Debt Limit and Ongoing Fiscal Debate: County Risks and Opportunities
Debt Limit and Ongoing Fiscal Debate:
County Risks and Opportunities

Presentation Overview

✓ Why Counties Should Care about the Debt Limit Debate
✓ What is the Debt Limit
✓ Why is there a Debt Limit
✓ Extraordinary Measures to Prevent Default
✓ Context for Federal Debt and Deficit Discussion
✓ Ongoing Fiscal Debate and the First Fiscal Cliff Deal
✓ County Risks and Opportunities
Why Counties Should Care About the Debt Limit Debate

✓ COUNTIES ALREADY IMPACTED: Nearly 70 percent of the 2010 Bowles-Simpson recommended cuts to discretionary spending have already been enacted into law.

✓ MORE CUTS AHEAD: With a first fiscal-cliff deal done, Congress has re-focused its attention on resolving the debt limit issue, sequestration, and tax and entitlement reform.
## Post-Fiscal Cliff Calendar

<table>
<thead>
<tr>
<th>December</th>
<th>January</th>
<th>February</th>
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<tbody>
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- **Key date in the past**
  - Expiring Tax Policies
  - Debt ceiling reached

- **Key date in the future**
  - Congress passes fiscal cliff legislation
  - Sequestration takes effect after 2-month punt
  - Funding measure expires; government shuts down unless new bill adopted

*Estimated end of February, exact date not specified

What is the Debt Limit?

Debt Limit= A statutory limitation on the amount that the federal government is allowed to borrow to finance its obligations

- The debt limit is currently set at $16.394 trillion as established by the Budget Control Act of 2011

The United States debt limit has been raised dozens of times since it was instituted in 1917, including under every president since FDR
Why is There a Debt Limit?

- Congress controls the annual surplus or deficit by determining the country's levels of taxation and spending

- Annual deficits contribute to the overall national debt, which the U.S. Treasury Dept. finances by issuing bonds

- The ceiling acts as a check on that overall debt: when the U.S. Treasury Dept. needs to issue debt above the ceiling, Congress raises the ceiling
U.S. Officially Reached Debt Limit

- According to the U.S. Treasury Dept., the U.S. reached the debt limit on December 31, 2012

- Absent action by Congress, once the debt ceiling is reached, the Treasury Secretary can take “Extraordinary Measures” to buy more time to avoid exceeding the limit

  ✓ Extraordinary Measures are legal financial maneuvers that allow the Treasury Department to raise additional cash to meet government obligations
Another Debt-Ceiling Crisis Looms:  
Current Debt Ceiling Reached in December

The U.S. hit the debt ceiling of $16.4T on December 31, 2012. The Treasury has begun to take “extraordinary measures” to keep the government running until mid-February or early March.
The Debt Limit

"If Congress fails to increase the debt limit, the government would default on its legal obligations - an event unprecedented in American history. This would cause investors here and around the world to doubt, for the first time, whether the United States will meet its commitments. That would precipitate a self-inflicted financial crisis potentially more severe than the one from which we are now recovering."

- U.S. Treasury Department
Historical Increases in Debt Limit:
April 1993 to Present

Jan. 2013: $16.39 trillion

April 1993: $4.37 trillion

Source: Congressional Research Service
### Extraordinary Measures

<table>
<thead>
<tr>
<th>Extraordinary Measures Available</th>
<th>Bipartisan Policy Center Estimate (Rounded)</th>
</tr>
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<tbody>
<tr>
<td>Do not reinvest the Federal Employees’ Retirement System G-Fund</td>
<td>$154 billion</td>
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<tr>
<td>Do not reinvest the Exchange Stabilization Fund</td>
<td>$23 billion</td>
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<tr>
<td>Do not reinvest interest payments and cash receipts to Civil Service Fund and Postal Fund</td>
<td>$21 billion</td>
</tr>
<tr>
<td>Do not reinvest maturing securities in the Civil Service Fund and Postal Fund</td>
<td>Not Applicable in Dec. 2012</td>
</tr>
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</table>

Total: $197 billion

Note: The totals indicate available measures. Treasury may not employ all available measures. Treasury also has measures available (not listed) that assist with cash flow and debt management, but do not extend the date after which Treasury would default on federal obligations absent an increase in the debt limit.

Sources: Bipartisan Policy Center, Government Accountability Office
Extraordinary Measures: Limitations

- Extraordinary Measures are limited; they won’t last forever
- Treasury Secretary Geithner has said the measures he is enacting will save about $200 billion—which could delay default for about two months (around February 2013)
Extraordinary Measures: *Limitations*

- In 2011, EMs lasted from May 16 until August 1
- The EMs won’t buy as much time as they did in 2011
  - *February is a “bad” month for the federal government’s finances as there are a high number of expenditures*

<table>
<thead>
<tr>
<th>Cash Outflow</th>
<th>Amount in February 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>IRS Tax Refunds</td>
<td>$112 billion</td>
</tr>
<tr>
<td>Medicare and Medicaid</td>
<td>$62 billion</td>
</tr>
<tr>
<td>Social Security Benefits</td>
<td>$55 billion</td>
</tr>
<tr>
<td>Interest on Debt</td>
<td>$33 billion</td>
</tr>
<tr>
<td>Defense Vendor Payments</td>
<td>$27 billion</td>
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</tbody>
</table>
Size of Debt Limit Increase:
How much would the debt limit need to be increased to get through 2013 or 2014

![Bar chart showing the size of debt limit increase to get through 2013 or 2014. The chart indicates that the low estimate for the end of 2013 is $730 billion and the high estimate is $1,250 billion. The low estimate for the end of 2014 is $1,300 billion and the high estimate is $2,200 billion.]

Source: Bipartisan Policy Center
No Congressional Action Could Lead to Default

Source: National Journal
Risks and Consequences

- Additional downgrades of the U.S. credit rating
  - Standards and Poor’s downgraded in 2011
  - Moody’s has already issued serious warning
- Prolonged uncertainty in the markets
- Additional borrowing costs for the federal government from delay in increasing the debt limit
Credit Ratings Determined Primarily by Current and Likely-Future Economic Factors

- **Economic Development**
  Certain levels of development suggest lower likelihood of default

- **GDP Growth**
  High rate of growth suggests debt burden will be easier to manage in the future

- **Inflation**
  Low rates of inflation suggest structural strength in government’s finances

- **Default History**
  No/few recent defaults suggest lower credit risks

- **Per Capita Income**
  Higher income suggests higher tax base and greater ability to repay debt

- **Federal Deficit**
  Lower deficits suggest debts can be repaid without resorting to extreme taxation

- **Debt**
  Lower levels of carried sovereign debt suggest lower risk of default

Source: National Journal
Impact of the 2011 Debt Limit Standoff

- Political brinksmanship over the debt limit led to the downgrade of the country's credit rating, roiled stock markets and raised questions about the country's ability to pay its obligations.

- According to the Government Accountability Office, the 2011 debt ceiling fight wasted $1.3 billion in taxpayer money because of the uncertainty it wrought on the complex task of federal borrowing.
Context for Federal Debt and Deficit Discussion and Action
Federal Budget Picture

Fiscal Year 2012 Outlays: $3.63 Trillion

Nearly One-Third of Our Spending is Borrowed

Source: Congressional Budget Office (January 2012)
FY2012 Federal Budget Snapshot

- Medicare and Medicaid, 21%
- Social Security, 21%
- Other Mandatory, 15%
- Interest, 7%
- Defense Discretionary, 19%
- Non-Defense Discretionary, 17%

Source: Congressional Budget Office (January 2012)
Entitlement and Defense Spending Percentage of GDP

Source: Office of Management and Budget
Federal Budget Picture

Absent reforms, U.S. debt is set to skyrocket in the coming decades

Source: Congressional Budget Office (January 2012) and Bipartisan Policy Center
Projected U.S. Debt
A Historical Comparison

Source: Fix the Debt
U.S. Debt Drivers

How We Got Here

- **Economic Crisis**
  (Lost revenue and increased spending on safety net programs, like unemployment benefits and food stamps)

- **Economic Response**
  (Stimulus spending/tax breaks and financial sector rescue policies)

- **Tax Cuts**

- **War Spending**
  (Iraq and Afghanistan)

- **Spending Increases**
  (General ramp up in spending)

Why It Will Get So Much Worse

- **Rapid Health Care Cost Growth**
  (Causing Medicare and Medicaid costs to rise)

- **Population Aging**
  (Causing Social Security and Medicare costs to rise, and revenues to fall)

- **Growing Interest Costs**
  (From continued debt accumulation)

- **Insufficient Revenue**
  (To meet the costs of funding government)

Source: Fix the Debt
Health Care Costs are the Primary Driver of the Debt

Sources: Congressional Budget Office’s Alternative Fiscal Scenario (January 2012), additionally assuming that troops overseas decline to 45,000 by 2015; Bipartisan Policy Center extrapolations

WWW.BIPARTISANPOLICY.ORG
U.S. Debt Drivers
Growing Entitlement Spending

Federal Spending and Revenues (Percent of GDP)

Source: Fix the Debt
Impact of Growing Deficits and Debt

- Large budget deficits and growing debt reduce national saving, leading to higher interest rates, more borrowing from abroad, and less domestic investment.

- Restricts policymakers’ ability to use tax and spending policies to respond to unexpected challenges, such as economic downturns or financial crises and increases the probability of a sudden fiscal crisis, during which the government would lose its ability to borrow at affordable rates.
Ongoing Fiscal Debate and First Fiscal-Cliff Deal
The Fiscal Cliff Was Avoided... For Now

Although the initial fiscal cliff deal (P.L. 112-240) will avert many of the year-end tax hikes and spending cuts that were set to kick in, it failed to address some of the major issues that have divided Congress in recent months.
The Latest Fiscal Deal is Not Enough to Bring the Debt-To-GDP Ratio to Sustainable Levels by 2022

Source: Bloomberg Government
Fiscal Cliff Dynamics

✓ With the debt limit coming into focus, there will be another showdown over sequestration, tax and entitlement reform, and a long-term solution to our nation’s debt and deficits

✓ This guarantees that counties will continue to be confronted with both risks and opportunities as lawmakers struggle to find solutions to these issues
Economic Impact of the Fiscal Cliff
Impact of the Cliff: GDP and Employment

If serious solutions are not enacted, the Congressional Budget Office projects for 2013:

- Change in GDP: -0.5%
- Unemployment rate at end of year: 9.1%

In other words... Going over the Fiscal Cliff could lead to another recession
The fiscal cliff would cause a substantial increase in unemployment.

Because of the sharp deficit reduction that will occur under current law, CBO projects that the unemployment rate will rise to about 9 percent in the fourth quarter of 2013. Under an alternative scenario, in which some changes specified in current law would not occur and many tax and spending policies that have been in effect in recent years would continue instead, unemployment would remain near 8 percent in 2013.

Source: Congressional Budget Office and USA.gov
Economic Impact of the Fiscal Cliff

Exhibit 6 - Comparison of Spread Between VIX Futures Contracts, as of October 11, 2012

- The fiscal cliff would occur in the 30 days following the expiration of what is currently the second VIX contract.
- Heightened level of volatility expected during early 2013.

Average spreads calculated using data since the beginning of 2009.

Source: Bloomberg
Ongoing Fiscal Debate: County Risks
Areas of Major Risk to Counties

- Medicaid cuts and cost shifts to states and counties
- Elimination or reductions in the benefit of tax exempt municipal bonds
- Elimination or reduction of state and local property, income, and sales tax deductions on federal income tax
- Sequestration: across-the-board cuts
County Risks
Fiscal Debate Could Impact Medicaid

- Medicaid is the federal health insurance program for low-income children and their parents, pregnant women, elderly, blind and disabled, and is jointly financed and administered by the federal government, states, and often through counties.

- Although Medicaid is exempt from sequestration and the most recent debt deal did not include any Medicaid cuts, it is still on the table for future action or a grand bargain.

- The Affordable Care Act (ACA) offers states the opportunity to expand Medicaid to cover all adults up to 133 percent of the federal poverty level.
Why Do Counties Care About Medicaid in a Grand Bargain?

- Counties put up part of the non-federal match for Medicaid in 27 states
- Counties are required to provide health care for indigent residents in 32 states
- Counties own 964 hospitals and 647 nursing homes serving Medicaid beneficiaries
- Reducing federal financial contributions to Medicaid puts counties at risk for absorbing shifted costs
County Risks: Medicaid

The 2011 House Budget Resolution Proposed Changing Medicaid to a Block Grant and repealing ACA = $1.7 trillion cut


- $4,591

38% Reduction in Spending

- $932
- $810

$2,849

Spending Under Current Law, Including ACA

Spending Under the House Budget Plan

Source: Urban Institute estimates prepared for the Kaiser Commission on Medicaid and the uninsured, October 2012
County Risks: Medicaid

Democrats may be motivated to protect Medicaid in a grand bargain because it is tied to the success of the Affordable Care Act

After Election 2012: Where the States Stand
What are the States Saying about ACA Medicaid Expansion?

Source: The Advisory Board Company, Jan 2013
County Risks: Taxes
Fiscal Debate May Impact Tax Provisions Important to Counties

✓ The first fiscal cliff deal left many tax provisions important to counties untouched

✓ However, as lawmakers and the administration continue to search for additional revenue, tax code provisions, especially those important to counties, may be targeted
County Risks: Tax-Exempt Municipal Bonds

✓ Identified as one of the top ten federal tax expenditures, the exclusion of interest on public purpose state and local bonds will surely be on the table as a means to generate revenue for the federal government.

✓ Without this low-cost financing mechanism, many roads, bridges, and wastewater treatment facilities may never have been built or repaired.

Tax-exempt bonds have been a feature of the tax code since 1913 and are a critical financial tool for counties nationwide.
County Risks: Tax-Exempt Municipal Bonds

Why are tax-exempt bonds important to counties?

- Altering their tax-exempt status could decrease the attractiveness of municipal bonds, thereby increasing the yields demanded by investors and ultimately increasing financing costs for counties.

- No federal grant program or funding stream can match the ability of tax-exempt bonds to produce solutions for local needs.
County Risks: Deduction for Property, Income and Sales Tax

- As with tax-exempt municipal bonds, deductions for state and local taxes are classified as federal tax expenditures, and are on the table as potential revenue in future fiscal negotiations.

- Eliminating these deductions could put additional pressure on already strained county budgets.
County Risks: Tax Issues

State and Local Tax Receipts: 4th Quarter through 3rd Quarter 2012

- Property Taxes: 34%
- Sales Taxes: 21%
- Individual Income Taxes: 22%
- Other Taxes: 13%
- Motor Vehicle Taxes: 2%
- Corporate Tax: 3%
- Tobacco Taxes: 1%
- Motor Fuel Taxes: 3%
- Alcohol Taxes: 1%
County Risks: Tax Issues

Sales Tax: Combined State and Average Local Rate
As of July 1, 2012
www.TaxFoundation.org

Source: Sales Tax Clearinghouse, Tax Foundation calculations, State Revenue Department Websites.

Note: Three states levy mandatory, statewide, local add-on sales taxes at the state level: California (1%), Utah (1.25%), and Virginia (1%) that we include in their state sales tax. The sales taxes in Hawaii, New Mexico, and South Dakota have broad bases that include many services.
County Risks: Sequestration

- Sequestration = Process of applying automatic, across-the-board spending reductions evenly divided between security (defense) and non-security (mandatory/entitlement funds + annual discretionary funds) functions

- Under the fiscal cliff deal, sequestration is postponed until March 1, 2013 unless Congress and the White House strike an accord on at least $1.2 trillion in additional deficit-reduction measures
County Risks: Sequestration

- The fiscal cliff deal reduced the scheduled 2013 sequestration by $24 billion, from $109.3 billion to $85.3 billion. This reduces the percentage of cuts in full-year funding for most eligible programs (those that the law does not exempt from the automatic cuts).

### Fiscal Cliff Deal Reduces Automatic Budget Cuts for 2013

<table>
<thead>
<tr>
<th>Category</th>
<th>Due January 2, 2013, under prior law</th>
<th>Due March 1, 2013, under amended law</th>
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<tbody>
<tr>
<td></td>
<td>In Billions</td>
<td>Percent</td>
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<tr>
<td>Defense, discretionary funding</td>
<td>$54.6</td>
<td>9.4%</td>
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<td>Defense, mandatory funding</td>
<td>$0.1</td>
<td>10.0%</td>
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<tr>
<td>Non-defense discretionary programs</td>
<td>$38.0</td>
<td>8.2%</td>
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<tr>
<td>Non-defense mandatory programs</td>
<td>$5.5</td>
<td>7.6%</td>
</tr>
<tr>
<td>Medicare</td>
<td>$11.1</td>
<td>2.0%</td>
</tr>
<tr>
<td>Certain mandatory health funding</td>
<td>*</td>
<td>2.0%</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>$109.3</strong></td>
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*Less than $50 million. Percentages apply only to amounts that are not exempt from sequestration. Discretionary funding is that provided by annual appropriations laws; non-defense discretionary programs are exempt from sequestration. Mandatory funding is for entitlement programs, whose levels are not controlled by appropriations bills (although most mandatory programs are exempt from sequestration).

Source: CBPP calculations from Office of Management and Budget and Congressional Budget Office data
County Risks: Sequestration

- If Congress does not act and sequestration goes into effect, many of the federal programs that are important to counties will face cuts including:

  - DOJ State Criminal Alien Assistance Program (SCAAP)
  - DOT Essential Air Service
  - Education Dept’s Elementary & Secondary Education
  - FTA Transit Capital Grants
  - HHS Substance Abuse & Mental Health
  - HHS Child Care Discretionary
  - HHS Older American / Aging Services
  - DOJ State & Local Law Enforcement
  - DOJ Juvenile Justice
  - DOL WIA Title I Formula Grants to States
  - Payment-in-Lieu-of-Taxes (PILT)
  - HHS Social Service Block Grant (SSBG)
  - HHS Prevention & Public Health Fund
  - NTIA State & Local Implementation Program
  - FHWA Federal-Aid Highways
  - HHS TANF
  - SNAP
  - Child Nutrition
Ongoing Fiscal Debate: Areas of Opportunity for Counties

- Gas tax increase
- Online sales tax
Potential Opportunity:
Gas Tax Increase

The last time the federal gas tax was increased was in 1993

If an increase is included in a future debt deal, this would generate additional revenue that would be distributed to counties through the federal highway and transit programs.
Potential Opportunity: Gas Tax Increase

✓ Because of the recession and more fuel efficient vehicles, revenue collections have decreased in recent years which has required $35 billion to be transferred from the General Fund to the Highway Trust Fund to maintain existing funding levels.

✓ Without an increase in the federal gas tax, current funding levels are unsustainable.

✓ It may be easier politically to include a gas tax increase in a debt deal than as part of the next transportation reauthorization bill.
Potential Opportunity: Online Sales Tax

✓ The ability for state and local governments to collect sales taxes on remote or online sales remains a potential source of revenue and could be on the table in future fiscal negotiations.

✓ The significant growth of e-commerce has resulted in state and local governments losing billions of dollars in uncollected sales tax and revenue each year—estimated at over $23 billion in 2012.
Potential Opportunity: Online Sales Tax

Online sales have skyrocketed over the past few years and are expected to see continued growth.

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales (billion)</th>
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<tbody>
<tr>
<td>2009</td>
<td>157</td>
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<tr>
<td>2010</td>
<td>176</td>
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<td>2011</td>
<td>197</td>
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<td>2012</td>
<td>218</td>
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<td>2013</td>
<td>240</td>
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<tr>
<td>2014</td>
<td>259</td>
</tr>
<tr>
<td>2015</td>
<td>279</td>
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</table>

Source: Internet Retailer
NACo Position

NACo is advocating for a **balanced approach** to deficit reduction negotiations. Our general principles include:

- It is nearly impossible to address the federal debt and deficit crisis by severely cutting domestic, non-military discretionary programs.
- Federal assistance to state and local governments will help mitigate further layoffs.
- Federal investments and matching funds in state and local infrastructure projects helps produce private sector jobs and improve our competitiveness.
- Deficit reduction should **NOT** be accomplished by shifting costs to counties, imposing unfunded mandates, or pre-empting county programs and taxing authority.
- Special care should be taken to ensure that reforms to Medicaid, in particular, are not simply a shift of health care costs to counties.
Contact Us!

For questions or more information, feel free to contact us below

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