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This report has been updated to reflect new data.

The Pending Automatic Budget Cuts
How the Two "Sequestrations" Would Work

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In budget circles and beyond, all eyes are focused on the automatic budget cuts, known as "sequestration," that are slated to take effect on March 1. But, in fact, March will bring two separate sequestrations — the first and well-known one of March 1 and a second and much smaller one later in March.

First, under the requirements of the 2011 Budget Control Act (BCA) as amended by January's American Taxpayer Relief Act (ATRA), both defense and non-defense programs will be subject to sequestration on March 1, reducing total funding by $85 billion. Second, based on appropriations levels under the continuing resolution that's now in effect, funding for appropriated (or "discretionary") programs will exceed the BCA funding caps for those programs and, thus, will be subject to a second (albeit much smaller) across-the-board cut, which is scheduled to take effect on March 27.

These two sequestrations will act independently of each other, so the savings generated by one do not reduce the cuts required by the other. The President and Congress can still agree to turn off the two cuts for 2013 before they occur or undo them after they take effect.

This paper — which refers to the March 1 cuts as the "supercommittee sequestration" and the March 27 cuts as the "cap sequestration" — updates our earlier analysis of these two sequestrations. Appendix 1 gives the details about how ATRA and supplemental appropriations for relief and reconstruction after Hurricane Sandy have changed the amounts and percentages associated with sequestration. The body of this paper explains the detailed calculations associated with the two pending sequestrations as they now stand.

- **The supercommittee sequestration.** The BCA established a congressional Joint Select Committee on Deficit Reduction (supercommittee) to propose legislation that would reduce deficits by $1.2 trillion over ten years. It also created a backup sequestration procedure to ensure that this level of deficit reduction would nonetheless be achieved if the supercommittee failed to reach agreement, which is what happened. The supercommittee sequestration mandates cuts to defense and non-defense funding totaling $109.3 billion in each year from

2014 to 2021. For 2013, however, the mandated cuts are $85.3 billion, a change made in ATRA. The sequestration law requires that the cuts be split 50-50 between defense and non-defense programs; in 2013, this results in cuts of $42.7 billion from defense and $42.7 billion from non-defense programs.

- **The cap sequestration.** The BCA also established statutory caps to limit discretionary funding through 2021. As a result of changes made in ATRA, there are separate security[1] and non-security caps in 2013. Congress has so far enacted only a continuing resolution (CR) — a stop-gap bill that funds discretionary programs in fiscal year 2013 through March 27. When viewed on a full-year basis, total discretionary funding enacted in the CR, combined with the supplemental appropriations for relief and reconstruction enacted after Hurricane Sandy, breaches the BCA's caps on the amount of funding Congress can enact. According to the Congressional Budget Office (CBO), enacted security funding exceeds its cap by $6.8 billion and non-security discretionary funding breaches its cap by $1.0 billion. If the current CR, which is slated to expire on March 27, is extended, then automatic across-the-board cuts will take effect that day to bring the enacted funding down to the cap levels.

Table 1

Summary of Dollar and Percent Cuts in 2013 Funding Required by the Supercommittee Sequestration on March 1st and the Cap Sequestration on March 27

(Percentages apply only to programs subject to sequestration)

	Billions	Percent
Supercommittee sequestration, March 1:		
National defense programs:	**42.7**	
Discretionary appropriations	42.6	7.7%
Mandatory programs	0.1	7.8%
All other programs:	**42.7**	
Discretionary appropriations	26.1	5.1%
Medicare (capped at 2%)	11.1	2.0%
Certain other mandatory health funding (capped at 2%)	*	2.0%
Other mandatory programs	5.4	5.2%
Total	**85.3**	
Cap sequestration, March 27:		
Security, discretionary appropriations	6.8	1.0%
All other discretionary appropriations	1.0	0.3%
Total	**7.9**	

* Indicates less than $50 million. Parts may not add to totals due to rounding. CBPP calculations based on CBO net scoring of discretionary appropriations and OMB estimates of mandatory funding, defense unobligated balances, and offsets to discretionary appropriations.

The BCA established both sequestrations for separate purposes: one ensures the savings assigned to the supercommittee are achieved, and the other ensures that the savings associated with the

[1] Security is a broader category than defense. In addition to most of the defense function, the security category includes veterans, international affairs, and homeland security.

discretionary caps are achieved. In order to attain the full amount of savings, therefore, the two sequestrations operate independently; there is no interaction between them. The savings resulting from the supercommittee sequestration are not counted for assessing whether enacted full-year appropriations have met the discretionary caps. And any savings from the cap sequestration cannot be used to mitigate the effects of the supercommittee sequestration.

It is important to note that estimates from the Office of Management and Budget (OMB), rather than CBO, will govern all aspects of sequestration, and OMB's estimates may differ slightly from CBO's. Not all of OMB's estimates are known at this time. The calculations in this analysis are based on OMB's estimates where they are known[2] and CBO's where they are not.

Part 1 of this report examines how the "supercommittee sequestration" works for 2013. Part 2 describes the "cap sequestration." Part 3 discusses the supercommittee sequestration in 2014 and subsequent years.

The figures in this analysis are based on OMB's interpretation of the sequestration law, except in those instances in which OMB has not specified its interpretation. Certain legal questions remain about how the sequestration applies, the most important being the relationship between the supercommittee sequestration and the cap cut. As explained above, we interpret these two cuts as independent events, each calculated separately and then added together. CBO has come to the same conclusion. Under this interpretation, the supercommittee sequestration on March 1 does *not* provide savings that count toward congressional adherence with the discretionary caps, required to be achieved by March 27.

All estimates in this report are based on the existing CR. We assume that the President and Congress do not replace the CR by enacting full-year appropriations at different levels until after the sequestrations are triggered, if ever.

Part 1: How the "Supercommittee Sequestration" Works in 2013

The BCA details the steps that OMB must take because the supercommittee — established by the BCA and charged to find $1.2 trillion in deficit reduction (including interest) over the ten-year period 2012-2021 — did not agree on a deficit reduction plan. As Table 2 shows, the sequestration law called for $1.2 trillion in deficit reduction through 2021; it required $984 billion in budget cuts and assumed those savings would reduce interest payments by $216 billion.[3] The $984 billion in budget cuts are divided equally over each of the nine years 2013-2021, for $109.3 billion per year. Those cuts themselves are divided equally between the "National Defense" budget function[4] and all other budget functions: $54.7 billion per year in defense and $54.7 billion per year in non-defense programs.

[2] 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.

[3] Because CBO now assumes lower interest rates than the BCA drafters assumed in 2011, CBO would likely estimate that the Supercommittee sequestration would actually reduce interest payments by about $135 billion through 2021.

[4] 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 that are classified as National Defense, such as a portion of the FBI, the Department of Homeland Security, and the Coast Guard.

ATRA, however, specified that the overall 2013 sequestration — but not the sequestration scheduled for later years — be reduced by precisely $24 billion, to $85.3 billion. (ATRA replaced this $24 billion in sequestration cuts with $24 billion of other savings.) The requirement of an even split between defense and non-defense programs was left untouched by ATRA, so ATRA reduced the 2013 defense and non-defense sequestrations by $12 billion apiece.

Table 2

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			1,200.0
Less 18% of shortfall, attributed to interest savings			-216.0
Equals required program cuts			984.0
Annual program cuts, 2013-2021 in equal amounts			109.3
Split equally between defense and non-defense programs	54.7	54.7	109.3
Reduction of $24 billion applicable only to 2013			-24.0
Program cuts for 2013 *only*	**42.7**	**42.7**	**85.3**

Figures do not add to totals due to rounding

Defense Sequestration

The $42.7 billion in 2013 defense cuts required by the post-ATRA supercommittee sequestration are imposed on both discretionary (non-entitlement) and mandatory (entitlement) defense programs, though some programs — including those that constitute most *mandatory* defense funding — are exempt.[5]

The vast bulk of the defense cuts will occur through across-the-board, proportional cuts in funding for discretionary defense accounts provided by the existing continuing resolution. Within the National Defense function, war costs are subject to sequestration, as are unobligated balances carried over from prior years; but military personnel funding is not, at the President's option.[6] Table 3 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

[5] 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).

[6] 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 (in this case, August 10, 2012). Exempting this funding results in an increase in the sequestration of other defense accounts, since the total dollar amount of the required defense reduction is not altered by a presidential decision on personnel funding. This is the only discretion granted to the executive under the sequestration law. For 2013, President Obama chose to completely exempt military personnel from sequestration.

and mandatory funding. The share of the cut allocated to discretionary funding is based on the *allocation target* for defense discretionary funding in fiscal year 2013, which is $544.0 billion[7]. The share allocated to defense mandatory funding is based on the amount of such funding actually subject to sequestration.

Table 3 **Defense Cuts Required by the March 1st Supercommittee Sequestration** (In billions of dollars)			
	Discretionary	**Mandatory**	**Total**
Step 1: allocate share of cuts for discretionary and mandatory programs:			
Discretionary = allocation target; mandatory = sequestrable funding	544.0	0.7	544.7
Percentage allocation of $42.667 billion in cuts	99.88%	0.12%	100.00%
Allocate $42.667 billion in required cuts according to above shares	42.613	0.053	42.667
Step 2: calculate amounts subject to sequestration:			
Defense funding in the CR, scorable against discretionary caps	556.9		
-- Plus war funding in the national defense function	88.7		
-- Plus emergency funding in the Sandy supplemental	0.1		
-- Plus unobligated balances of defense funding carried over from prior years and additional sequestrable funding offset by collections attributable to defense accounts	63.9		
-- Minus military personnel funding, exempt by presidential decision	-154.0		
Equals defense funding subject to sequestration	555.6	0.7	556.2
Step 3: percentage cuts in sequestrable funding (Step 1 divided by Step 2)	**7.7%**	**7.8%**	

- Step 2 shows the amount of defense discretionary funding that is subject to sequestration ($555.6 billion), after adjusting for war costs, emergency funding in the Sandy supplemental, unobligated balances, and the exemption of military personnel funding.[8]

[7] Under the BCA, the defense cap (which was $546 billion) was the figure used in this step of the calculation. Because ATRA reconfigured the BCA's 2013 caps on discretionary funding to apply to security and non-security funding rather than to defense and non-defense funding, an applicable defense cap for this purpose no longer exists. Therefore, ATRA also created an allocation target to serve this purpose, and set it at the $544 billion figure shown in Table 3. As a result, this figure is *not* the cap that applies to discretionary funding for this year. Rather, this figure exists only for the purpose of starting the allocation calculations for the supercommittee sequestration, which is why we call it an "allocation target." In later years, however, the corresponding figure will remain the statutory cap on defense funding (or, as applicable, the cap on non-defense discretionary funding), as required by the BCA.

[8] The September OMB report (cited in footnote 2) shows $580.1 billion in sequestrable defense funding rather than the $555.6 billion we show here. However, OMB's estimates were required to be 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 plus CBO scoring of supplemental Sandy funding. The largest difference is that war funding in the 2013 CR is well below the 2012 freeze level.

- 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 are subject to sequestration.

Table 3 shows that the cut in sequestrable discretionary defense funding is 7.7 percent. Had the President not chosen to exempt military personnel from sequestration, the figure would have been 6.0 percent.

Table 3 also shows that defense mandatory funding is cut by 7.8 percent, slightly higher than the discretionary cut of 7.7 percent. If the sequestration were administered uniformly across all sequestrable defense funding, the two percentages would be identical, of course. They differ only because the required sequestration is allocated to mandatory and defense discretionary programs based on the amount of sequestrable mandatory funding and the defense discretionary allocation target, as seen in Step 1 of Table 3. The amount of discretionary, sequestrable defense funding ($555.6 billion) is modestly larger than the defense discretionary allocation target ($544.0 billion); as a result, the required percentage reduction to achieve the needed defense discretionary reduction is slightly lower.

A final note: the law requires that unobligated balances of funding carried over from prior years be subject to the defense sequestration. This does not change the *dollar* amount of the defense sequestration but does lower the *percentage* cut because it increases the size of the sequestrable base, as shown in Step 2. (Effectively, subjecting carryover unobligated balances to sequestration modestly reallocates the sequestration within the defense function, for example by reducing the dollar cut to Operations and Maintenance funding and increasing the dollar cut to Procurement funding.) However, OMB interprets this calculation to apply only to those carryover balances unobligated as of the sequestration date. The OMB estimate of those balances used here is the estimate as of January 2, the required sequestration date before ATRA changed it to March 1. Presumably, some of the $63.9 billion in carryover balances and funding offset by collections shown in Table 3 will be obligated between January 2 and March 1, reducing the sequestrable base and thus slightly increasing the percentage. We have no way of estimating how much of these carryover balances will be obligated during this period. But to illustrate this phenomenon, if $10 billion is obligated beyond what OMB estimated as of January 2, the $42.6 billion sequestration of defense discretionary funding will require a 7.8 percent reduction rather than the 7.7 percent reduction shown in Tables 1 and 3.

Non-Defense Sequestration

As with the defense cuts, the $42.7 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 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 made to health insurance plans on behalf of Medicare participants.[9]

- *About $5.4 billion in cuts to other mandatory programs subject to sequestration.* The biggest such program is Emergency Unemployment Compensation, which is now providing federally funded unemployment benefits to workers who have been unemployed for more than six months and are still looking for jobs. Other mandatory programs that will be subject to sequestration include farm price supports, 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 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.[10]

In 2013, about $16.6 billion of the $42.7 billion in non-defense cuts will come from mandatory programs. The remaining non-defense cuts — about $26.1 billion in 2013 — will come from discretionary programs. For 2013, the non-defense discretionary cuts will occur through across-the-board, proportional cuts in the new funding[11] provided for each non-exempt discretionary program in the continuing resolution and in the Hurricane Sandy supplemental. The BCA exempts all veterans' funding, Pell Grants, and the administrative costs of the Supplemental Security Income (SSI) program from those cuts, even though they count against the BCA caps. Non-defense discretionary programs that are essentially excluded from the BCA discretionary caps but are *not* exempt from sequestration include war costs within the budget's International Affairs function, disaster and emergency funding, and program integrity funding.[12]

Table 4 on the next page shows the six steps that OMB will take in calculating the supercommittee sequestration of non-defense funding.

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[9] 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; the $11.1 billion figure thus represents the 12-month savings in Medicare. See Appendix 2.

[10] 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. Therefore, these exemptions and special rules generally apply to this supercommittee sequestration, just as they have applied to all laws since 1985 containing a sequestration mechanism. These two sections of BBEDCA were most recently updated by the Statutory Pay-As-You-Go Act of 2010, and were not altered by the Budget Control Act or ATRA.

[11] For non-defense appropriations, "new funding" means new budget authority provided for 2013, including advance appropriations enacted in prior years that first become available for obligation in 2013. The term does not include unobligated balances carried over from prior years.

[12] Program integrity funding refers to the fact that the BCA allows the discretionary caps to be adjusted upward by a limited amount to the extent that 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.

- Step 1 shows the Medicare sequestration, which is limited to 2 percent of Medicare costs, with minor exceptions.[13] The Medicare sequestration is calculated before the remaining sequestration is allocated between non-defense discretionary funding and other non-defense 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 2, this allocation is based on the non-defense discretionary allocation target[14] (not the amount of non-defense discretionary funding that is subject to sequestration) and the non-defense mandatory funding that is subject to sequestration. This allocation is thus not strictly proportional to the amount of non-defense discretionary and non-defense mandatory funding subject to sequestration, which is why the non-defense discretionary percentage and the "other mandatory" percentage are not identical.

- Step 3 shows that a 2 percent limitation on the cut to mandatory funding for community health centers and the Indian health service means that mandatory funding for those programs is cut by $27 million.[15] Unlike the Medicare 2 percent limit, this 2 percent limit slightly increases the sequestration of other *mandatory* programs, but none of the offsetting increase is imposed on non-defense *discretionary* programs.

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[13] Some Medicare costs, such as the low-income subsidy for the prescriptions drug benefit, are 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.

[14] As explained in footnote 7, this $499 billion is not a cap on NDD funding in 2013; because of ATRA's reconfiguration of the 2013 discretionary caps, the actual cap applies to non-*security* funding. The $499 billion figure exists only for the purpose of allocating the non-defense sequestration between discretionary and mandatory funding for the supercommittee sequestration, which is why we call it an "allocation target."

[15] For obscure legal reasons, the 2 percent limit on the cut to funding for health centers and the Indian Health Service applies to mandatory funding for those programs but not discretionary funding for those programs for purposes of the supercommittee sequestration. Under a supercommittee sequestration, discretionary funding for those programs is cut by the standard non-defense discretionary percentage, which we estimate at 5.1 percent. However, for purposes of the *cap* sequestration discussed in Part 2 of this analysis, the 2 percent limit would apply to discretionary funding for those programs, shown in Table 5, if the nonsecurity cut were greater than 2 percent rather than the 0.3 percent we estimate.

Table 4 **Non-Defense Cuts Required by the March 1st 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			42.7
Medicare funding subject to the 2% cut			557.0
2% cut of Medicare			11.1
Equals remaining non-defense cuts			31.5
Step 2: allocate share of remaining cuts for discretionary and mandatory programs:			
Discretionary = allocation target ; mandatory = sequestrable funding	499.0	103.6	602.6
Percentage allocation of non-Medicare cuts	82.8%	17.2%	100.0%
Allocate $31.5 billion in required cuts according to above shares	26.1	5.4	31.5
Step 3: apply 2% limit to mandatory funding for "special health" programs:			
Base level of mandatory "special health" programs		1.3	
2% cut in "special health" programs		0.027	
Remaining required cuts, to be taken across the board	26.1	5.4	31.5
Step 4: account for special treatment of student loans:			
De facto student loan sequestrable base		1.2	
Add student loans but subtract "special health" from sequestration base		103.5	
Step 5: calculate non-defense discretionary amounts subject to across-the-board sequestration:			
CR funding that is subject to discretionary caps	490.5		
Sandy funding that is subject to discretionary caps	3.5		
-- Plus war funding in the international affairs function (outside caps)	11.2		
-- Plus program integrity funding (outside caps)	0.5		
-- Plus disaster and emergency funding in the CR and Sandy supplemental (outside caps)	52.9[c]		
-- Plus additional sequestrable funding financed by offsets (where the offsets are unaffected by sequestration):	39.0		
-- Minus Pell funding, exempt from sequestration	-23.0		
-- Minus veterans funding, exempt from sequestration	-63.2		
-- Minus SSI adm. funding, exempt from sequestration	-3.7		
Equals non-defense funding subject to sequestration	507.8	103.5	611.3
Step 6: percentage cuts in sequestrable funding (Step 3 divided by Step 5)	**5.1%**	**5.2%**	

May not add due to rounding.
Sources: CBO estimates of the 2013 CR, ATRA, and the Sandy supplemental; 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. 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 is handled in Step 3. The net impact of these two changes is to reduce the mandatory starting base of $103.6 billion to $103.5 billion.

- Step 5 shows how the non-defense discretionary amount subject to sequestration differs from the amount that is subject to the discretionary caps. In addition to the continuing resolution and Sandy funding that counts against the caps, those laws contain sequestrable funding that does *not* count against the caps: war funding, program integrity funding (see footnote 12), disaster funding, and emergency funding.[16]

  Step 5 also shows another reason that the level of sequestrable non-defense funding exceeds the amounts that are scored for purposes of compliance with the discretionary caps. Savings from changes in mandatory programs (CHIMPs), negative credit subsidies, and certain types of federal collections are scored as offsets to funding. These three types of budget transactions produce savings totaling $39 billion. Because these savings count towards meeting the BCA caps, their inclusion in the CR allows for $39 billion in offsetting, additional funding. That is, the $39 billion in savings and the $39 billion in additional funding 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, as shown in Step 5.

  Finally, Step 5 shows that the CR and Sandy supplemental together contain $23 billion in funding for Pell Grants, $63 billion in discretionary veterans' funding (primarily for the VA health system), and almost $4 billion in funding for SSI administrative costs, which are exempt from sequestration.

  As a result, the amount of gross non-defense discretionary funding that is subject to sequestration totals $508 billion.

- Step 6 divides the required across-the-board dollar sequestration amounts calculated in Step 3 by the discretionary and mandatory funding subject to those cuts, shown in Step 5, thereby deriving the percentage cut in nondefense discretionary funding (5.1 percent) and the percentage cut in nondefense mandatory funding (5.2 percent) for programs subject to sequestration.

OMB's published report on sequestration, required by the Sequestration Transparency Act (STA), showed a sequestration of 8.2 percent in non-defense discretionary programs and 7.6 percent in non-defense mandatory programs. Our percentage figures are lower for several reasons. The most important is that ATRA reduced the total size of the 2013 sequestration from $109.3 billion to $85.3

[16] Technically, war, program integrity, disaster, and emergency funding are not outside the BCA caps but rather trigger an automatic upward adjustment in the caps. The distinction between disaster and emergency funding 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).

billion. Also, ATRA and the Sandy supplemental increased the funding subject to sequestration and so spread the required cuts across broader bases. Appendix 1 explains these effects in more detail.

Part 2: How the "Cap Cuts" Will Work in 2013

According to CBO, security funding for fiscal year 2013 is $6.8 billion over its cap, triggering an automatic across-the-board cut in those programs to offset the breach. Similarly, CBO scores non-security funding as $1.0 billion over its cap, also triggering an across-the-board cut. Previously set to occur within 15 days of the 112th Congress's adjournment *sine die*, ATRA pushed back the cut date to March 27, when the continuing resolution (CR) will also expire.

Of course, implementing cuts required by the cap sequestration simultaneous with the expiration of the CR is impossible. It is best to conceive of this part of our analysis, therefore, as an explanation of the cuts to the funding levels in the CR and in the Sandy supplemental that will be required *if* the CR is extended at its current levels on or before March 27, perhaps through the end of the year.

The CR that Congress enacted in September, just before the start of the fiscal year, was designed to adhere to the discretionary caps. The current breach has occurred for three reasons. First, ATRA reduced the 2013 caps by a total of $4 billion. Second, for technical reasons, ATRA also increased the discretionary funding attributed to the CR by $0.4 billion.[17] And third, the Sandy supplemental appropriations bill included $3.5 billion of funding that was not designated as either disaster or emergency funding and so counts against the discretionary caps.

Table 5 shows that cutting $6.8 billion from the security category requires a 1.0 percent cut in sequestrable security funding. Likewise, cutting $1.0 billion from the non-security category requires a 0.3 percent cut from sequestrable funding. Which discretionary funding is subject to sequestration and which is exempt is the *same* for purposes of these across-the-board cuts as for the supercommittee sequestration shown in Tables 3 and 4 with two exceptions.[18]

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[17] As one of its savings provisions, the CR carried forward a 2012 rescission of $0.4 billion in mandatory funds provided by the Affordable Care Act; because this action is taken in the CR, CBO originally scored the savings as helping the CR comply with the discretionary caps. ATRA then rescinded those funds, however, so OMB and CBO no longer score the CR as containing that $0.4 billion in savings.

[18] The first exception is the treatment of discretionary funding for the special health programs, health centers and the Indian Health Service. As explained in footnote 15, the cut to discretionary funding for the programs is limited to 2 percent under a cap sequestration but not so limited under a supercommittee sequestration. Since we estimate the cap sequestration of non-security funding to be only 0.3 percent, however, the 2 percent limitation applicable to these programs has no effect in this case.

In addition, the administrative expenses of the Supplemental Security Income (SSI) program are exempt from the Supercommittee sequestration, as shown in Table 4, but are subject to sequestration for purposes of enforcing the discretionary caps.

Table 5		
Cap Cut to Offset the Breach of the 2013 Security and Non-Security Caps (In billions of dollars)		
	Security	**Non-Security**
Breach: amount to be cut across the board on March 27	6.8	1.0
Funding subject to the caps (from above)	690.8	360.0
-- Plus war funding (outside caps)	99.9	0.0
-- Plus program integrity funding (outside caps)	0.0	0.5
-- Plus disaster/emergency funding (outside caps)	18.9	34.1
-- Plus defense unobligated balances and additional sequestrable funding financed by offsets (where the offsets are unaffected by cap cuts)	69.4	33.5
-- Minus military personnel funding, exempt at presidential option	-154.0	n.a.
-- Minus Veterans funding, exempt by law	-63.1	-0.1
-- Minus Pell grant funding, exempt by law	n.a.	-23.0
Equals funding subject to across-the-board cuts	**661.9**	**405.1**
Percent reduction in funding subject to cap cuts	**1.0%**	**0.3%**

Source: OMB estimates of unobligated balances and sequestrable funding offset by collections; CBO estimates of all other amounts.

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 2014 through 2021; ATRA lowers the 2013 target to $85.3 billion. The process for the 2013 sequestration (described in Part 1) has several features for discretionary programs that are not repeated in future years.

For *mandatory* programs, the supercommittee sequestration will work in essentially the same way in future years as in 2013. In effect, this means that mandatory sequestrations ordered on March 1, 2013, would be repeated each year for nine years. Each year the mandatory sequestration percentage would change modestly, but the sequestration would otherwise be implemented the same way, except that it would be effective on October 1, the start of each fiscal year, rather than five months later. The percentage cuts in mandatory programs would change from year to year for four reasons.

- The percentage cuts are higher in 2014 and subsequent years than in 2013 because the total non-defense sequestration is larger: $54.7 billion rather than the $42.7 billion that applies for 2013.

- In the outyears, the discretionary target that is used in allocating the cuts between discretionary and mandatory programs (see Step 1 of Table 3 regarding defense, and Step 2 of Table 4 regarding non-defense) are the actual defense and NDD caps, not the allocation targets that apply in 2013. And those discretionary cap amounts change each year.

- The allocation of the sequestration between discretionary and mandatory programs 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 calculation of the 2 percent Medicare sequestration occurs first and so reduces the necessary dollar cut in both the discretionary and the remaining mandatory programs subject to sequestration. Because Medicare generally grows more rapidly than other programs, the dollar amount of cuts to be applied across the board to non-defense programs other than Medicare will shrink each year.

For *discretionary* programs, the supercommittee sequestration works very differently 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 provided by those bills, the law requires that the sequestration of discretionary programs be implemented *up front through reductions in the defense and non-defense discretionary caps themselves*. Policymakers then determine how to live within those reduced caps. Essentially, after 2013, there are *no automatic, proportional cuts of affected discretionary programs*; instead, the Appropriations Committees (and then, more broadly, the President and Congress) decide how to fund discretionary defense and non-defense programs within the newly reduced funding caps.

Specifically, in each year from 2014 through 2021:

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

- The defense sequestration comes almost entirely from discretionary defense funding, with only a tiny amount from mandatory defense funding.

- For the non-defense sequestration, the first step is to calculate the 2 percent cut in 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 4) to $11.6 billion in 2014 and ultimately to $18.2 billion in 2021 (see Table 6).[19]

- 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: a) the statutory cap on overall NDD funding, and b) other non-exempt mandatory programs.[20] Because Medicare will account for a growing share of the $54.7 billion annual non-defense cut — 21 percent in 2014, rising to 33 percent in 2021 — other non-defense programs will absorb a falling share of the cut, as Table 6 shows.

Because the defense and non-defense discretionary cuts will occur through the normal appropriations process, Pell Grants, the administrative costs of the Supplemental Security Income

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[19] 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 — when it submits its budget each year. While these estimates are unlikely to change much from year to year from those shown in Table 6 (which are CBO's current projections), any change in estimated mandatory savings will necessarily produce an offsetting change 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.

[20] The 2 percent limit on the sequestration of certain mandatory health funding and the special treatment of student loans will also continue to apply in the outyears, as they do in 2013 and as described in Table 4.

(SSI) program, 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 choose.

Table 6

Sequestration in 2014 through 2021

(In billions of dollars)

	2014	2015	2016	2017	2018	2019	2020	2021
Defense caps before reduction	552	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	9.9%	9.7%	9.5%	9.3%	9.1%	8.9%	8.7%	8.5%
Resulting level of defense caps	497	511	522	535	548	561	575	589
Non-exempt defense mandatory cuts	*	*	*	*	*	*	*	*
2% Medicare sequestration, dollars	11.6	12.3	12.8	13.6	14.7	15.7	16.9	18.2
Non-defense caps before reduction	506	520	530	541	553	566	578	590
Required reduction, dollars	37.0	36.7	36.5	36.0	35.4	34.5	33.0	32.2
Required reduction, percent	7.3%	7.1%	6.9%	6.7%	6.4%	6.1%	5.7%	5.5%
Resulting level of non-defense caps	469	483	494	505	518	532	545	558
Other non-exempt mandatory programs								
Required reduction, dollars	6.0	5.7	5.4	5.0	4.6	4.5	4.8	4.2
Required reduction, percent	7.3%	7.1%	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
How ATRA and the Sandy Supplemental Have Changed the Sequestration Calculations

The supercommittee sequestration: the supercommittee sequestration has changed from what would have been required on January 2 for three reasons.

- In ATRA the President and Congress chose to reduce the 2013 sequestration by $24 billion, from $109.3 billion to $85.3 billion.[21] As shown in Tables 7 and 8, this by itself reduces the dollar and percent sequestrations that are otherwise required. The non-defense discretionary sequestration is reduced from $38.0 billion to $27.5 billion (from 8.3 percent to 6.0 percent); the cut in non-defense mandatory programs drops from $5.6 billion to $4.0 billion (from 7.6 percent to 5.5 percent); and the defense discretionary sequestration drops from $54.6 billion to $42.6 billion (from 9.8 percent to 7.7 percent).

- ATRA continued Emergency Unemployment Compensation for another year, increasing the mandatory sequestrable base by $30 billion. In addition, the Sandy supplemental appropriations bill increased 2013 funding for the Social Services Block Grant, a capped entitlement, by $0.5 billion. Both of these programs are subject to sequestration.

  The effect of these increases is twofold. First, almost $1.4 billion of the required non-defense sequestration shifts from discretionary to mandatory programs. For discretionary programs, the shift reduces the required cut from 6.0 percent to 5.7 percent. Second, because the sequestrable base of mandatory programs is bigger, the required percentage reduction is smaller. The shift in cuts towards mandatory programs is more than offset by the larger sequestrable base, so the required cut falls from 5.5 percent to 5.2 percent.

- The Sandy supplemental appropriations bill also increased by $49.7 billion the amount of non-defense discretionary funding that is subject to sequestration and by $0.1 billion the amount of defense funding that is subject to sequestration. Because the sequestrable base of discretionary funding is therefore larger, the required percentage reductions are smaller.

Table 7

The Effect of ATRA and the Sandy Supplemental on the Non-Defense Supercommittee Sequestration
(In billions of dollars)

	Medicare (2%)	Discretionary		Other mandatory	
	dollars	dollars	percent	dollars	percent
Sequestration without ATRA or Sandy supplemental	$11.1	$38.0	8.3%	$5.6	7.6%
ATRA reduces[a] targeted savings	$11.1	$27.5	6.0%	$4.0	5.5%
ATRA increases SSBG, provides EUC, cuts discretionary	$11.1	$26.1	5.7%	$5.4	5.2%
Sandy provides new funding, increasing sequestrable base	$11.1	$26.1	5.1%	$5.4	5.2%

[a] ATRA also reallocates the required saving from discretionary to mandatory by a very small amount. This occurs because ATRA imposes an allocation target of $499 billion (see Step 2 of Table 4) to replace the previous nondefense discretionary cap of $501 billion (see footnote 7) in the calculation. This provision by itself reallocates $17 million of the nondefense sequestration from discretionary to mandatory programs.

[21] The President and Congress chose to offset this $24 billion reduction in the size of the 2013 sequestration, and so included in ATRA $12 billion in other spending cuts and $12 billion in revenue from a timing shift that moves up tax receipts on certain retirement accounts. ATRA also delayed the cut from January 2 to March 1, 2013.

Table 8		
The Effect of ATRA and the Sandy Supplemental on the Supercommittee Defense Sequestration (In billions of dollars)		
	dollars	**percent**
Sequestration without ATRA or Sandy supplemental	$54.6	9.8%
Sequestration with ATRA and the Sandy supplemental	$42.6	7.7%
Note: This table shows only the discretionary portion of the defense sequestration. The mandatory sequestration is tiny.		

The cap sequestration: ATRA lowered the total cap on discretionary appropriations for 2013 by $4.0 billion. It also changed the two *categories* of discretionary appropriations for 2013 that are enforced by the BCA caps from the previous defense/non-defense categories to security/non-security,[22] but only for 2013. With these changes, instead of requiring a $10.9 billion cut to defense funding on January 2, there is now a $6.8 billion cut to *security* funding scheduled for March 27. And while 2013 non-defense funding had been $10.9 billion below its cap, ATRA changed this so that non-*security* funding in the CR is $2.8 billion under its new cap.

On top of that, supplemental funding to assist in the wake of Hurricane Sandy provided funding of $3.5 billion for the Corps of Engineers that counts against the 2013 non-security cap[23] and ATRA increased scorable non-security funding by $0.4 billion (see footnote 17), so non-security funding now faces a cut on March 27 of $1.0 billion.

The effect of these two changes is shown in Table 9

Table 9				
Fiscal Cliff Deal Changes the Discretionary Caps for 2013 (In billions of dollars)				
	Caps	**Funding**	**Over/Under**	**Percent cut**
Prior law:				
Defense: full-year funding in CR	546.0	556.9	+10.9	1.9%
Non-defense: full-year funding in CR	501.0	490.1	-10.9	n.a.
TOTAL	**1,047.0**	**1,047.0**	**0.0**	
New law, post ATRA and Sandy supplemental:				
Security: full-year funding in CR	684.0	690.8	+6.8	1.0%
Non-security: full-year funding in CR *plus Sandy*	359.0	360.0	+1.0	0.3%
`	**1,043.0**	**1,050.9**	**+7.9**	
Figures may not add to totals due to rounding. "CR" refers to the existing continuing resolution, which funds most programs at very slightly above 2012 levels but expires March 27. "Funding" refers only to amounts that count against the caps.				

[22] See Part 2 of the main body of this report for a discussion of the defense and security distinction in the context of the BCA caps.

[23] Most funding in the Sandy supplemental appropriations bill was designated by Congress as either disaster or emergency funding and so is effectively exempt from the caps.

Appendix 2
Technical Notes about the Sequestration of Medicare and Student Loans

Medicare: with ATRA's two-month delay in the date of the supercommittee sequestration, the Medicare cuts will now begin April 1, 2013. As before, they will last for 12 months. This means that the "2013" sequestration of Medicare occurs partly in fiscal year 2013 and partly in fiscal year 2014. However, under the Statutory PAYGO Act, which the BCA cross-references in describing how sequestration will be implemented, the fiscal year *2014* Medicare savings from the cut in reimbursement rates ordered in March 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 $11.1 billion in Medicare savings — a full 12 months' worth — to achieving the *2013* non-defense sequestration target of $42.7 billion, rather than attributing only six months of Medicare savings.[24]

The Statutory PAYGO Act also provides that there be no overlapping Medicare sequestrations. As a result, because the 2013 Medicare sequestration runs from April 2013 through March 2014, of necessity the 2014 Medicare sequestration cannot start until April 2014 and so runs through March 2015. As result of this requirement, the nine-year Medicare sequestration starts April 2013 and ends March 2022. In essence, there is a full nine-year period starting April 2013 during which Medicare providers and plans will bill Medicare in the normal way but be reimbursed 98 cents on the dollar (unless sequestration is cancelled by legislation that Congress and the President enact).

Student loans: 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 5 percent, the fee rises to $105.

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 for 2013 is $1.2 billion. Although OMB did not portray its calculations this way, that $1.2 billion is effectively part of the mandatory sequestration base of $103.5 billion shown in Table 4 at the end of Step 4. However, OMB does not treat this $1.2 billion as a "sequestrable budgetary resource" for purposes of the allocation of the required cuts between discretionary and mandatory programs in Step 2.

[24] A similar rule applies for sequestration of farm price support payments, which are cut for each crop-year that starts after March 1 and so will spill over into fiscal year 2014, but will all be attributed to the fiscal year 2013 target.