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

by Richard Kogan

The Budget Control Act (BCA) of 2011 imposed caps on discretionary programs that will reduce their funding by more than \$1 trillion over the ten years from 2012 through 2021, relative to the Congressional Budget Office (CBO) baseline from 2010. It also established a Joint Select Committee on Deficit Reduction to propose legislation reducing deficits by another \$1.2 trillion over that period, and established a backup “sequestration” procedure to increase the incentive on the Joint Committee to reach a compromise. Because the Joint Committee failed to achieve its goal, sequestration — a form of automatic cuts that apply largely across the board — is now scheduled to occur starting in January 2013 and to cover the period through 2021.

Part 1 of this report outlines how these across-the-board cuts will work in 2013. Part 2 describes how they will work from 2014 through 2021. As explained below, the process for 2013 is substantially different from that for the ensuing eight years.

Broadly speaking, for 2013 the across-the-board cuts will mean about an 8.4 percent cut in most affected non-defense discretionary programs, a 7.5 percent cut in affected defense programs, an 8.0 percent cut in affected mandatory programs other than Medicare, and a 2.0 percent cut in Medicare provider payments. For 2014 through 2021, the Medicare cut will remain at 2 percent while the percentage cuts in other programs will gradually shrink. These estimates — which are revised from estimates in our December 2, 2011, analysis — take into account new CBO budget projections and the details of the President’s funding requests for 2013.

With one exception, this report is based on estimates from CBO on the *dollar* cuts from the four program categories outlined above — non-defense discretionary, defense, affected mandatory programs, and Medicare — provided as part of CBO’s March 2012 baseline. The Appendix discusses why we have revised our previous estimates and the ways in which we use or alter CBO’s estimates.

Background: Main Elements of the BCA

The Budget Control Act:

- allowed the President to raise the debt limit by \$2.1 trillion (in steps), which is currently

estimated to be sufficient through early 2013; this debt limit increase is not contingent on any further action;

- established binding limits or “caps” on annual appropriations bills (which cover “discretionary” — or non-entitlement — programs such as defense, education, national parks, the FBI, the EPA, low-income housing assistance, medical research, and many others); the caps reduce projected funding for these programs by more than \$1 trillion through 2021, relative to the funding levels in CBO’s August 2010 baseline;
- required the House and Senate to vote in the fall of 2011 on an amendment to the Constitution to mandate a balanced budget every year; the House defeated the amendment on November 18 and the Senate defeated it on December 14 (a two-thirds vote is needed to amend the Constitution);
- established a Joint Select Committee on Deficit Reduction (the “Supercommittee”) to produce legislation to reduce projected deficits by at least an additional \$1.2 trillion through 2021 (beyond the savings generated by the discretionary caps); on November 21, 2011, the Committee’s co-chairs announced they could not reach agreement;
- established a fall-back mechanism to ensure that \$1.2 trillion in deficit reduction would be achieved if the Supercommittee failed (and to provide an incentive for members of the Supercommittee to reach agreement), providing for:
 - automatic, across-the-board budget cuts in many programs in 2013; and
 - reductions in each year from 2014 through 2021 in the annual caps on discretionary appropriations as well as automatic cuts in selected entitlement programs.

Part 1: How the 2013 Sequestration Will Work

Table 1			
How the \$1.2 Trillion in Deficit Reduction Is Apportioned			
In billions of dollars			
	Non-Defense	Defense	Total
\$1.2 trillion shortfall due to Joint Select Committee inaction			1,200
Less 18% of shortfall, attributed to interest savings			-216
Equals required program cuts			984
Annual program cuts, 2013-2021 in equal amounts			109.3
Split equally between defense and non-defense programs	54.7	54.7	109.3
<i>Does not add due to rounding</i>			

The Budget Control Act spells out the steps that the Office of Management and Budget (OMB) must take because of the Joint Committee’s inability to agree. As Table 1 shows, the 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.¹ The \$984 billion in budget cuts is

¹ Because CBO assumes lower interest rates than the drafters of the budget deal, CBO would estimate that the sequestration program savings would actually reduce interest payments by about \$160 billion through 2021.

spread in equal dollar amounts over each of the nine years 2013-2021, or \$109.3 billion per year. Those cuts themselves are divided equally between the “national defense” budget function and all other budget functions: \$54.7 billion per year in defense and \$54.7 billion per year in non-defense programs.

Non-defense sequestration. The \$54.7 billion in non-defense cuts will come from both mandatory (entitlement) and discretionary (non-entitlement) 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 in any year, or \$11 billion in 2013. This means that Medicare providers will continue to bill Medicare in the normal way but will be reimbursed at a rate of 98 cents on the dollar.
- About \$5.2 billion in cuts in the other mandatory programs that are subject to sequestration, the biggest of which supports farm prices; other affected programs include student loans, vocational rehabilitation, mineral leasing payments, the Social Services Block Grant, and dozens of smaller programs. A number of key mandatory programs are *exempt* from sequestration, including Social Security, Medicaid, the Children’s Health Insurance Program (CHIP), SNAP (formerly known as the Food Stamp Program), child nutrition, Supplemental Security Income (SSI), refundable tax credits such as the Child Tax Credit and the Earned Income Tax Credit, veterans’ compensation and other benefits, and federal retirement.²

Thus, in 2013, about \$16.2 billion of the \$54.7 billion in non-defense cuts will come from mandatory programs. The remaining non-defense cuts — about \$38.5 billion in 2013 — will come from discretionary programs. For fiscal year 2013, the non-defense cuts would occur through across-the-board, proportional reductions in the new funding provided for each discretionary program in the appropriations bills, which Congress should already have enacted before the January 2013 sequestration order is issued.³ The BCA exempts most veterans’ funding and Pell Grants from those cuts.⁴ In addition, the Act limits to 2 percent the cuts in funding for community and migrant health centers and for Indian health services and facilities. War costs within the International Affairs function, specified funding to strengthen program integrity, and disaster funding are not exempt from sequestration, even though certain types and amounts of such funding are effectively outside the discretionary caps the BCA created.

² The Budget Control Act is drafted as a portion of the Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA, also known as Gramm-Rudman-Hollings), which contains a list of exemptions in section 255 and a list of special rules in section 256. Those two provisions of BBEDCA were most recently updated by the Statutory PAYGO Act of 2010, and are not changed by the Budget Control Act.

³ For non-defense appropriations, “new funding” means new budget authority and includes advance appropriations that first become available for obligation in 2013. The term does not include unobligated balances carried over from prior years. If a part-year “continuing resolution” is in place at the time of the January 2013 sequestration, the sequestration is calculated as though that legislation extended for the entire fiscal year, and the calculated dollar cuts continue to apply without change when the temporary continuing resolution is replaced by year-long funding, except that if a budget account in the subsequent regular bill is reduced below the level in the baseline, that reduction counts toward the required sequestration in that account.

⁴ Even if programs are exempt from sequestration, in almost all cases the administrative costs of the programs are not exempt. However, the law does not define “administrative” costs, so it is uncertain, for example, *precisely* how much of discretionary veterans’ programs such as medical care are exempt from sequestration.

Table 2

Sequestration in 2013 if Appropriations Match 2013 Caps In billions of dollars

	Resources Before Sequestration	Sequestration	
		Dollar reduction	Percent reduction
Defense	\$728	\$54.7	
Funding subject to cap	546	41.1	7.5%
War funding, outside of cap ^a	96	7.2	7.5%
Unobligated balances from prior years	84	6.3	7.5%
Non-Defense discretionary (NDD) programs	535	38.5	
Non-exempt programs	421	35.5	8.4%
Veterans' health and Pell Grants, exempt	74	0.0	0.0%
Health centers and Indian health, 2% limit	6	0.1	2.0%
<i>Subtotal, funding subject to the cap</i>	501		
Above-cap funding that is offset by CHIMPs ^b	19	1.6	8.4%
Program integrity and disaster funding, outside of cap	7	0.6	8.4%
War funding, outside of cap ^a	9	0.8	8.4%
Non-Defense mandatory programs that are not exempt	617	16.2	
Medicare payments to providers and plans, 2% limit	549	11.0	2.0%
Other non-exempt mandatory programs ^c	65	5.2	8.0%
Non-Defense Total, Discretionary and Mandatory		54.7	

May not add due to rounding

Notes:

- a) Estimates of discretionary resources for 2013 are generally taken from the President's 2013 budget request. However, we assume that Congress will increase amounts for war funding, since they are not subject to caps, by the amounts necessary to offset the pending sequestration. Thus, the post-sequestration war funding levels will equal the President's requests. This is not possible for other amounts, which are subject to caps or other constraints.
- b) CHIMPs refers to "changes in mandatory programs" accomplished through legislative language in appropriations bills. The president has proposed CHIMPs for FY 2013 that would reduce budget authority by almost \$19 billion. Under longstanding scorekeeping rules, this would free up room for almost \$19 billion in additional discretionary funding without violating the discretionary caps. That additional \$19 billion in discretionary funding will be subject to sequestration, as we show above.
- c) The percentage cut in non-exempt mandatory funding of 8.0 percent is smaller than the 8.4 percent cut generally applicable to non-defense discretionary funding. The two percentages would be identical if the basic non-defense sequestration had been allocated proportionally across all non-exempt programs, and if the additional cuts needed to offset the effect of the 2 percent limit on the sequestration of some health programs had likewise been allocated proportionally across all other non-exempt programs. But the Budget Control Act does not work that way. To begin with, the 2 percent limit on the cut to discretionary community and migrant health centers and Indian health is offset only by increasing the cut to other non-defense discretionary (NDD) programs. Similarly, the exemption of Pell Grants and veterans' medical care from sequestration must be offset by deeper cuts in other NDD programs. Thus, non-exempt mandatory programs do not help offset the exemption for Pell Grants and veterans' medical care or the 2 percent limit on the cut to discretionary health centers and Indian health. In contrast, the Act specifies that the 2 percent limit on the cut to Medicare is offset by deeper cuts to both non-exempt mandatory programs and non-exempt NDD programs. These rules result in somewhat different sequestration percentages applying to those two categories of non-exempt non-defense programs.

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

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

The percentage cuts in 2013. As Table 2 shows, we calculate that a *non*-defense sequestration of \$54.7 billion in 2013 would result in cuts of approximately 8.4 percent in affected non-defense discretionary programs and 8.0 percent in non-exempt mandatory programs, as well as the 2 percent maximum cut in Medicare provider payments the law allows. A defense sequestration of \$54.7 billion would entail a cut of about 7.5 percent in defense programs, including war funding and unobligated balances, if military personnel funding is not exempt from sequestration. If the President chooses to exempt some military personnel, the percentage cut on the other defense accounts would rise, to 9.5 percent if all military personnel accounts are fully exempted and are funded at the level he has requested.

Part 2: What Will Happen in 2014 and Subsequent Years?

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

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

- Medicare payments to providers and health insurance plans will continue to be cut by 2 percent; in other words, for the entire nine-year period 2013-2021, providers and plans will be paid 98 cents on the dollar. But because Medicare costs are projected to rise from 2013 through 2021, the dollar amount saved by this 2 percent cut will increase, from \$11.0 billion in 2013 (see Table 2) to \$11.4 billion in 2014 and ultimately to \$17.8 billion in 2021 (see Table 3).⁵

⁵ The amount of mandatory savings from sequestration — for example the amount estimated to be saved by the 2 percent cut in Medicare reimbursement rates — will be reestimated by OMB at the beginning of each session of Congress. While these estimates are unlikely to change much from year to year, any changes in estimated mandatory

- In each year from 2014 through 2021, the remaining amount of the total \$54.7 billion in annual non-defense cuts will be applied proportionally to: 1) other non-exempt mandatory programs in the aggregate; and 2) the statutory cap on overall non-defense discretionary funding. Because Medicare will take a growing share of the \$54.7 billion annual non-defense cut (it will account for 21 percent of that amount in 2014 but 33 percent in 2021), other non-defense programs will absorb a declining share of the cut, as Table 3 shows.
- As with defense, the non-defense discretionary cuts will be accomplished through the normal appropriations process as Congress writes appropriations bills to remain within the newly reduced caps for total non-defense appropriations. Therefore, Pell Grants, veterans' medical care, community and migrant health centers, and Indian health will have no special status; the normal process of policymaking will determine how Congress adheres to the newly reduced caps.

Table 3								
What Will Happen in 2014 through 2021?								
In billions of dollars								
	2014	2015	2016	2017	2018	2019	2020	2021
Defense caps before reduction	556	566	577	590	603	616	630	644
Required reduction, dollars	54.7	54.7	54.7	54.7	54.7	54.7	54.7	54.7
Required reduction, percent	9.8%	9.7%	9.5%	9.3%	9.1%	8.9%	8.7%	8.5%
Resulting level of caps	501	511	522	535	548	561	575	589
NDD caps before reduction	510	520	530	541	553	566	578	590
Required reduction, dollars	38	37	37	36	35	34	33	32
Required reduction, percent	7.5%	7.2%	6.9%	6.7%	6.4%	6.1%	5.7%	5.4%
Resulting level of caps	472	483	493	505	518	532	545	558
2% Medicare sequestration, dollars	11.4	12.2	12.9	13.4	14.2	15.4	16.5	17.8
Non-exempt mandatory cuts other than Medicare, dollars	5.2	5.2	5.2	5.1	5.1	5.0	5.4	4.8
Non-exempt mandatory cuts other than Medicare, percent	7.5%	7.2%	6.9%	6.7%	6.4%	6.1%	5.7%	5.4%

savings will necessarily produce offsetting changes in the amount of the reduction in the non-defense discretionary caps, since the total amount of non-defense savings each year must equal \$54.7 billion.

Appendix: Technical Notes about the Estimates

Our estimates of the funding for 2013 that will occur in programs *exempt* from sequestration (such as discretionary veterans' programs) or budgetary resources that are subject to sequestration but outside the caps (such as war costs) differ from those we made last fall because they are now based on the President's funding requests for 2013. Moreover, our estimates of the savings that sequestration will achieve in each category of programs are derived from CBO's estimates in its account-level database accompanying its March 2012 baseline; those estimates differ modestly from ones issued by CBO last September and also from its estimates of January 2012, which CBO discussed in Box 1-2 of its *Budget and Economic Outlook*.⁶

With respect to the sequestration of Medicare, however, we have altered CBO's new estimates. CBO has taken a broad-brush approach to calculating sequestration; a more precise approach produces somewhat different results.

Specifically, the sequestration of Medicare is required to start on February 1, 2013, and remain in effect 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 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 is to be implemented, the fiscal year 2014 Medicare savings from the cut in reimbursement rates ordered in January 2013 will count toward meeting 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.

The effect of our approach, then, is to attribute more Medicare savings to the 2013 sequestration than CBO did. Because the total dollar amount of non-defense savings is fixed at \$54.7 billion, our approach also means that we calculate smaller cuts in non-defense discretionary and other mandatory programs than CBO does. It should be noted that our approach would result in the required \$984 billion in program costs being sequestered over nine years, while an approach in which a portion of Medicare savings are not attributed to the sequestration targets would mean that the total sequestration would exceed the \$984 billion in savings required by the Act.

⁶ Congressional Budget Office, *The Budget and Economic Outlook, Fiscal Years 2012-2022*, January 31, 2012, pp 12-13.