never defaulted on its obligations before. Default would likely be seismic for the U.S. economy and markets across the world, especially when coupled with uncertainty stemming from the war in Ukraine and rising global power competition between the United States and China. In testimony this week, Securities and Exchange Commission Chair Gary Gensler said that default would mean the country would "start to see fraying, less liquidity in the Treasury markets, which ultimately means higher costs to the taxpayers." Gensler added that those effects "would ripple into the banking system as well." It should also be worth noting that in 2011 the mere threat of default contributed to Moody's downgrade of federal debt.

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Policy Considerations around Federal Spending and Tax Policy

Leading up to the 2022 midterm elections, Republicans sought to link the looming debt limit fight with plans to balance the federal budget and rein in federal spending, with some hinting at reforms to entitlement programs such as Medicare, Medicaid and Social Security—mandatory spending programs that Republicans have argued for more than a decade are the main drivers of the national debt. Further, lawmakers have acknowledged that reforms are needed to maintain the social safety net and ensure the solvency of these programs. The latest Social Security and Medicare Trustees report estimates the Social Security Old-Age and Survivors Insurance Trust Fund will be insolvent by 2033, while the Medicare Hospital Insurance Trust Fund will be insolvent by 2031.

Nevertheless, fundamental reforms are nearly impossible in a divided Congress and the conversation has shifted in recent months away from budget reforms and mandatory spending. Speaker McCarthy has stated that cuts to Medicare and Social Security are "off the table" in the context of debt limit discussions. In his March 28 letter to President Biden on the debt limit and proposals to reduce federal spending, the Speaker made no mention of either program. Meanwhile, Speaker McCarthy has dismissed the White House's demand that House Republicans release a budget proposal before negotiating further on the debt limit. Instead, Republicans released their own debt limit legislation reflecting the broad priorities outlined in his recent letter with the ascribed goals to "Limit, Save, Grow."

Under the banner of "limit," rather than tackle mandatory spending programs, lawmakers are focused on limiting discretionary spending growth to 1% annually over a decade—a cap that Republicans argue would save $3.6 trillion over the next 10 years.

In the "save" space, Republicans have called for clawing back an estimated $60 billion in unobligated programmatic funding related to COVID-19 and $71 billion to fund 87,000 new IRS agents. It also includes a repeal of the President's student loan forgiveness program, announced in August 2022, which would provide up to $20,000 in debt relief to certain student borrowers. The legality of the student loan relief plan has been challenged in the courts and is currently pending before the Supreme Court. In the meantime, the GOP is seeking to rescind the program and recapturing an estimated $465 billion. Additionally, the proposed debt limit bill repeals the "Green New Deal" tax credits and subsidies that Republicans have characterized as massive giveaways for the wealthy and a vehicle that will cause energy and utility prices to soar for everyday consumers.

In the "grow" space, the proposal includes strengthening Medicaid work requirements for those without dependents in order to help address labor shortage issues and lift people out of poverty. The proposal includes some minor changes to the Supplemental Nutrition Assistance Program (SNAP) and Temporary Assistance for Needy Families (TANF) programs.

Another tool that House Republicans have included in their debt limit proposal is the Regulations from the Executive in Need of Scrutiny (REINS) Act of 2023 (H.R. 277; S. 184). This would require major rules of the executive branch to be approved by a joint resolution of approval by Congress before being enacted into law in order to ease the regulatory burden on American businesses. A Republican priority for years, this policy is aimed at curbing unnecessary government regulations and excessive red tape that add significant regulatory costs and stifle economic growth.

Finally, under the "grow" umbrella, House Republicans have been focused on their energy and permitting reform priorities, sending the Lower Energy Cost Act (H.R. 1) to the Senate with unanimous Republican support and four Democratic votes. In the context of debt limit negotiations, the House Republican's proposal includes energy and permitting reforms. In fact, the House Republican's proposed debt limit bill includes the entirety of the H.R.1 energy package. They argue the bill would unleash reliable, cleaner American-made energy, tap abundant natural resources, cut red tape for project permitting, reduce our dependence on China and foreign adversaries, and lower the cost of gas and utilities.

The battle lines on energy and the environment in the 118th Congress will be familiar, BUT there has been a paradigm shift around permitting reform. Whereas permitting reform traditionally meant building more oil and gas pipelines—a priority for Republicans—Democrats now view permitting reform as essential to the clean energy transition and effectively leveraging the IRA's funding. Nevertheless, whether bipartisan agreement can be reached to include such reforms in the context of debt ceiling negotiations remains to be seen.

While it remains unclear whether the Biden-Harris administration will engage in any meaningful way in these areas proposed by House Republicans, the Biden FY 2024 Budget provides some insight into its priorities when it comes to decreasing federal spending, including expanding upon the IRA drug pricing provisions, which were enacted as part of a very partisan legislative process last August. The budget proposals include expanding the Medicare Drug Price Negotiation Program to apply to more drugs and accelerating the timeline for the Negotiation Program, applying the inflation rebate requirements to commercial insurance and extending the cap for patient cost-sharing to insulin products in the commercial markets. The FY 2024 Budget also included proposals that go beyond the IRA, such as giving the Department of Health and Human Services the authority to negotiate additional, supplemental Medicaid drug rebates on behalf of states, extending existing Medicaid drug requirements to states that operate their Children's Health Insurance Programs separately from Medicaid and capping Part D cost-sharing on certain generic drugs to $2 per prescription per month. However, this suite of proposals appear unlikely to gain traction in the current Congress given the concerns expressed by House Republicans with the

IRA's drug pricing provisions and raised during recent hearings on the President's FY 2024 Budget.

The President's FY 2024 Budget also proposed significant tax increases, including raising the Medicare tax rate on high earners and increasing the IRA's 1% stock buyback tax to 4%. While there has been some discussion of including tax policies in a GOP debt limit bill, including extensions of expiring provisions included in the Tax Cuts and Jobs Act of 2017 and changes to bolster program integrity around the child tax credit, it is not an area of Republican focus in terms of any debt limit deal.

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Next Steps

Speaker McCarthy announced the House would vote on the Limit, Save, Grow Act next week to increase pressure on President Biden to resume debt limit negotiations, but the President has been steadfast that Republicans should not threaten debt limit default with conditions detrimental to working class Americans. Any party-line bill the House adopts is likely to fail in the Senate, where the Democratic majority favors a clean debt limit bill and a separate negotiation on spending policy in the context of the annual appropriations process. With default looming absent Congress acting to prevent it, stakeholders will continue to watch how the debt limit debate and related policy initiatives unfold in the coming weeks and months.

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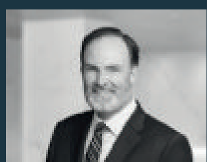

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