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HOW THE ACROSS-THE-BOARD CUTS IN THE BUDGET CONTROL ACT WILL OCCUR

by Richard Kogan

The debt limit deal of August 2 — the Budget Control Act (BCA) — imposed caps on discretionary programs that will reduce their funding by almost $1 trillion over the next decade, relative to the Congressional Budget Office (CBO) baseline of this past March. In addition, it established a Joint Select Committee on Deficit Reduction to propose legislation reducing deficits by another $1.2 trillion over that period, and established a backup "sequestration" procedure. Because the Joint Committee process has failed, sequestration — a form of automatic cuts that apply largely across-the-board — is now scheduled to occur starting in January 2013 and will cover the nine-year period through 2021.

In 2013 those across-the-board cuts will represent approximately a 9 percent annual cut in most of the affected non-defense discretionary programs, a 2 percent cut in Medicare provider payments, an 8 percent cut in other affected mandatory programs, and a 9 percent cut in affected defense programs. The Medicare cut will continue at 2 percent over the remaining eight years but the percentage cuts in other programs will gradually shrink.

Part 1 of this report outlines how the 2013 cuts will occur. Part 2 describes how the cuts will occur in the next eight years, 2014-2021. Please note that the process for 2013 is substantially different from the process in the ensuing eight years.

Background: Main Elements of the Legislation

The Budget Control Act:

- raises the debt limit by $2.1 trillion (in steps), which is currently estimated to be sufficient through early 2013; this debt limit increase is not contingent on any further action;

- establishes binding limits or "caps" on annual appropriations bills (which cover "discretionary" — or non-entitlement — programs such as defense, education, national parks, the FBI, the EPA, low-income housing assistance, medical research, and many others); the caps reduce projected funding for these programs by almost $1 trillion through 2021, relative to the funding levels in CBO's March baseline;

- requires the House and Senate to vote this fall on an amendment to the Constitution to require a balanced budget every year; the House defeated the amendment on November 18 (a two-thirds vote is required to amend the Constitution) while the Senate is expected to vote shortly;

- established a Joint Select Committee on Deficit Reduction to produce legislation to reduce projected deficits by at least an additional $1.2 trillion through 2021 (beyond the $1 trillion plus interest generated by the discretionary caps); on November 21, the Committee's co-chairs announced they could not reach agreement;

- because of the failure of the Joint Select Committee, provides for automatic, across-the-board budget cuts in many programs in *2013*; and

- also because of the failure of the Joint Select Committee, provides reductions in each year from 2014 through 2021 in the annual caps on discretionary appropriations as well as automatic cuts in selected entitlement programs.

Part 1: How the 2013 Sequestration Will Work

The Budget Control Act spells out the steps that the Office of Management and Budget (OMB) must take because of the Joint Committee's inability to agree. Specifically, the law calls for $1.2 trillion in deficit reduction through 2021, specifying $984 billion in budget cuts and $216 billion in reduced interest payments.[1] The $984 billion in budget cuts is spread in equal dollar amounts over each of the nine years 2013-2021, or $109.3 billion per year. Those cuts themselves are divided equally between the "national defense" budget function and all other budget functions: $54.7 billion per year in defense and $54.7 billion per year in non-defense programs.

Table 1
How the $1.2 Trillion in Deficit Reduction Is Apportioned
In billions of dollars

	Non-defense	Defense	Total
$1.2 trillion shortfall due to Joint Select Committee inaction			1,200
Less 18% of shortfall, attributed to interest savings			-216
Equals required program cuts			984
Annual program cuts, 2013-2021 in equal amounts			109.3
Split equally between defense and non-defense programs	54.7	54.7	109.3
Does not add due to rounding			

In 2013, the $54.7 billion in *non*-defense cuts will come from both mandatory (entitlement) and discretionary programs. The mandatory cuts will include:

[1] In a September report, the Congressional Budget Office estimates that a sequestration of $984 billion, as required by the law, would actually reduce interest payments by $169 billion over ten years; CBO assumes lower interest rates than the drafters of the budget deal. See *Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act*, CBO, September 12, 2011, at http://www.cbo.gov/ftpdocs/124xx/doc12414/09-12-BudgetControlAct.pdf.

- Cuts in Medicare payments to providers and insurance plans; those cuts are limited to 2 percent of such payments in any year, or about $10.8 billion in 2013.[2] This means that Medicare providers will continue to bill Medicare in the normal way but will be reimbursed at a rate of 98 cents on the dollar.

- About $5.2 billion in cuts in the other mandatory programs that are subject to sequestration, the biggest of which is farm price supports. A number of key mandatory programs are *exempt* from sequestration, including Social Security, Medicaid, CHIP, SNAP (formerly known as the Food Stamp Program), child nutrition, Supplemental Security Income (SSI), refundable tax credits such as the Child Tax Credit and the Earned Income Tax Credit, veterans' compensation and other benefits, and federal retirement.[3]

Thus, in 2013, some $16 billion of the $54.7 billion in non-defense cuts will come from mandatory programs. The remaining non-defense cuts — about $38.7 billion in 2013 — will come from discretionary programs. For fiscal year 2013, the non-defense cuts would occur through across-the-board, proportional reductions in the new funding provided for each discretionary program in the appropriations bills for fiscal year 2013, which Congress should already have enacted before the January 2013 sequestration order is issued.[4] The Budget Control Act exempts veterans' medical care and Pell grants from those cuts. In addition, the Act limits to 2 percent the cuts in funding for community and migrant health centers and for Indian health services and facilities.

The $54.7 billion in 2013 *defense* cuts will be imposed in a similar but not identical manner. The defense cuts will occur through across-the-board, proportional reductions in the funding provided for defense accounts in the appropriations bills. War costs are subject to sequestration, as are defense unobligated balances carried over from prior years. (Although war costs, like other emergency costs, are not subject to the discretionary caps that the BCA created, sequestration is a separate process, and war and other emergency costs *are* subject to sequestration.)

In 2013, the one year in which the cuts will affect defense funding that Congress will already have appropriated, the President can exempt some or all military personnel funding from the sequestration. To the extent he chooses that option, the cuts in other defense funding would increase.

The Percentage Cut in 2013

Our calculations show that a *non*-defense sequestration of $54.7 billion in 2013 would result in

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[2] The estimated amount of program funding that is subject to sequestration, except where noted otherwise, is taken directly from CBO's report of September 12, cited in footnote 1.

[3] The Budget Control Act is drafted as a portion of the Balanced Budget and Emergency Deficit Control of Act of 1985 (BBEDCA, also known as Gramm-Rudman-Hollings), which contains a list of exemptions in section 255 and a list of special rules in section 256. Those two provisions of BBEDCA were most recently updated by the Statutory PAYGO Act of 2010, and are not changed by the Budget Control Act.

[4] For non-defense appropriations, "new funding" means new budget authority and includes advance appropriations that first become available for obligation in 2013. The term does not include unobligated balances carried over from prior years. If a part-year "continuing resolution" is in place at the time of the January 2013 sequestration, the sequestration is calculated as though that legislation extended for the entire fiscal year, and the dollar cuts continue to apply when the temporary continuing resolution is replaced by year-long funding.

cuts of approximately 9.1 percent in non-exempt non-defense discretionary programs and 8.2 percent in non-exempt mandatory programs, as well as the 2 percent maximum cut in Medicare provider payments the law allows. A defense sequestration of $54.7 billion would represent a cut of about 9.3 percent in defense programs, including war funding and unobligated balances, if military personnel funding is exempt from sequestration, and about a 7.5 percent cut if it is not exempt.

Table 2

Sequestration in 2013 if Appropriations Match 2013 Caps

In billions of dollars

	Resources Before Sequestration	Sequestration	
		Dollar reduction	Percent reduction
Defense	**$726**	**$54.7**	
Military personnel funding, assumed to be **exempt** (est.)	136	0	0.0%
Other non-war funding for 2013	410	38.0	9.3%
Subtotal, amount subject to caps	*546*		
War funding, outside of caps (estimated)	90	8.3	9.3%
Unobligated balances from prior years (estimated)	90	8.3	9.3%
Non-defense discretionary (NDD) programs	**501**	**38.6**	
Non-exempt programs	423	38.5	9.1%
Veterans' health and Pell grants, **exempt** (estimated)	72	0.0	0.0%
Health centers and Indian health, **2% limit** (estimated)	6	0.1	2.0%
Non-exempt mandatory programs	**605**	**16.1**	
Medicare payments to providers and plans, **2% limit**	542	10.8	2.0%
Other non-exempt mandatory programs	63	5.2	8.2%

Note: The percentage cut in non-exempt, non-defense discretionary funding of 9.1 percent is deeper than the percentage cut in non-exempt mandatory funding of 8.2 percent. The two percentages would be identical if the basic non-defense sequestration had been allocated proportionally across all non-exempt programs, and if the additional cuts needed to offset the effect of the 2 percent limit on the sequestration of some health programs had also been allocated proportionally across all other non-exempt programs. But the Budget Control Act does not work that way. To begin with, the 2 percent limit on the cut to discretionary health centers and Indian health is offset only by increasing the cut to other non-defense discretionary (NDD) programs. Similarly, the exemption of Pell grants and VA medical care from sequestration must be offset by deeper cuts in other NDD programs. Thus, non-exempt mandatory programs do not help offset the exemption for Pell grants and VA medical care or the 2 percent limit on the cut to discretionary health centers and Indian health. In contrast, the Act specifies that the 2 percent Medicare limit is offset by deeper cuts to both non-exempt mandatory programs and non-exempt NDD programs. This structure results in somewhat different sequestration percentages applying to those two categories of non-exempt non-defense programs.

Part 2: What Will Happen in 2014 and Subsequent Years

The required defense funding cut of $54.7 billion in each year from 2014 through 2021 will occur through reductions in the annual statutory caps on defense funding that the Budget Control Act sets for each of those years if sequestration is triggered. Unlike in 2013, there will be *no automatic cut of all affected defense programs by the same percentage*; instead, the Appropriations Committees will decide how to live within the newly reduced defense funding caps. As can be seen, the process for years after 2013 is quite different from the process for 2013.

For non-defense programs, the process in years after 2013 is the *same as in 2013 for entitlements* but *different for discretionary (NDD) programs*.

- Medicare payments to providers and health insurance plans will continue to be cut by 2 percent; in other words, for the entire nine-year period 2013-2021, providers and plans will be paid 98 cents on the dollar. Because Medicare costs are projected to rise from 2013 through 2021, the dollar amount saved by this 2 percent cut will increase, from $10.8 billion in 2013 (see Table 2) to $11.4 billion in 2014 and ultimately to $17.2 billion in 2021, according to CBO.

- In each year from 2014 through 2021, the remaining amount of the total $54.7 billion in annual non-defense cuts will be applied proportionally to: 1) other non-exempt mandatory programs in the aggregate; and 2) the statutory cap on overall non-defense discretionary funding. Because Medicare will take a growing share of the $54.7 billion annual non-defense cut (it will account for 21 percent of that cut in 2014 but 31 percent in 2021), other non-defense programs will absorb a somewhat declining share of the cut, as Table 3 shows.

- As with defense, the non-defense discretionary cuts will be accomplished through the normal appropriations process as Congress writes appropriations bills to remain within the newly reduced caps for total non-defense appropriations. Therefore, Pell grants, VA medical care, health centers, and Indian health will have no special status; the normal process of policymaking will determine how Congress adheres to the newly reduced caps.

Why Our 2013 Figures Differ from CBO's

We use CBO's estimates of 2013 mandatory funding that is subject to sequestration, from CBO's September 12 report (see footnote 1). Nevertheless, in that report CBO portrays different percentage cuts from those in Table 2. The reason is that, to make its presentation simpler and less technical, CBO treated the 2013 sequestration base as though it were the $546 billion cap level for defense and the $501 billion cap level for non-defense discretionary programs; CBO did not take into account funding *outside* the caps that is *subject* to sequestration (war funding and defense unobligated balances) or funding *within* the caps that is *exempt* from sequestration (VA medical care, Pell grants, and potentially military personnel) or subject to a 2 percent limit (health centers and Indian health). In effect, CBO portrayed the 2013 reductions as though they were the effect of *cap reductions* rather than sequestration of actual appropriations bills. This allowed CBO's 2013 figures to be comparable to its 2014-2021 figures, which the Budget Control Act requires to be cap reductions, but it is technically incorrect and oversimplifies (and slightly distorts) the likely 2013 effects on non-exempt programs if they are funded at plausible levels.

Table 3								
What Will Happen in 2014 through 2021 In billions of dollars								
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Defense caps before reduction	556	566	577	590	603	616	630	644
Required reduction, dollars	-54.7	-54.7	54.7	-54.7	54.7	-54.7	54.7	-54.7
Required reduction, percent	9.8%	9.7%	9.5%	9.3%	9.1%	8.9%	8.7%	8.5%
Resulting level of caps	501	511	522	535	548	561	575	589
NDD caps before reduction	510	520	530	541	553	566	578	590
Required reduction, dollars	-38	-37	-36	-36	-35	-34	-33	-33
Required reduction, percent	7.4%	7.1%	6.8%	6.6%	6.4%	6.1%	5.8%	5.5%
Resulting level of caps	472	483	494	505	518	532	545	557
2% Medicare sequestration, dollars	-11.4	-12.0	-12.9	-13.4	-14.1	-15.1	-16.1	-17.2
Non-exempt mandatory cuts other than Medicare, dollars	-5.3	-5.7	-5.7	-5.4	-5.3	-5.2	-5.1	-5.0
Non-exempt mandatory cuts other than Medicare, percent	7.4%	7.1%	6.8%	6.6%	6.4%	6.1%	5.8%	5.5%