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This report has been updated to reflect new data.

Two Sequestrations:
How the Pending Automatic Budget Cuts Would Work

by Richard Kogan

A prominent part of the "fiscal cliff" is the automatic, across-the-board funding reductions known as sequestration. Required under the 2011 Budget Control Act (BCA), these automatic cuts will occur in both defense and non-defense programs on January 2, 2013 — absent action by the President and Congress to turn them off. Less well known is that a second automatic sequestration, applying only to defense, is also slated to take effect due to other aspects of the BCA. Absent intervening action, this second sequestration will occur in mid-January or sooner; it must occur within 15 days after Congress adjourns at the end of its current session. Together, these two sequestrations would reduce 2013 funding by about $120 billion.

The first sequestration: Along with raising the debt limit last July, the BCA imposed caps on "discretionary" funding — funding subject to the annual appropriations process — and established a congressional Joint Select Committee on Deficit Reduction (Supercommittee) to propose legislation that would reduce deficits by another $1.2 trillion over ten years. In the event that the Supercommittee failed, the BCA created a backup sequestration procedure to ensure that the desired level of deficit reduction over the coming decade would nonetheless be achieved. Because the Supercommittee did not fulfill its goal, sequestration is scheduled to cut defense and non-defense funding in 2013 by $109.3 billion. In this report, we call this the "Supercommittee sequestration."

The second sequestration: The BCA established separate caps for defense and non-defense discretionary funding for each year from 2013 through 2021. For 2013, Congress has so far enacted only a continuing resolution (CR) — a stop-gap bill that funds discretionary programs through March 27, 2013. When viewed on a full-year basis, the CR's total discretionary funding is consistent with the overall levels in the BCA, but the amount provided for defense breaches the BCA's cap on defense funding (see the box on page 3). That will trigger a separate sequestration of 2013 defense funding, reducing it by $10.9 billion in order to bring defense funding back down to the BCA cap level. We call this the "cap sequestration."

This report explains in detail how these two aspects of sequestration will work. The President and Congress, of course, may agree to turn off the two threatened sequestrations for 2013 before they occur or undo them shortly after they take effect.

The Two Sequestrations for 2013

Table 1 summarizes the dollar and percentage sequestrations for 2013. All the figures in this report are based on Office of Management and Budget (OMB) estimates from its September 24, 2012 report.[1] Where OMB data are not available, we used equivalent estimates from the Congressional Budget Office (CBO).

Table 1: Dollar and Percentage Sequestrations for 2013		
	Dollar Cuts (billions)	**Percent Cuts**
"Supercommittee sequestration":		
Defense, discretionary funding	54.6	9.4%
Defense, mandatory funding	0.1	10.0%
Non-defense, discretionary funding	38.0	8.2%
Non-exempt mandatory programs generally	5.5	7.6%
Medicare funding	11.1	2.0%
Certain other mandatory health programs	*	2.0%
Subtotal, Supercommittee sequestration	109.3	
"Cap sequestration" of discretionary defense funding	10.9	1.9%
Both sequestrations	120.2	

Note: Cuts are measured from the 2013 funding provided by PL 112-175, the 2013 continuing resolution.

Percentages apply only to amounts that are not exempt from sequestration.

*Less than $0.05 billion. Total may not add due to rounding. For purposes of this table, the Supercommittee sequestration is assumed to be ordered before the cap sequestration; see Appendix 2.

In general, the figures are based on OMB's interpretation of the sequestration law, except in those instances in which OMB did not specify its interpretation. Certain legal questions remain about how the sequestration applies, the most important being the relationship between the cap sequestration and the Supercommittee sequestration. We interpret these two sequestrations as independent events, each calculated separately and then added together. That is, the cap sequestration does not provide savings that count toward the Supercommittee sequestration, and the Supercommittee sequestration does not provides savings that count toward the cap sequestration. In this respect, the order in which the two sequestrations occur largely does not matter (see Appendix 2 for a more detailed discussion).

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[1] See *OMB Report Pursuant to the Sequestration Transparency Act of 2012*, September 24, 2012, at http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf.

All estimates in this report are based on the existing CR, and we assume that the President and Congress will not replace the CR by enacting full-year appropriations until after the sequestrations are triggered.

The Continuing Resolution

Continuing resolutions (CRs) are temporary, stop-gap appropriations bills that allow programs to continue for a specified time when policymakers have not enacted regular appropriations for the entire fiscal year by the October 1 start of the fiscal year. Currently, none of the 12 regular appropriation bills has been enacted for fiscal year 2013, so the government is operating under a CR that expires March 27, 2013.

The total for 2013 discretionary funding under the BCA caps is $1.047 trillion. This total is enforced through separate caps on defense and non-defense funding. While the full-year amounts in the CR adhere to the $1.047 trillion funding total allowed by the BCA, the CR does not adhere to the separate caps on defense and non-defense funding. Specifically, the CR breaches the defense cap by $10.9 billion while falling short of the non-defense cap by the same amount (see Table 2).

Table 2:

The Existing CR Adheres to the BCA in Total but Violates the Defense Cap
2013 discretionary funding (budget authority) in billions of dollars

	BCA caps	Funding in CR	over(+) / under(-) caps
Defense	546.0	556.9	+10.9
Non-defense	501.0	490.1	-10.9
Total	1,047.0	1,047.0	0.0
*Plus amounts exempt from caps:**			
War funding (defense and non-defense)		*99.9*	
Disaster/emergency funding		*6.4*	
Program integrity funding		*0.5*	

**Technically, this funding is not exempt from the caps but rather results in an automatic, upward revision of the caps.*

CRs and Sequestration

A part-year CR is treated as providing a full year's appropriation for purposes of the sequestration calculations (both the Supercommittee sequestration described in Part 1 and the cap sequestration described in Part 2). A sequestration thus reduces the full-year amount of the CR.

Consider a program that customarily costs $1 billion over the course of an entire fiscal year. Many people would think of a six-month CR as providing $500 million in funding for that program, to last six months. But for purposes of sequestration calculations, the law says that the CR is treated as providing $1 billion over a full year. As a result, a sequestration of 8 percent, for example, would reduce that amount to $920 million for the year. Thus, an 8 percent sequestration means that the agency is expected to operate as though $920 million had been provided for the full year under the CR, but with the authority to operate expiring after six months.

A sequestration neither decreases nor increases the flexibility that agencies may have under a CR; the sequestration merely reduces the amount of funding available for each program. In this way, an 8 percent sequestration on January 2, 2013, is no different from the enactment of a rescission on that date that reduces by 8 percent all amounts that are made available under the terms of the current CR.

Part 1 of this report examines how the "Supercommittee sequestration" works for 2013. Part 2 describes the "cap sequestration," which affects only defense discretionary funding in 2013. Part 3 discusses the Supercommittee sequestration in 2014 and subsequent years.

Part 1: How the "Supercommittee Sequestration" Will Work in 2013

The BCA details the steps that OMB must take because the Supercommittee did not reach agreement on a deficit reduction plan. As Table 3 shows, the sequestration law calls for $1.2 trillion in deficit reduction through 2021; it requires $984 billion in budget cuts and assumes those savings will reduce interest payments by $216 billion.[2] The $984 billion in budget cuts is divided equally 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[3] and all other budget functions: $54.7 billion per year in defense and $54.7 billion per year in non-defense programs.

Table 3

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			

Defense sequestration. The $54.7 billion in 2013 defense cuts required by the Supercommittee sequestration are imposed on discretionary and mandatory defense programs that are not exempt from sequestration.[4]

The vast bulk of the defense cuts will occur through across-the-board, proportional cuts in funding for discretionary defense accounts in the existing CR. Within the National Defense function, war costs are subject to sequestration, as are unobligated balances carried over from prior

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[2] Because CBO now assumes far lower interest rates than the budget deal drafters assumed in 2011, CBO would likely estimate that the Supercommittee sequestration would actually reduce interest payments by about $125 billion through 2021.

[3] The National Defense function includes all the military programs of the Department of Defense as well as the nuclear weapons and clean-up activities of the Department of Energy and some other activities by other agencies that are classified as National Defense, such as a portion of the FBI, the Department of Homeland Security, and the Coast Guard.

[4] All mandatory defense funding, except $679 million, is exempt from sequestration. The three largest examples of non-exempt funding are administrative costs of commissaries financed by surcharge collections, the national defense stockpile transaction fund, and administrative expenses of the Energy Employees Occupational Illness Compensation Fund (which is administered by the Department of Energy).

Table 4: Defense Cuts Required by the January 2nd Supercommittee Sequestration In billions of dollars	Discretionary	Mandatory	Total
Step 1: allocate share of cuts for discretionary and mandatory programs:			
Discretionary = cap; mandatory = sequestrable funding	546.0	0.7	546.7
Percentage allocation of $54.7 billion in cuts	99.88%	0.12%	100.00%
Allocate $54.667 billion in required cuts according to above shares	-54.599	-0.068	-54.667
Step 2: calculate amounts subject to sequestration:			
Defense funding in the CR, subject to the $546.0 billion cap	556.9		
-- Plus war funding in the national defense function	88.7		
-- Plus unobligated balances of defense funding carried over from prior years and additional sequestrable funding offset by collections attributable to defense accounts	90.9		
-- Minus military personnel funding, exempt by presidential decision	-154.0		
Equals defense funding subject to sequestration	582.5	0.7	583.2
Step 3: percentage cuts in sequestrable funding (Step 1 divided by Step 2)	9.4%	10.0%	

Source: CBO estimates of the 2013 CR, OMB estimates of unobligated balances and sequestrable funding offset by collections.

years; but military personal funding is not, at the President's option.[5] Table 4 shows the three steps that OMB will take in calculating the Supercommittee sequestration of defense funding.

- Step 1 shows how the required dollar sequestration in defense is allocated between discretionary (non-entitlement) and mandatory (entitlement) funding. But the share of the cut allocated to discretionary funding is based on the cap on new discretionary defense funding ($546.0 billion, the level specified in the BCA), while the share allocated to mandatory funding is based on that mandatory funding that is actually subject to sequestration (most mandatory defense funding is

[5] Under the law, the President has the option to exempt none, some, or all funding for military personnel from a coming sequestration or to reduce the percentage cut applicable to military personnel, if he announces his decision by the applicable date (August 10). Exempting this funding increases the sequestration of other defense accounts, since the total dollar amount of the required defense reduction is not altered by his decision on personnel funding. This is the only discretion granted to the executive under the sequestration law. For 2013, President Obama chose a complete exemption for military personnel funding.

exempt from sequestration).

- Step 2 shows the amount of discretionary defense funding that is subject to sequestration, $582.5 billion, after adjusting for war costs, unobligated balances, and military personnel funding.[6]

- Step 3 divides the required cut for discretionary and mandatory defense funding (Step 1) by the amount of such funding that is subject to sequestration (Step 2) to derive the percentages applicable to discretionary and mandatory defense funding that is subject to sequestration.

Sequestrable mandatory funding is cut by 10.0 percent, while sequestrable discretionary funding is cut by 9.4 percent. That's because the required sequestration is allocated to mandatory and discretionary defense programs based on the amount of sequestrable mandatory funding and the discretionary defense *cap,* as seen in Step 1 of Table 4. But the amount of discretionary, sequestrable defense funding ($582.5 billion) is larger than the defense cap ($546.0 billion); as a result, the required percentage reduction to achieve the needed defense discretionary reduction is lower.

Non-defense sequestration. As with the defense cuts, the $54.7 billion in non-defense cuts will come from both mandatory and discretionary programs. The mandatory cuts will include:

- Cuts in Medicare payments to providers and insurance plans. Those cuts are limited to 2 percent of such payments a year, or $11.1 billion in 2013. That means that Medicare doctors, hospitals, and providers will continue to bill Medicare in the normal way, but will be reimbursed at 98 cents on the dollar, as will per-capita premium payments on behalf of Medicare participants to health insurance plans.[7]

- About $5.6 billion in cuts to other mandatory programs subject to sequestration. The biggest such program supports farm prices; other affected programs include vocational rehabilitation, mineral leasing payments to states, the Social Services Block Grant, and dozens of smaller programs. A special rule limits the sequestration of mandatory funding for community health centers and the Indian health service to 2 percent.

- Some key mandatory programs are *exempt* from sequestration, including Social Security, Medicaid, the Children's Health Insurance Program (CHIP), SNAP (formerly known as food stamps), child nutrition, Supplemental Security Income (SSI), refundable tax credits such as the Child Tax Credit and the Earned Income Tax Credit, veterans' compensation and pensions, and federal retirement.[8]

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[6] The OMB report (cited in footnote 1) that was issued in September shows $580.1 billion in sequestrable defense funding rather than the $582.5 billion we show here. However, OMB's estimates were based on a hypothetical freeze-level CR defined in the Sequestration Transparency Act, while our estimates are based on CBO's scoring of the actual CR now in effect.

[7] A special rule in the sequestration law provides that the Medicare sequestration starts the first full month after the order is issued and continues for 12 months. See Appendix 1.

[8] 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

Thus, in 2013, about $16.6 billion of the $54.7 billion in non-defense cuts will come from mandatory programs. The remaining non-defense cuts — about $38.0 billion in 2013 — will come from discretionary programs. For 2013, the non-defense cuts would occur through across-the-board, proportional cuts in the new funding provided for each non-exempt discretionary program in the CR.[9] The BCA exempts all veterans' funding and Pell Grants from those cuts, even though they count against the BCA caps. Programs that are essentially excluded from the BCA discretionary caps, but that are *not* exempt from sequestration, include war costs within the International Affairs function, disaster and emergency funding, and program integrity funding.[10]

Table 5 on the next page shows the six steps that OMB will take in calculating the Supercommittee sequestration of non-defense funding.

- Step 1 shows the Medicare sequestration, which is limited to 2 percent.[11] The Medicare sequestration is calculated before the remaining sequestration is allocated between discretionary and other mandatory funding. As a result, limiting the Medicare cut to 2 percent increases the subsequent cut in both discretionary and other mandatory non-defense programs.

- Step 2 allocates the remaining non-defense sequestration, after accounting for Medicare cuts, between discretionary and other mandatory programs. Just as with the defense sequestration outlined in Table 4, this allocation is based on the non-defense discretionary *caps* (not the amount of non-defense discretionary funding that is subject to sequestration) and the non-defense mandatory funding that is subject to sequestration. Just as with the defense sequestration, this allocation is thus not strictly proportional to the amount of discretionary and mandatory funding subject to sequestration.

- Step 3 shows that a 2 percent limitation on the cut to mandatory funding for community health centers and Indian health reduces mandatory funding for those programs by $27 million. Unlike the Medicare 2 percent limit, this 2 percent limit increases the sequestration of other *mandatory* programs, but none of the offsetting increase is imposed on non-defense *discretionary* programs.

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special rules in section 256. Those two provisions of BBEDCA were most recently updated by the Statutory Pay-As-You-Go Act of 2010, and were not changed by the Budget Control Act.

[9] 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.

[10] The BCA allows the discretionary caps to be adjusted upward by a limited amount to the extent Congress increases funding for the Social Security Administration to review disability cases and for the Department of Health and Human Services to fight Medicare fraud. This extra program integrity funding more than pays for itself by generating savings in disability and Medicare payments.

[11] A portion of Medicare, such as the low-income subsidy for the prescriptions drug benefit, is exempt from sequestration. Also, about $1 billion of mandatory Medicare funding for administrative costs is subject to across-the-board sequestration rather than being limited to 2 percent. For simplicity this analysis refers to a "2 percent limit on Medicare sequestration" but the calculations account for the portion of Medicare that is completely exempt and the portion that is subject to across-the-board sequestration.

Table 5: Non-Defense Cuts Required by the January 2nd Supercommittee Sequestration In billions of dollars	Discretionary	Mandatory	Total
Step 1: apply 2% cut to Medicare and calculate remaining required cuts:			
Total required non-defense cuts			-54.667
Medicare funding subject to the 2% cut			554.265
2% cut of Medicare			-11.085
Equals remaining non-defense cuts			-43.581
Step 2: allocate share of remaining cuts for discretionary and mandatory programs:			
Discretionary = cap; mandatory = sequestrable funding	501.000	73.302	574.302
Percentage allocation of non-Medicare cuts	87.24%	12.76%	100.00%
Allocate $43.581 billion in required cuts according to above shares	-38.019	-5.563	-43.581
Step 3: apply 2% limit to mandatory funding for "special health" programs:			
Base level of mandatory "special health" programs		1.344	
2% cut in "special health" programs		-0.027	
Remaining required cuts, to be taken across the board	-38.019	-5.536	-43.554
Step 4: account for special treatment of student loans:			
De facto student loan sequestration base		1.200	
Add student loans but subtract "special health" from sequestration base		73.158	
Step 5: calculate NDD amounts subject to across-the-board sequestration:			
Non-war funding in the CR, subject to the $501.0 billion cap	490.135		
-- Plus war funding in the international affairs function	11.203		
-- Plus program integrity, disaster, and emergency funding (outside cap)	6.898		
-- Plus additional sequestrable funding financed by offsets (where the offsets are unaffected by sequestration):			
• Offset by CHIMP savings	18.818		
• Offset by negative credit subsidies	11.701		
• Offset by collections	12.856		
-- Minus Pell funding, exempt from sequestration	-22.964		
-- Minus veterans funding, exempt from sequestration	-63.018		
Equals non-defense funding subject to sequestration	465.629	73.158	538.787
Step 6: percentage cuts in sequestrable funding (Step 3 divided by Step 5)	8.2%	7.6%	

Source: CBO estimates of the 2013 CR, OMB estimates of sequestrable funding offset by collections.

- Step 4 adjusts the base of sequestrable funding for mandatory programs in two ways. First, it adds $1.2 billion for student loans, which is the *de facto* sequestrable base for that program and which was not included in the mandatory sequestrable funding base in Step 2. (This issue is discussed at greater length in Appendix 1.) Second, it reduces the starting base by $1.344 billion, the amount associated with the special health programs discussed in Step 3, because the 2 percent sequestration of those programs has already been handled. The net impact of these two changes is to reduce the mandatory starting base of $73.302 billion to $73.158 billion.

- Step 5 shows how the non-defense discretionary amount subject to sequestration differs from the amount in the CR that counts against the $501 billion BCA cap on non-defense discretionary funding. In addition to the CR funding that counts against the cap, the CR contains some funding that does not count against the cap (or, more precisely, the cap is automatically increased by the amount of that funding): war, disaster and emergency,[12] and program integrity funding (see footnote 10).

  Step 5 also shows three other types of funding that add to the level of sequestrable non-defense funding: savings from changes in mandatory programs (CHIMPs), negative credit subsidies, and certain types of federal collections for voluntary payments to the government for goods and services. These three types of budget transactions produce savings in the CR totaling more than $43 billion. Since these savings count towards meeting the BCA caps, their inclusion in the CR allows for $43 billion in offsetting, additional funding. That is, the $43 billion in savings and the $43 billion in additional costs net to zero when scored against the BCA caps. The key point is that although these savings cannot be subject to sequestration, the extra funding that they finance *is* subject to sequestration, which is shown in Step 5.

  Finally, Step 5 shows that the CR contains $23 billion in funding for Pell grants and $63 billion in discretionary veterans funding (primarily for the VA health system), which are exempt from sequestration.

  As a result, the amount of gross non-defense discretionary funding in the CR that is subject to sequestration totals $466 billion, a figure smaller than both the BCA cap of $501 billion and the $490 billion in the CR that is scored against the BCA cap.

- Step 6 divides the required across-the-board dollar sequestrations calculated in Step 3 by the discretionary and mandatory funding subject to those cuts, shown in Step 5, thereby deriving the discretionary percentage (8.2 percent) and mandatory percentage (7.6 percent) cuts that are applicable to each program that's subject to those across-the-board cuts.

OMB's published report on sequestration, as required by the Sequestration Transparency Act (STA), derives 8.2 percent in non-defense discretionary cuts and 7.6 percent in non-defense mandatory cuts. Although our percentage figures are the same as OMB's, our discretionary funding figures are based on the CR as scored by CBO, rather than on a hypothetical CR that OMB was directed to assume under the terms of the Sequestration Transparency Act.

[12] The distinction is unimportant in a legal sense, but the BCA provides for upward adjustments both for disaster funding (within limits) and emergency funding (with no specified limits).

Part 2: How the "Cap Sequestration" for Defense Funding Will Work in 2013

The existing CR for 2013 is subject to the BCA's caps on defense and non-defense discretionary funding. While the full-year amounts in the CR are consistent with the overall $1.047 trillion funding total that the BCA allows, the levels in the CR exceed the defense cap by $10.9 billion and are below the non-defense cap by the same amount (see the box on page 3).

This breach of the BCA defense cap may be confusing, given that the 2013 CR basically reflects a freeze of the 2012 funding levels (with a few minor adjustments) and the defense cap did not actually fall by $11 billion from 2012 to 2013. Two factors caused the CR to breach the 2013 defense cap:

- First, CBO scored the first version of the CR as providing about $6 billion less than the $1.047 trillion total that the BCA allowed. Not wanting to set a precedent for budget cuts beyond those imposed by the BCA, Congress increased all amounts in the CR, other than war funding, by about 0.6 percent across the broad.

- The second and more important factor derives from the history of the caps. Appropriations for 2012 were constrained by caps on *security* and *non-security* funding, while appropriations for 2013 through 2021 are constrained by caps on *defense* and *non-defense* funding. Security is a much broader category than defense; it includes veterans, international affairs, and homeland security. The total amount of 2012 security funding complied with the security cap. But within the security category, 2012 appropriations bills provided more defense and less international and homeland security funding than the designers of the caps probably had assumed when they set the defense and non-defense caps for subsequent years. As a result, a freeze of 2012 funding provides more defense and less international and homeland security than the 2013 defense and non-defense caps allow.

Regardless of the source of this breach, the existing 2013 CR will trigger a sequestration of defense discretionary funding sufficient to offset the $10.9 billion violation. By law, this sequestration must be ordered within 15 days after the 112th Congress adjourns *sine die*, which is expected to occur by December 31.

Table 6 on the following page shows that cutting $10.9 billion requires a 1.9 percent cut in defense funding subject to sequestration. The amount of defense funding subject to sequestration is $582.5 billion, greater than the $556.9 billion that the CR provided that's subject to the defense cap. As shown in Table 6, the differences are that sequestrable funding includes war funding and unobligated balances of defense budget authority carried over from prior years, but excludes military personnel funding (identical to the adjustments made for the Supercommittee sequestration to defense discretionary funds; see Step 2 in Table 4).

Table 6: Sequestration to Offset the Breach of the 2013 Defense Cap In billions of dollars	
Defense funding in the CR, subject to the $546.0 billion cap	556.9
-- Plus war funding in the national defense function	88.7
-- Plus unobligated balances of defense funding carried over from prior years and additional sequestrable funding offset by collections attributable to defense accounts	90.9
-- Minus military personnel funding, exempt by presidential decision	-154.0
Equals defense funding subject to sequestration	582.5
Required dollar sequestration to correct breach of the defense cap	10.9
Percent reduction in funding subject to sequestration	1.9%

Source: CBO estimates of the 2013 CR, OMB estimates of unobligated balances and sequestrable funding offset by collections.

Part 3: The Supercommittee Sequestration in 2014 and Subsequent Years

The sequestration required by the Supercommittee's failure entails an annual cut of $109.3 billion in each year from 2013 through 2021. The process for the 2013 sequestration (described in Part 1) has several unique features for discretionary programs that are not repeated in future years.

For mandatory programs, the Supercommittee sequestration essentially works the same way in 2013 as in all years thereafter. In effect, this means that mandatory sequestrations ordered on January 2, 2013, would be repeated each year for a total of nine years. Each year the mandatory sequestration percentage would change modestly, but the sequestration would otherwise work the same way. The percentage cuts in mandatory programs would change from year to year for three reasons.

- The allocation of the dollar cut between discretionary and mandatory programs (Step 1 of Table 4 regarding defense, and Step 2 of Table 5 regarding non-defense) depends on the levels of the discretionary caps, which change each year.
- The allocation changes each year as the estimated amount of mandatory funding subject to sequestration changes, since estimates for these programs change over time.
- For non-defense programs, the 2 percent Medicare sequestration occurs first and so reduces the necessary dollar cut in both discretionary and remaining mandatory programs subject to sequestration. Because Medicare generally grows more rapidly than other programs, the dollar amount of non-defense cuts to be applied across the board will shrink each year.

For discretionary programs, the Supercommittee sequestration works very differently in the years after 2013. Instead of Congress enacting appropriations bills at levels that do not breach the existing discretionary caps and the President then ordering an across-the-board sequestration of the funding amounts in those bills, the law requires that the sequestration of discretionary programs be implemented by reducing the defense and non-defense discretionary caps themselves. Policymakers would then determine how to live within those reduced caps. Essentially, after 2013, there will be *no automatic, proportional cut of all affected discretionary programs*; instead, the Appropriations Committees (and then, more broadly, the President and Congress) will decide how to fund discretionary defense and non-defense programs within the newly reduced funding caps.

Specifically:

- The $109.3 billion sequestration amount is divided evenly between defense and non-defense, or $54.7 billion for each category.

- The defense sequestration largely comes from discretionary defense funding, with only a small amount from mandatory defense funding.

- For the non-defense sequestration, the first step is to calculate the 2 percent cut to Medicare payments to providers and health insurance plans. Because Medicare costs are projected to rise from 2013 through 2021, the dollar amount saved by this 2 percent cut will increase each year, from $11.1 billion in 2013 (see Table 5) to $11.3 billion in 2014 and ultimately to $17.6 billion in 2021 (see Table 7 on the following page).[13]

- In each year from 2014 through 2021, the remaining amount of the $54.7 billion in annual non-defense cuts will be applied proportionally to: 1) other non-exempt mandatory programs and 2) the statutory cap on overall non-defense discretionary funding. Because Medicare will account for a growing share of the $54.7 billion annual non-defense cut — it will account for 21 percent of that amount in 2014, but 33 percent in 2021 — other non-defense programs will absorb a falling share of the cut, as Table 7 shows.

- Because the defense and non-defense discretionary cuts will occur through the normal appropriations process, Pell Grants, veterans' medical care, and military personnel will have no special status; the normal process of policymaking will determine how the President and Congress adhere to the newly reduced caps, and they will be able to cut these programs to help fit within the reduced caps, if they so choose.

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[13] OMB will re-estimate the amount of mandatory savings from sequestration — for example, the amount estimated to be saved by the 2 percent cut in Medicare reimbursement rates — at the beginning of each Congressional session. While these estimates are unlikely to change much from year to year from those shown in Table 7, any changes in estimated mandatory savings will necessarily produce offsetting changes in the size of the reduction in the non-defense discretionary cap, since the total amount of non-defense savings each year must equal $54.7 billion.

Table 7								
Sequestration 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	54.6	54.6	54.6	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 defense caps	501	511	522	535	548	561	575	589
Non-exempt defense mandatory cuts	*	*	*	*	*	*	*	*
2% Medicare sequestration, dollars	11.3	11.8	12.8	13.3	14.0	15.3	16.4	17.6
Non-defense caps before reduction	510	520	530	541	553	566	578	590
Required reduction, dollars	38	38	37	36	36	34	33	32
Required reduction, percent	7.5%	7.2%	6.9%	6.7%	6.4%	6.1%	5.7%	5.5%
Resulting level of non-defense	472	482	493	505	517	532	545	558
Non-exempt, non-defense								
Dollars	5.2	5.2	5.2	5.1	5.1	5.0	5.4	4.8
Percent	7.5%	7.2%	6.9%	6.7%	6.4%	6.1%	5.7%	5.5%
Total sequestration	109.3	109.3	109.3	109.3	109.3	109.3	109.3	109.3

* Less than $0.05 billion.

CBPP estimates from CBO data. The cap levels shown in this analysis do not include later adjustments for the actual enactment of war funding, disaster funding, or program integrity funding because the downward adjustments in the caps required each year by the sequestration law are made before Congress has enacted any such funding.

Appendix 1:
Technical Notes about Medicare and Student Loans

The Supercommittee sequestration of Medicare will begin February 1, 2013, and last for 12 months. This means that the "2013" sequestration of Medicare occurs partly in fiscal year 2013 and partly in fiscal year 2014. CBO's budgetary estimates of the Medicare savings by fiscal year reflect this fact. However, under the Statutory PAYGO Act, which the Budget Control Act cross-references in describing how sequestration will be implemented, the fiscal year *2014* Medicare savings from the cut in reimbursement rates ordered in January 2013 will count toward the sequestration target for fiscal year *2013*. (The same phenomenon applies in each subsequent year, but we will illustrate this point by reference to the 2013 sequestration.) In our estimates, therefore, we take this requirement into account, which is why we attribute $11 billion in Medicare savings — a full 12 months' worth — to achieving the *2013* non-defense sequestration target of $54.7 billion, rather than attributing only eight months of Medicare savings.[14]

The student loan program is mandatory and is not exempt from the Supercommittee sequestration. The law includes a special rule for the program: under a sequestration, origination fees that borrowers pay to the government rise by the uniform percentage applicable to non-exempt mandatory programs generally. For example, if a student's origination fee would otherwise be $100 and the sequestration would be 8 percent, the fee rises to $108.

In its Sequestration Transparency Act (STA) report, OMB stated that each 1 percent increase in the sequestration rate would save the government $12 million. In effect, this means that the student loan sequestration base is $1.2 billion. Although OMB did not portray its calculations this way, that $1.2 billion was effectively part of the mandatory sequestration base of $73.158 billion shown in Table 5 at the end of Step 4. In this respect, we and OMB make identical calculations.

Unlike OMB, we believe that the $1.2 billion student loan sequestration base should also be part of the mandatory base that is used in Step 2 of Table 6 to *allocate* the non-defense cuts between discretionary and mandatory programs. OMB, in contrast, does not include this $1.2 billion as a "sequestrable budgetary resource" in Step 2. In this analysis, we nonetheless follow OMB's approach as outlined in the STA. Had we used the approach that we believe appropriate, the mandatory sequestration base in Step 2 would have been $74.502 billion. In that case, there would have been $79 million less in discretionary cuts and $79 million more in mandatory cuts.

That's a technical issue. We believe that our approach is correct because: the student loan special rule states that the student origination fees are subject to sequestration; those fees are (negative) budget authority under the statutory definition of budget authority even though they flow to, rather than from, the government; and budget authority is defined in the sequestration law as a budgetary resource subject to sequestration. As noted, the STA report treats student loans as subject to sequestration for purposes of Steps 4-6, but does not treat the $1.2 billion student loan sequestration base as a budgetary resource for purposes of Step 2. We believe that it would be more consistent with the structure of the sequestration act, and appropriate under legal definitions, to do so.

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[14] A similar rule applies for sequestration of farm price support payments, which are cut for each crop-year that starts after January 2nd and so will spill over into fiscal year 2014, but will all be attributed to the fiscal year 2013 target.

Appendix 2:
The Timing of the Two Sequestrations

On page 2 of this analysis, we say that the cap sequestration does not provide savings that count toward the Supercommittee sequestration, and we do not believe that the Supercommittee sequestration provides savings that count toward the cap sequestration. In this respect, the order in which the two sequestrations occur does not matter.

The timing of the two sequestrations does matter in one respect, however. Step 1 of Table 4 shows how the Supercommittee defense sequestration is allocated between discretionary and mandatory programs, based in part on the level of the defense cap. Likewise, Step 2 of Table 5 shows how the Supercommittee non-defense sequestration is allocated between discretionary and mandatory programs, based in part on the level of the non-defense discretionary (NDD) cap.

In these two tables, we have used the dollar value of the defense and NDD caps before any adjustments for war, disaster, emergency, or program integrity funding that the BCA permits. This is the correct approach if the Supercommittee sequestration is ordered first, on January 2, 2013, because cap adjustments are only implemented when OMB issues a final sequestration report with respect to the caps — not when it issues the report associated with the Supercommittee sequestration. The end-of-year cap sequestration report, however, must be issued within 15 days of Congress' *sine die* adjournment, and it is at least conceivable that OMB could issue that report before issuing the Supercommittee sequestration report.

If so, the dollar sequestration of discretionary programs would be slightly higher, and the dollar sequestration of mandatory programs correspondingly lower, than shown in Tables 4 and 5. Table 8, below, shows the difference this would make, based on existing funding for war, disaster, and program integrity activities. In addition, Table 8 shows the effects if $60 billion in non-defense additional funding is also enacted for disaster relief and reconstruction related to Hurricane Sandy before the Supercommittee sequestration report is issued.

Table 8:

Changes to Tables 4 and 5 if the "cap sequestration report" is issued before the "Supercommittee sequestration report" and if relief from Hurricane Sandy is enacted
In millions of dollars

	Defense (Table 4)		Non-defense (Table 5)	
	discretionary	mandatory	discretionary	mandatory
Percent cuts shown in Tables 4 and 5	9.4%	10.0%	8.2%	7.6%
Effects of issuing the cap sequestration report first				
Dollar effects, before rounding	+9	-9	+170	-170
Resulting percent cuts	9.4%	8.6%	8.2%	7.3%
Additional effects: $60 billion hurricane relief				
Dollar effects, before rounding	n.a.	n.a.	+496	-496
Resulting percent cuts	n.a.	n.a.	8.3%	6.7%

To be clear, the total size of the required defense cut remains $54.7 billion regardless of the changes, and the total size of the required non-defense cut likewise remains $54.7 billion. These additional assumptions merely change the distribution of the cuts between discretionary and mandatory programs; any actual change in the size of the sequestrations is due to rounding.