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Commentary: Senate Republican Proposal Fails to Address Key Sequestration Problems

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A measure from Senators James Inhofe (R-OK) and Patrick Toomey (R-PA), which the Senate is expected to consider today, is presented by supporters as giving the President the needed flexibility to address the impending $85 billion in across-the-board spending cuts ("sequestration"), enabling him to cut some programs more and some less to hit the $85 billion target.

The measure gives the President sweeping powers to make cuts and changes in *any* program — including even Social Security, veterans' disability compensation, and other programs that are currently exempt from sequestration. The delegation of authority is so broad that some prominent Republicans, such as Arizona Senator John McCain, have expressed concern that Congress is abdicating its powers and responsibilities.[1]

Nevertheless, this measure fails to address the most serious problems that sequestration presents: (1) the required cuts would be made while the economy remains weak; and (2) the President must rely solely on spending cuts rather than taking a more balanced approach by achieving some savings on the revenue side (such as by closing tax loopholes).

What Does the Bill Do?

The bill requires the President to design a "sequester replacement plan" no later than March 15. The plan must outline how the President will make $85 billion in cuts to 2013 program funding, with no more than half coming from defense. The bill would allow the Administration to cut *less* from defense and *more* from domestic programs, but not the reverse. The replacement plan could include cuts to entitlement and discretionary programs now exempt from sequestration cuts, such as Social Security, Medicaid, veterans' benefits, and military personnel. It also could cut Medicare as deeply as the President may choose, ignoring the 2 percent limit in the sequestration law.

Congress would have seven days to vote on a resolution of disapproval. If Congress passes such a resolution, the President can sign or veto that legislation, just like any other bill. If a resolution of disapproval is enacted (it passes Congress and either is signed by the President or the President's veto is overridden), then the automatic 2013 sequestration cuts that are triggered on March 1 would remain in place. If Congress does *not* pass a resolution of disapproval, then the President would implement the replacement plan in lieu of the 2013 sequestration cuts. (If the President does not submit a plan, then the 2013 sequestration remains in effect.)

If the March 1 automatic sequestration remains in place and defense is funded through a continuing resolution, then the bill provides the Defense Department with authority to transfer amounts between defense accounts. Transfers cannot cause an account to exceed the amount authorized to be appropriated for that account by the National Defense Authorization Act for fiscal year 2013. The bill provides no such transfer authority to domestic agencies.

Flexibility Does Not Significantly Lessen Negative Effects on the Economy

Congressional Budget Office (CBO) director Douglas Elmendorf has said that if sequestration cuts go into effect, it will reduce projected economic growth in 2013 from 2.0 percent to 1.4 percent — and will lead to 750,000 fewer jobs by the end of the year.[2] In testimony yesterday, Federal Reserve chairman Ben Bernanke concurred with this negative assessment, saying "it would be a drag on near-term economic recovery" and specifically citing these CBO figures.[3]

But there is little in the bill that allows the President to mitigate these negative economic effects. In replacing sequestration, the bill would still require him to cut $85 billion in budget authority from federal programs *in 2013*. The President would be prohibited from delaying cuts until later years when the economy is stronger, as Mr. Bernanke explicitly recommended.

In theory, the President could shift some of the 2013 cuts from faster-spending programs such as personnel to slower-spending programs such as infrastructure spending.[4] But, the short-term economic benefit isn't likely to be substantial.

Furthermore, other changes could worsen the drag on the economy in 2013, while it is still struggling to recover. For instance, under the sequestration rules, Medicare savings occurring in the first half of FY 2014 count toward meeting the $85 billion target. This is not the case under the bill, which requires that all cuts occur in 2013. Moreover, if the President chooses to makes cuts in entitlement programs now exempt or limited under sequestration (to reduce cuts in critical discretionary programs), those savings are likely to be felt more quickly than the current mix of sequestration cuts.

Flexibility Does Not Undo Fundamental Unfairness

Nor will the measure make the required deficit reduction fundamentally fairer. The bill continues the unfair distinction under which spending through federal programs is subject to reduction while spending that occurs through the tax code is not. None of the $85 billion in cuts required in 2013 (at least half of which would have to come from non-defense programs) can be replaced by eliminating or scaling back any "tax expenditure" — that is, any deduction, exclusion, preference, or other subsidy or benefit in the tax code — no matter how unproductive or abusive it may be or how much its presence in the tax code may reflect the power of special interests. Yet CBO's Elmendorf has explained that tax expenditures are essentially government spending; former Reagan economic adviser Martin Feldstein has said that tax expenditures include some of the most wasteful of all government spending; and Alan Greenspan has said that tax expenditures are really "tax entitlements."

Thus, under the Inhofe-Toomey proposal, the President could protect funding for one set of programs — perhaps food safety or unemployment insurance — by cutting more deeply in other programs, such as public transportation, housing assistance, or even Social Security benefits. But he could *not* shield essential programs or services by trimming tax subsidies for corporate jets, the carried-interest loophole for hedge-fund managers, like-kind exchanges (a tax break some real estate investors use to avoid capital gains tax on profits they make), or any other special-interest tax break, no matter how unproductive or abusive.[5]

In reality, the distinction between the revenue side of the budget and the spending side isn't always meaningful. Feldstein wrote in the *Wall Street Journal* last week, "Republicans want to reduce the deficit by cutting government spending while Democrats insist that raising revenue must be part of the solution. Yet the distinction between spending cuts and revenue increases breaks down if one considers tax expenditures."[6] It makes little sense that the Inhofe-Toomey proposal, while giving the President new powers so sweeping he'd be permitted to alter longstanding program rules and unilaterally cut veterans' benefits, Medicare, Medicaid, or even Social Security, walls off the entire revenue side of the budget, including all $1.1 trillion in annual tax expenditures.

The Bottom Line

This measure is fundamentally flawed. It is more about shifting responsibility — and blame — than finding a solution. Proponents of the measure seem willing to give up one of Congress's most fundamental roles — its power of the purse — by turning vast budgetary powers over to the President, giving him responsibility to identify the $85 billion in cuts triggered by the failure of the supercommittee in 2011 to agree on a deficit-reduction plan.[7] Remarkably, it would give the President just two weeks to craft a replacement for the sequestration, something that Congress has been unwilling or unable to agree on for many months.

It is misguided to open up parts of the budget that, under long-standing precedents, are exempt from the sequestration cuts — programs such as Social Security, veterans' disability compensation, and those that support the poor and disadvantaged (including Medicaid, SNAP, and Supplemental Security Income) — while declaring tax breaks that benefit the wealthy off limits. And by requiring that all of the cuts be made in 2013 funding, the bill will do little to help correct the economic problems that sequestration will cause. The Senate should reject this measure and find a solution to sequestration that doesn't impede the economic recovery and ensures the burden of deficit reduction is equitably shared.

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[1] http://sotu.blogs.cnn.com/2013/02/24/mccain-obama-must-lead-on-budget-deal/?iref=allsearch

[2] http://www.c-spanvideo.org/program/310969-1

[3] http://www.nbcnews.com/video/nbc-news/50957395#50957395

[4] CBO assumes that the scheduled $85 billion sequestration will result in $44 billion in lower spending in fiscal year 2013 (with the remainder of the spending reduction being felt in future years, primarily 2014).

[5] Chuck Marr, Chye-Ching Huang, and Joel Friedman, "Tax Expenditure Reform: An Essential Ingredient of Needed Deficit Reduction," Center on Budget and Policy Priorities, February 27, 2013, http://www.cbpp.org/cms/index.cfm?fa=view&id=3912.

[6] Martin Feldstein, "A Simple Route to Major Deficit Reduction," *Wall Street Journal,* February 21, 2013, http://online.wsj.com/article/SB10001424127887324880504578296920278921676.html.

[7] Richard Kogan, "The Pending Automatic Budget Cuts: How the Two 'Sequestrations' Would Work," Center on Budget and Policy Priorities, February 26, 2013, http://www.cbpp.org/cms/index.cfm?fa=view&id=3910.