Economic Policy Program
Economic Policy Project

National Security Program
Foreign Policy Project

Indefensible: The Sequester's Mechanics and Adverse Effects on National and Economic Security

TASK FORCE ON DEFENSE BUDGET AND STRATEGY

June 2012

BIPARTISAN POLICY CENTER

DISCLAIMER

This report is the product of the Bipartisan Policy Center's Economic Policy Program and National Security Program. The findings and recommendations expressed herein do not necessarily represent the views or opinions of the Bipartisan Policy Center, its founders, or its board of directors.

Economic Policy Program & National Security Program

CO-CHAIRS

Senator Pete Domenici
Former Chairman, U.S. Senate Budget Committee; Co-Chair, BPC's Debt Reduction Task Force; Senior Fellow, BPC

Secretary Dan Glickman
Former U.S. Agriculture Secretary; Former Chairman, U.S. House Select Intelligence Committee; Senior Fellow, BPC

General (ret.) James Jones
Former National Security Advisor; Former Commander, U.S. European Command; Senior Fellow, BPC

MEMBERS

Dr. Graham Allison
Director of Belfer Center, Kennedy School of Government, Harvard University

General (ret.) Peter Chiarelli
Former Vice Chief of Staff, U.S. Army

Admiral (ret.) Gregory Johnson
Former Commander, U.S. Naval Forces, Europe

General (ret.) George Joulwan
Former Commander, U.S. European Command

Rear Admiral (ret.) David Mercer
Former Commander, Navy Region Europe, Africa, Southwest Asia

Dr. Michael O'Hanlon
Senior Fellow, 21st Century Defense Initiative, Brookings Institution

Ross Perot, Jr.
Chairman of the Board, Perot Systems

Major General (ret.) Arnold Punaro
Senior Fellow, Defense Business Board; Former Staff Director, U.S. Senate Armed Services Committee

Dr. Abram Shulsky
Senior Fellow, Hudson Institute

General (ret.) Charles Wald
Former Deputy Commander, U.S. European Command

Dr. Dov Zakheim
Former Under Secretary of Defense (Comptroller)

BPC TASK FORCE STAFF

Steve Bell
Senior Director of Economic Policy

Dr. Michael Makovsky
Foreign Policy Director

Blaise Misztal
Associate Foreign Policy Director

Loren Adler
Policy Analyst, Economic Policy Project

Shai Akabas
Policy Analyst, Economic Policy Project

Ashton Kunkle
Administrative Assistant

Marissa McCauley
Operations Coordinator

Jonathan Ruhe
Senior Policy Analyst, Foreign Policy Project

Economic Policy Program | **National Security Program**
Economic Policy Project | *Foreign Policy Project*

ACKNOWLEDGEMENTS

Special thanks to Task Force Member Gen. Arnold Punaro and Micah Edmond of The Punaro Group for their help with the in-depth technical analysis that was conducted for this paper; former Acting Director of CBO Barry Anderson, former Staff Director of the Senate Budget Committee Dr. Bill Hoagland, Senior Vice President and Director of Economic Research at the Committee for Economic Development Dr. Joe Minarik, and former CBO and OMB Director Dr. Alice Rivlin for their vast experience and knowledge of the federal budget; and George Washington University's Associate Dean for Government Procurement Law Dan Gordon for his generous assistance on the intricacies of procurement law. We would also like to acknowledge the tremendous assistance of BPC's interns: Kevin McGrath, Rebecca Morris, Chris Hellie and Caitlyn Turgeon. Additional input we would like to acknowledge was provided by Tom Gramaglia.

ABOUT BPC

Founded in 2007 by former Senate Majority Leaders Howard Baker, Tom Daschle, Bob Dole and George Mitchell, Bipartisan Policy Center (BPC) is a non-profit organization that drives principled solutions through rigorous analysis, reasoned negotiation and respectful dialogue. With projects in multiple issue areas, BPC combines politically balanced policymaking with strong, proactive advocacy and outreach.

Letter from the Co-Chairs

This is a critical moment for U.S. defense strategy. The wars in Iraq and Afghanistan that defined the last decade are winding down as persistent and new threats compete for our attention. Meanwhile, budgetary pressure has already forced cuts to defense spending, and additional automatic reductions, known as the sequester, will go into effect in 2013. These debates cannot be undertaken separately. We are proud to chair this new initiative of the Bipartisan Policy Center (BPC)—a joint effort of its Economic and Foreign Policy Projects—to provide a blueprint for a realistic and affordable 21st century national security strategy.

This white paper is the first product of our effort. It offers a detailed analysis of the mechanics and effects of the sequester, primarily on defense. After reviewing the evidence, we have concluded that the indiscriminate and irrational application of sequester cuts in 2013 will have adverse impacts on our military capabilities and readiness and economic vibrancy without significantly improving our fiscal situation. In short, the sequester is indefensible.

We know that in Washington any mention of spending cuts elicits doom and gloom pronouncements. Every government department carefully guards its budget, and each constituency and member of Congress has government programs that are dear to their heart. Each is quick to invoke worst-case scenarios to ward off any prospective cuts. This time is different. The sequester is not just any spending cut. The primary issue is not the size of its cuts but the nonsensical manner in which they are to be executed.

With business leaders already tightening their belts, staving off the worst of the consequences requires taking action now. We hope that this report provides policymakers and the public with the information and analysis to understand the intensifying impact that the sequester is having on our economy, still fragile as it recovers from recession, and its pending fallout for our military, as it seeks to recapitalize from a decade of war and modernize to execute a new defense strategy.

Although imposition of the sequester will have very significant adverse consequences on our national security, this does not mean that critically needed reforms to the DoD budget and business models should not be undertaken. Specifically, the areas of manpower costs and acquisition systems need urgent attention and reform in order for the defense budgets of the future to better address our national security needs. Our Task Force on Defense Budget and Strategy will issue a follow-up report over the next few months, in which we will propose a defense strategy and a series of reforms that will lead to a more efficient defense budget that is consistent with evolving national security and fiscal imperatives.

Sincerely,

Senator Pete Domenici

Secretary Dan Glickman

General (ret.) James Jones

Economic Policy Program | National Security Program
Economic Policy Project | *Foreign Policy Project*

Table of Contents

Economic Policy Program | **National Security Program**
Economic Policy Project | *Foreign Policy Project*

Introduction

Our nation faces a serious fiscal challenge, which requires making difficult budgetary decisions. Without action, growing deficits and debt will erode our prosperity and leadership role in the world. Yet, the current method for tackling this problem – automatic spending cuts, totaling more than $1 trillion over a nine-year period, set to go into effect on January 2, 2013 – is indefensible. The sequester, as these cuts are known, is neither an effective nor rational form of deficit reduction. It will have serious repercussions on our national security, economic health, and public safety, while only minimally affecting our national debt. Furthermore, the adverse effects caused by anticipation of the sequester have already begun.

Based on a plausible set of assumptions, our analysis indicates that:

- The Fiscal Year (FY) 2013 defense sequester will result in an indiscriminate 15 percent cut at the program, project, and activity level in the defense budget – and not a 10 percent cut, as is often assumed. Many domestic programs will face similar, though slightly smaller, across-the-board reductions.
- The full defense and non-defense sequester cuts for just next year could – due to their arbitrary and abrupt nature – reduce U.S. gross domestic product (GDP) by roughly half a percentage point in 2013 and cause more than one million jobs to be lost over the course of two years.
- Although scheduled to go into effect on January 2, 2013, the economic effects of the sequester will be felt well beforehand. Spurred by uncertainty about the sequester's implementation and effects, department heads will slow spending, and business leaders have already started to curtail hiring in preparation for these arbitrary cuts.
- There is significant ambiguity as to what constitutes "program, project, and activity." The more granular the level at which the cuts occur, the less discretion there is for agencies to eliminate inefficient programs and fund those that are more critical.
- The arbitrary nature of the sequester cuts will degrade U.S. military capabilities and readiness, undermining the effectiveness of any credible defense strategy, including President Barack Obama's *Strategic Guidance*, without accomplishing any sensible and necessary reforms to the defense budget.
- The estimated savings from the sequester will postpone by only two years the date when publicly-held U.S. debt surpasses 100 percent of GDP.

Fixing the sequester, therefore, is an urgent matter. Yet many policymakers have suggested that any fixes to the sequester will not be considered until the lame duck congressional session following the November elections. However, with an already packed agenda for the end of the year, there is little reason to think Congress will find time to address the sequester. Moreover, if the deleterious consequences of the sequester are to be averted, it must be done before the lame duck. Indeed, since most elected officials will spend most of the fall campaigning, the sequester must be dealt with by September.

While there is a growing chorus highlighting the negative impacts of the sequester and the sense of urgency to act to avoid them, many are not proposing responsible alternatives, if any at all. The most responsible solution would be a grand bargain, such as those proposed by the Bipartisan Policy Center's (BPC) Debt Reduction Task Force (Domenici-Rivlin) and the National Commission on Fiscal Responsibility and Reform (Simpson-Bowles), but Congress and the administration are unlikely to strike such an agreement this year.[1] In its absence, we recommend the following:

- The Office of Management and Budget (OMB) should, by August 20, 2012, release an account-by-account analysis of the expected effects of the sequester, and the likely impact on: personnel; procurement contracts; operations and maintenance; research and development; training; and domestic agencies. OMB should also work with the Department of Defense (DoD) to determine impacts on military readiness and capabilities.
- No later than September, in tandem with the continuing resolution (CR) on appropriations for FY 2013, policymakers should replace both the defense and non-defense FY 2013 sequester with a strong legislative process to address – in a meaningful, deliberate, and sustainable fashion – the structural problems driving our budget woes: entitlement programs and inadequate revenues. Agreement should be reached now to reduce uncertainty.

Economic Policy Program | **National Security Program**

Economic Policy Project | *Foreign Policy Project*

Chapter 1:
The Budget: Structure, Trends & Pressures

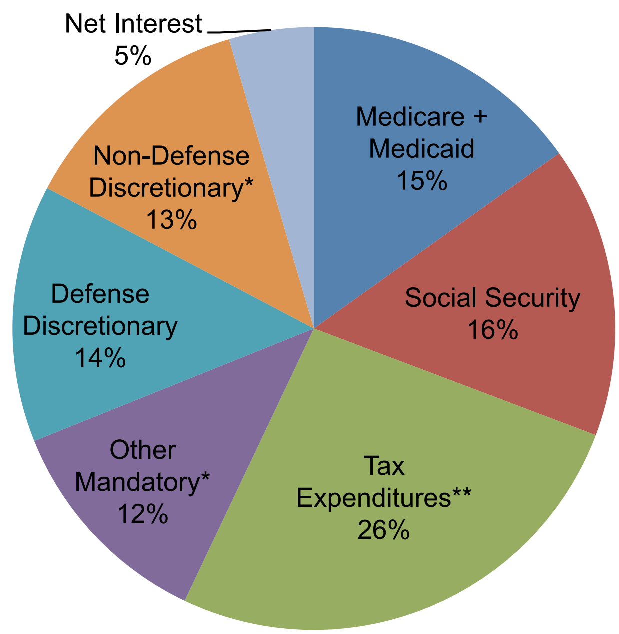
After enjoying brief surpluses at the turn of the century, by 2009, the U.S. federal budget was running the biggest deficit as a percentage of the economy since the end of World War II. Due to increased countercyclical spending and depressed revenues stemming from the recession, the deficit has exceeded $1 trillion in each of the past four years. Such high deficits might be tolerable if they were likely to be short-lived, but that is far from the case.

Even if the economy recovers and grows steadily for the foreseeable future, the gap between government spending and revenues will continue to widen, driving deficits ever higher. U.S. debt held by the public already exceeds $10 trillion – equivalent to 71 percent of the Gross Domestic Product (GDP), a level not seen in the last 62 years – and is growing rapidly. This course is unsustainable. Reflecting this, former Joint Chiefs of Staff Chairman Mike Mullen called the debt “the single biggest threat to our national security.”[2]

The most commonly cited fixes – eliminating foreign aid, slashing domestic discretionary spending, or raising tax rates on wealthier Americans – would do relatively little to reduce the deficit. Nor can the budget be balanced solely on the back of defense spending, even if it does require reforms, since it accounts for only 14 percent of federal expenditures (including tax subsidies, which should be considered spending through the tax code).[3]

The problems are fundamentally structural and so too must be the solution. As made clear by Domenici-Rivlin and Simpson-Bowles, the only politically viable and sustainable way to lower deficits and bring our debt under control will require curbing entitlement spending and raising additional revenues.

Figure 1. The Complete Budget Picture in FY 2012

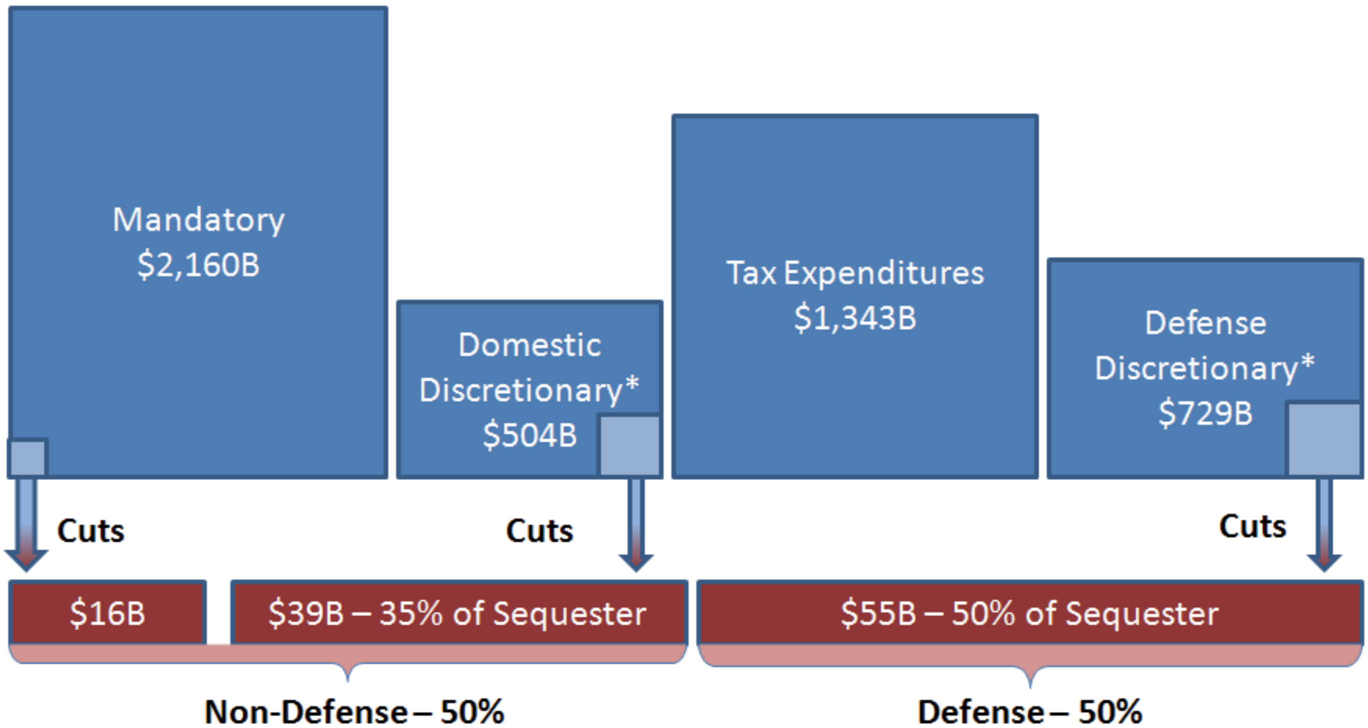


*Some defense-related spending, such as veterans’ benefits and military retirement, fall into these categories.

** There is a significant amount of spending that occurs through the tax code in the form of provisions that are commonly referred to as tax expenditures.

Source: Congressional Budget Office (CBO) Budget and Economic Outlook (January 2012), Joint Committee on Taxation

Figure 2. FY 2013 Sequester Cuts Fall Almost Entirely on Smallest Pieces of the Budget

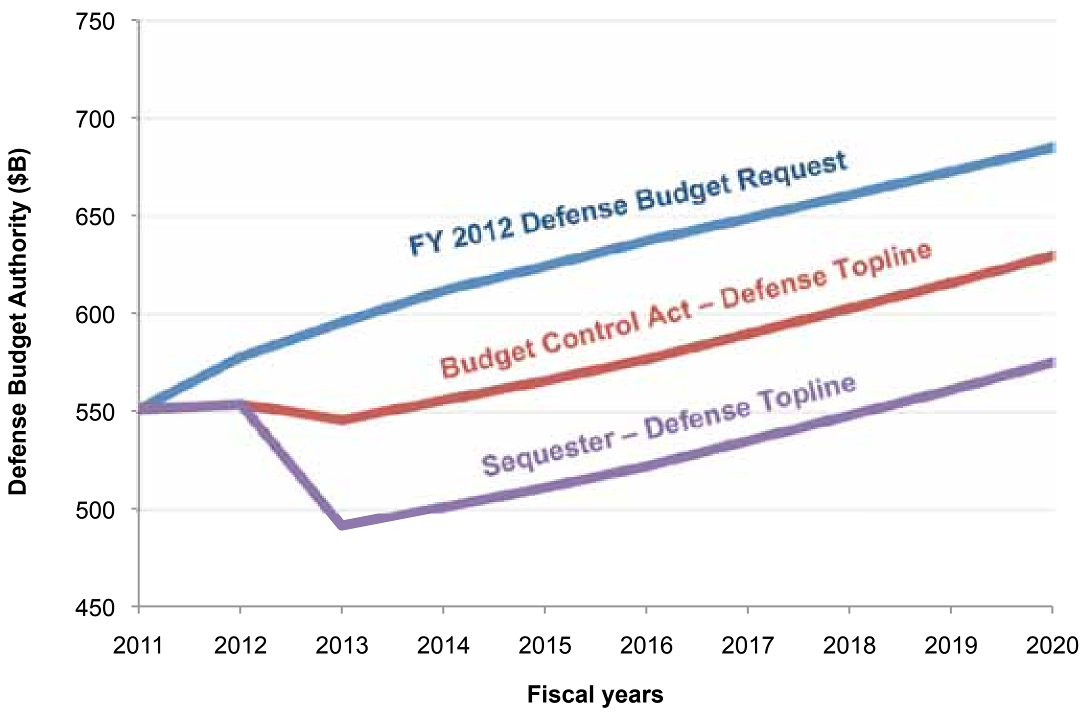


* These amounts include all discretionary budgetary resources for the duration of FY 2013, not solely the non-exempt monies that are subject to sequester. Additionally, the figures assume that a CR at FY 2012 levels is enacted for FY 2013 and that war funding (Overseas Contingency Operations funds) is provided at the level requested by the president. Defense discretionary funds include unobligated balances from prior years, which are subject to sequester.

Source: CBO, Donald Marron and the Tax Policy Center (using data from the OMB and the U.S. Department of the Treasury)

Figure 3. Non-War Defense Discretionary Budget Authority Under the BCA and Sequester

With sequester, defense budget authority in Fiscal Year (FY) 2013 will be $100 billion lower than the president's FY 2012 request



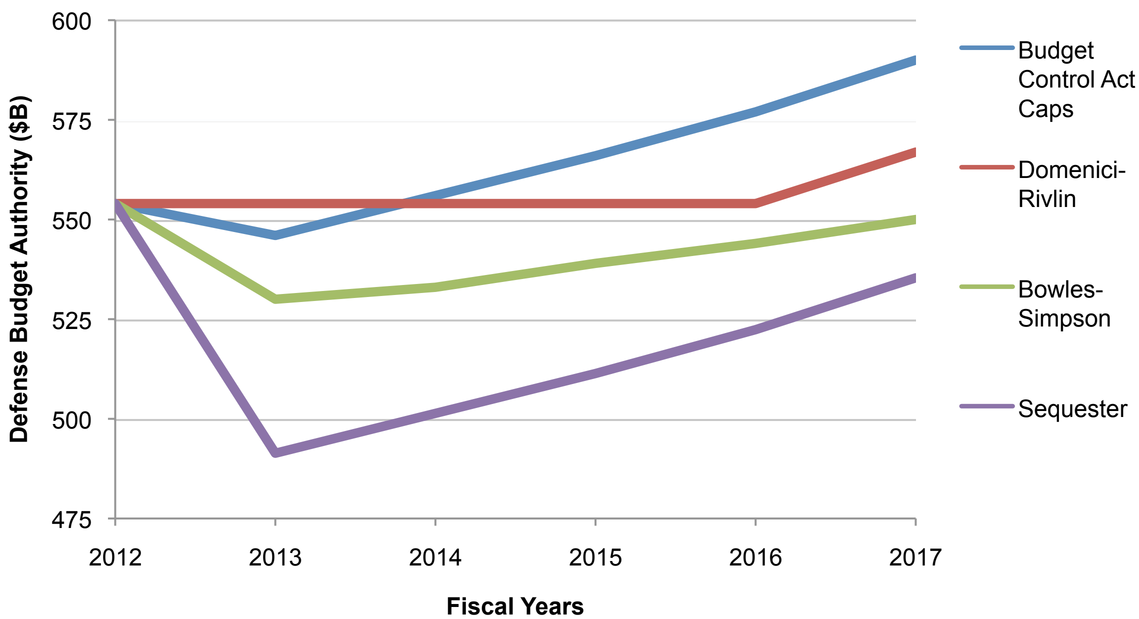
Source: The President's Budget for Fiscal Year 2012, CBO Budget and Economic Outlook (January 2012), Budget Control Act of 2011, Analysis based on materials from The Punaro Group

Current efforts at deficit reduction, however, address neither of these issues. In 2011, Congress enacted over $1 trillion in cuts to defense and non-defense discretionary appropriations over ten years, primarily through the Budget Control Act of 2011 (BCA), which placed binding caps on discretionary spending for each year.[4] In defense, the reductions were significant – amounting to roughly $487 billion in cuts over the next decade to the president's FY 2012 budget request.

Additionally, the BCA formed a Joint Select Committee on Deficit Reduction (the "super committee") to propose further measures for addressing the nation's fiscal problems. As a backstop, the agreement also put in place what is known as the sequester: an additional set of cuts totaling over $1 trillion, mostly to defense and non-defense discretionary spending, that would go into effect if the super committee failed to reach an agreement.

The idea of a sequester was not new. It was lifted from an analogous effort to control budget deficits more than a quarter century ago: the Balanced Budget and Emergency Deficit Control Act of 1985, known as Gramm-Rudman-Hollings (GRH), after the three senators who authored the legislation.

Figure 4. Discretionary Defense Budget Authority: Sequester vs. Bipartisan Fiscal Plans



Sources: CBO, Moment of Truth

Crucially, in the words of then-Senator Phil Gramm (R-TX), one of the namesakes of the original legislation, "it was never the objective of [GRH] to trigger the sequester; the objective of [GRH] was to have the threat of the sequester force compromise and action."[5] Similarly, in 2011, the sequester was included in the BCA to motivate the super committee to arrive at a workable consensus. Unfortunately, the threat of the cuts was not sufficient to spur action. Now, the sequester will begin on January 2, 2013 absent a change in the law.

Reasonable people can disagree about whether additional discretionary cuts should be made beyond the BCA caps. But the sequester for FY 2013 would cut both defense and non-defense discretionary spending to levels significantly below what both Domenici-Rivlin and Simpson-Bowles deemed necessary to address our nation's fiscal woes. Moreover, it would do so in an irrational fashion, stoking uncertainty and leading to deleterious effects.

Economic Policy Program | National Security Program

Economic Policy Project | *Foreign Policy Project*

Chapter 2:
Sequester: Mechanics & Implementation

Sequestration is an obscure budgetary mechanism. At its simplest, it is an automatic reduction to federal government spending for a given fiscal year. Implementing it, however, will be anything but simple. This is due to ambiguities and complexities inherent in the law. Ultimately, OMB is vested with the authority to both interpret and implement the BCA sequester.

Mechanics

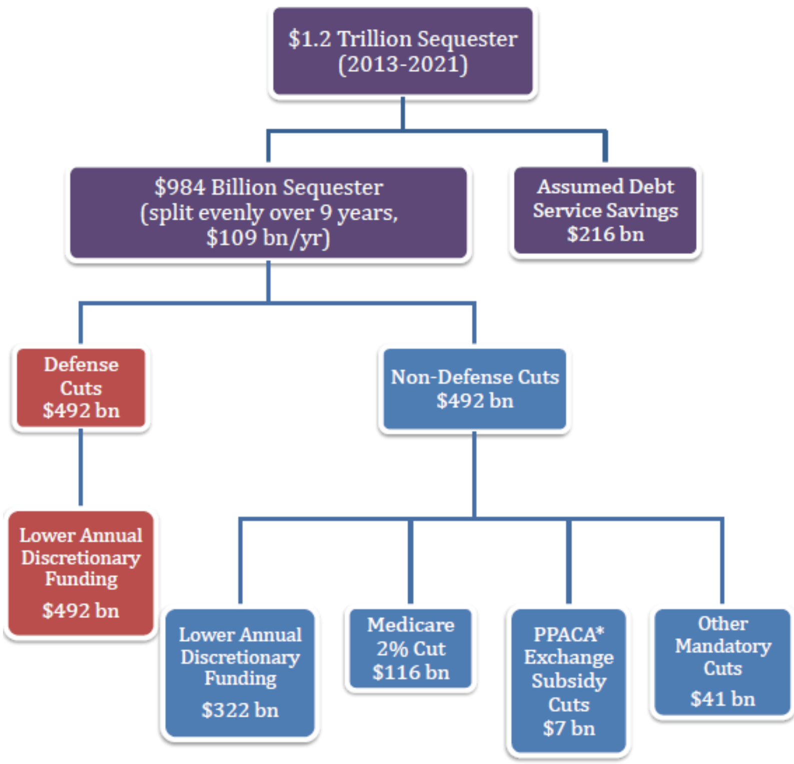
Beginning in FY 2013, the sequester is scheduled to reduce federal expenditures for nine consecutive fiscal years such that the cuts, including associated debt service savings, total to $1.2 trillion.[6] Of that amount, the BCA assumes that $216 billion will come from debt service savings. The remaining $984 billion will come from cuts divided evenly among the nine relevant years, meaning that $109 billion will be sequestered each year. The annual cuts are, in turn, split evenly between defense and non-defense spending – an approximate cut of $55 billion to each.

Nearly all spending that is characterized as defense in the budget is annually appropriated (discretionary). Therefore, essentially the entire $55 billion annual defense reduction will be achieved through defense discretionary spending reductions. Similarly, on the non-defense side, even though much of the federal budget consists of spending on domestic entitlement programs, most of them are safeguarded (i.e., exempted) from the sequester, meaning that the cuts to non-defense spending will also apply predominantly to discretionary programs.[7] Of the $55 billion in annual cuts to non-defense funds made by the sequester, approximately $39 billion will come from discretionary spending.

In its latter eight years – i.e., FYs 2014-2021 – the sequester of discretionary spending takes the form of more stringent spending caps, further lowering the ones originally set by the BCA. Thus, the sequester will reduce the total amounts that can be appropriated for each of defense and non-defense discretionary spending, with policymakers retaining the power to decide in advance how to distribute the cuts across government functions and programs. (The law does include a provision, however, that would trigger across-the-board cuts if appropriations made by Congress exceed the established spending caps.)

The sequester of discretionary spending in FY 2013, however, will take a starkly different form. These appropriations cuts ($55 billion in defense and $39 billion in non-defense[8]) will be carried out through automatic reductions to each non-exempt account on January 2,

Figure 5. Breaking Down the Sequester



*PPACA stands for the Patient Protection and Affordable Care Act.

2013. That means, importantly, that the FY 2013 cuts will occur regardless of the levels that Congress chooses to appropriate. Defense, for example, will face the same $55 billion cut if appropriators reduce its FY 2013 allocation to $200 billion as if they appropriate to the BCA cap at $546 billion.[9]

Specifically, our analysis indicates that the $55 billion in defense cuts mandated by the sequester for FY 2013 will force a 15 percent reduction at DoD and to some defense-related programs, and that the $39 billion in cuts to non-defense discretionary will require a 12 percent across-the-board cut at every other government agency. We arrive at these numbers by making several assumptions about how the sequester will be implemented.[10]

Figure 6. Assumptions about the Sequester's Mechanics

The president will exercise his authority to exempt the pay and benefits of military personnel from the sequester;
While OMB has indicated that the funds supporting our war efforts abroad, known as Overseas Contingency Operations (OCO), are subject to the sequester, we assume that policymakers will pass legislation to exempt them;
On January 2, 2013, Congress will not yet have passed appropriations bills for FY 2013, instead funding the government through a CR, meaning that the sequester cuts will actually be applied to FY 2012 funding levels; and,
Because three months of FY 2013 will have transpired before the sequester goes into effect, agencies will already have obligated 25 percent of their funds for the year. Therefore, the sequester cuts will be taken out of only 75 percent of their funds.

Figure 7. Effect of the Sequester on Defense Spending (050)

$531 B	**Base Budget under CR at FY 2012 rates**
+ $26 B	DOE Nuclear & other related activities (enacted FY 2012)
+ $85 B	Unobligated balances from FY 2012 + previous years
+ $88 B	Overseas Contingency Operations (OCO) (FY 2013 Request)
$729 B	**Total Defense Spending**
- $141 B	Military Personnel (assumed exempted by president)
- $88 B	OCO (assumed exempted by legislation)
- $125 B	Monies obligated during 1st Qtr. of fiscal year*, 10/01/12 – 01/01/13
$374 B	**Total defense pot for reduction by sequester**
- 15%	**Effect of the $55 B sequester on the $374 B remaining**

* For simplicity, we assume that funds are obligated uniformly throughout the duration of the relevant appropriations bill.

Sources: DoD National Budget Estimates for FY 2013, BPC analysis

The indiscriminate nature of the cuts is exacerbated by the facts that they will likely be made from a CR at FY 2012 levels, and that they will occur in the midst of a fiscal year, after many spending decisions have already been made.

Implementation

The convoluted form of the FY 2013 sequester makes it incredibly difficult to implement. Ultimately, OMB will have to issue instructions for carrying out the cuts, but much of the law is vague. In some instances, it is not clear how to apply the sequester, while in others, the demands of the sequester appear clear but are highly impractical. From such complexity flows great uncertainty, the antithesis of properly designed public policy, which threatens to cause disruption across the government and private sector well before the sequester even goes into effect.

In FY 2013, sequestration will force DoD and other departments to make cuts of 15 and 12 percent, respectively, to individual accounts, thereby eroding flexibility to prioritize and occasionally mandating unfeasible dictates. To begin with, there is significant ambiguity as to what level of departmental budgets the sequester's cuts will apply. The law requires that they be uniformly distributed at the "program, project, and activity" (PPA) level across every budget account that is not explicitly exempted.

PPAs generally refer to granular levels of spending deep within each department's budget, but no widely-applicable definition of the PPA level exists and many government departments do not even have active, concrete definitions of PPAs. In fact, the Government Accountability Office (GAO), in its *Compliance Report for FY 1986* sequestration, "found widespread confusion among agencies in applying the program, project, and activity definitions."[11] A similar vagueness in the law this time around will leave the critical issue of how the cuts will be applied potentially unresolved until late in the process.

The lack of guidance thus far from OMB and mixed signals from lawmakers as to whether the cuts will be allowed to take effect only stoke this uncertainty. Neither government officials nor business leaders can appropriately plan for cuts whose composition is unclear and which may or may not occur.

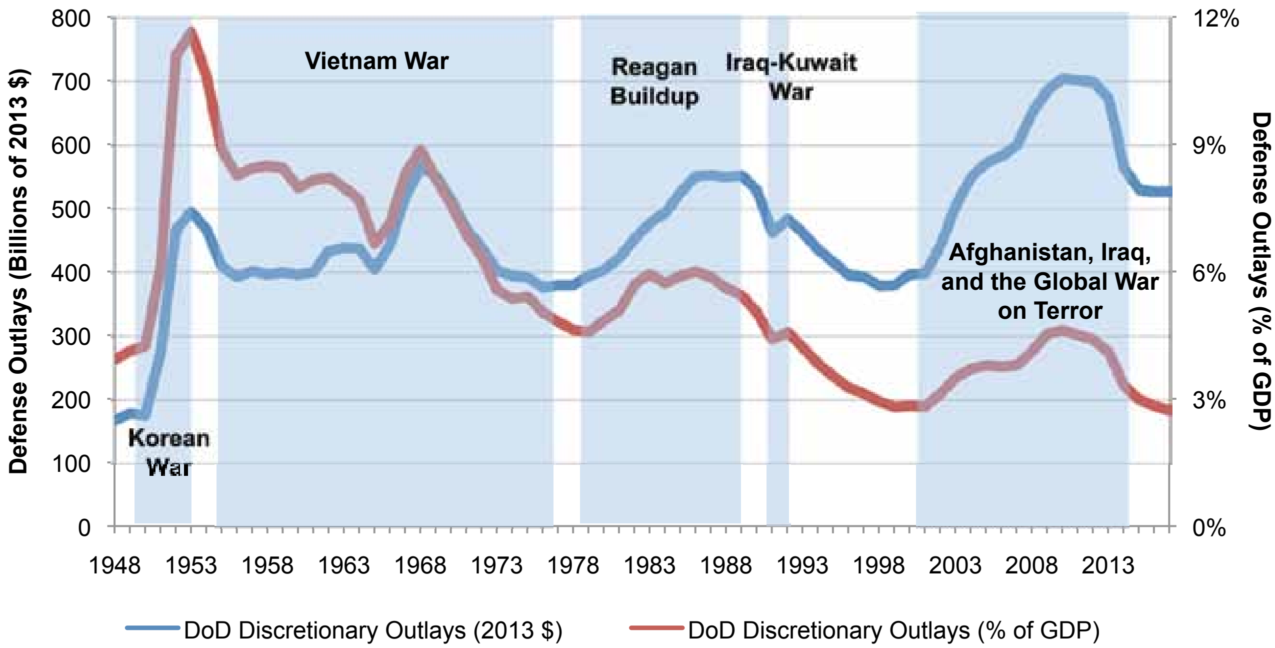
Generally, there are three main difficulties that officials tasked with implementing the sequester will face, depending on how the appropriations bills in effect at the time define the PPA level for the type of account that they manage.[12]

First, for PPAs that might consist of one, or just a handful of, large procurement or construction activities, slashing 15 percent will be nearly impossible. Cutting that amount for certain projects could force the entire undertaking to be scrapped. For example, the "Virginia Class Submarine" PPA within the Navy Shipbuilding and Conversion Procurement account contains funds for two high-cost submarines scheduled for construction. But since it is impossible to operate just 85 percent of a submarine, cutting this PPA by 15 percent will make it difficult for these two vessels to be completed on schedule.

Second, for other acquisition accounts, even when there are many items within a PPA, it will be difficult to implement cuts without delaying the signing of contracts or raising costs. Managers might be able to scale back contracts, buying less of a given product, but as Secretary of Defense Leon Panetta warned lawmakers in a letter on the effects of the sequester, slashing weapons programs "would drive up unit costs and lead to reductions in quantity" disproportionately larger than the percentage cut.[13]

Finally, personnel-heavy PPAs, many of which are found in non-defense government agencies, will require officials to make difficult decisions while staying within the confines of the law. Salaries of federal employees cannot be cut, terminating their employment is exceedingly difficult, and in order for departments to lay off substantial civilian personnel – termed a reduction in force (RIF) – the Office of Personnel Management stipulates that at least 60 days notice must be given.[14] This could force agencies to issue RIF warnings just days before the November elections. The more likely scenario for accounts like "Border Security and Control," which only contain funds used to pay salaries and benefits, is that some employees will be laid off, while many others will face furloughs, and any work that is contracted out would be cut even more sharply.[15] Running a federal agency efficiently under these circumstances – with general planning, contracting, and personnel uncertainty – will be impossible.

Figure 8. Two Ways to Look at Defense Spending



Source: DoD National Defense Budget Estimates for FY 2013 (“Green Book”)

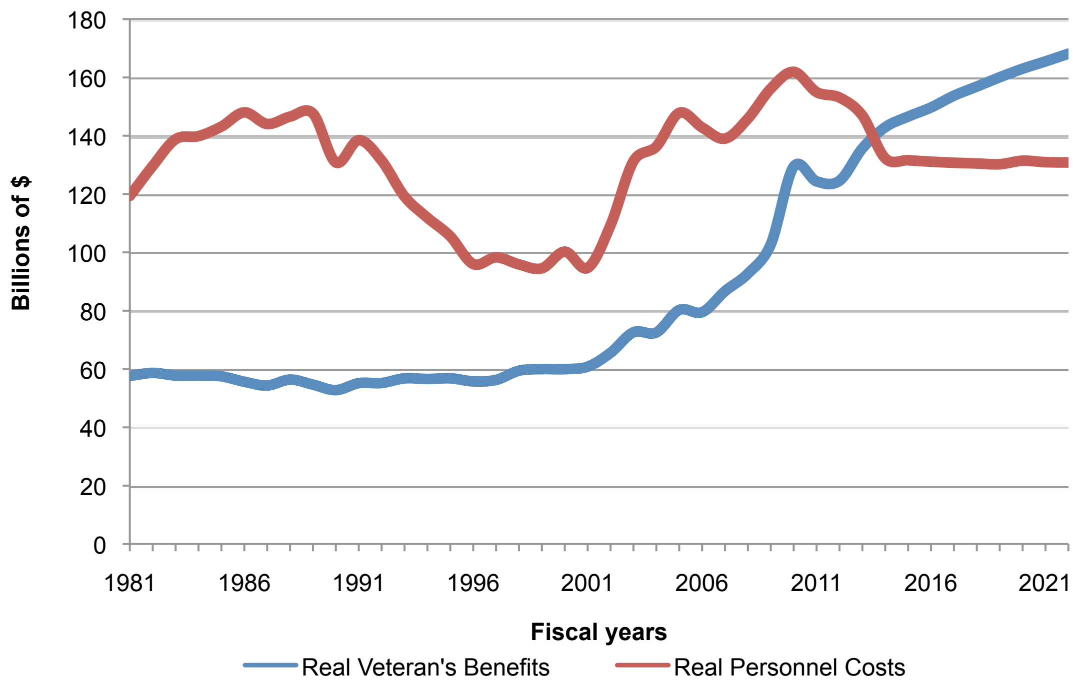
Standard maneuvers of “reprogramming” and limited “transfer authority” will give officials some minor flexibility in these matters, but not enough to fully avoid the damage.[16] Further, any movement of funds will have to remain within the reduced sequester levels.

All of this uncertainty about the sequester’s implementation will have a paralytic effect. Unsure of how many funds they will have available in coming years, program managers at the Pentagon are already delaying signing contracts and slowing the procurement process. Contractors, unable to plan accurately, will have to begin making guesses about where they think cuts will come so that they can tighten their belts accordingly.

Moreover, for all the disruption caused to day-to-day operations at DoD, the sequester does nothing to reform its inefficiencies. Less and less of money appropriated to defense is actually spent on purchasing security. For example, in constant dollars, DoD’s budget has increased by 73 percent from 1980 to 2012, despite large reductions in the size of the armed forces.

Total active duty personnel dropped 32 percent over the same period, and civilian defense employment dropped 25 percent. The United States has gone from a 521-ship Navy and an Air Force that boasted more than 2,700 fighters and attack aircraft, to 285 ships and 1,500 aircraft in service today.

Figure 9. Within a Few Years, Veteran's Benefits Will Exceed Current Personnel Costs



Note: Veterans Affairs spending primarily includes veteran's retirement pay, TRICARE for Life, GI Bill benefits, and housing benefits. Personnel costs consist primarily of the pay and benefits for military personnel.

Sources: The President's Budget for Fiscal Year 2013, Analysis based on materials from The Punaro Group

Of course, judging capability is not as easy as looking at how much money is spent on defense or how many ships are bought. Technological advances and increasingly sophisticated weaponry have enabled our armed forces to do a lot more with fewer people and platforms. However, serially ignored inefficiencies in the defense budget have seriously constrained the funds available for acquiring future war-fighting capability, whether it be researching, developing and buying the next generation of weapons, or the ability to recruit, train, equip and maintain future soldiers.

Indeed, three main pathologies internal to the structure of the DoD budget are increasingly detracting from investment in military capabilities: personnel costs consume a growing portion, with large overhead and a ballooning procurement system also leaving less money to be spent on defense itself. And these trends are unlikely to change any time soon. Although DoD plans for nearly 100,000 fewer troops in five years, it expects to be spending more on personnel in 2017 than today, and in 2014 – regardless of the sequester – the cost of benefits for veterans is projected to exceed the amount spent on salaries and benefits for active duty troops.

By addressing the drivers of DoD spending – personnel, overhead, and acquisition costs – the defense budget can be brought in line with current fiscal constraints without sacrificing national security, as we will address in a subsequent report. Yet, the sequester does nothing to address these issues and even exacerbates them. With personnel accounts almost certainly exempted from the automatic cuts, the rising long-term cost curve of the all-volunteer force will remain untouched. Furthermore, although the sequester will affect acquisition and civilian employees, the indiscriminate nature of the reductions will not promote any meaningful reforms that would curb future costs.

Finally, although it is an attempt at deficit reduction, the arbitrary nature of the sequester cuts inevitably will result in additional undue costs for DoD and other departments, partially counteracting the savings. Examples of these antithetical consequences include the additional unemployment payments that will fall on the federal government from civilian layoffs, productivity losses from furloughs in critical bureaus, and the increased costs associated with delayed procurement. If the goal is deficit reduction, the sequester is a highly inefficient way of achieving it.

Spending cuts can be designed intelligently to be transparent, dampen any external costs, target inefficiencies within government, and avoid disrupting important functions. Sequestration, on the other hand, embodies none of these hallmarks of good public policy. Its mechanistic, straitjacket approach will leave almost no room for program managers to protect their most critical activities by sacrificing those that are less essential.

Economic Policy Program
Economic Policy Project

National Security Program
Foreign Policy Project

Chapter 3:
The Sequester's Impact

In addition to the challenges posed by implementation of the sequester – and the negative effects of that process – the abrupt and arbitrary nature of the cuts will have negative effects on our national security and economic recovery, while doing very little to improve the nation's fiscal health.

Sequester as Defense Policy

The FY 2013 sequester will replace the ability of elected leaders to set defense policy with a procedure that will indiscriminately cut 15 percent from defense programs. Indeed, at a time when the military is reorienting its missions to new strategic priorities and seeking to modernize its forces as two major land wars wind down, these across-the-board cuts will make it significantly more difficult to ensure readiness, procure new weapons systems, and invest in new technology to meet emerging threats.

The president is charged with defining the threats that the United States is likely to confront and a strategic vision for how to avoid or defeat them. The Pentagon contributes to formulating that strategy, and is responsible for ensuring that our forces are prepared and have the necessary equipment to enact it. Through the authorization and appropriations processes, lawmakers are able to modify that blueprint to best serve the security interests of the nation. But on January 2, 2013, the views of the president, Pentagon, and Congress will matter little.

The sequester will deprive all three of these stakeholders of their power to shape the country's defense policy. Instead, a mechanism that uniformly slashes 15 percent from most defense budget accounts will take the place of the best judgments of our elected representatives and their appointed officials about what is needed to keep us safe.

Such cuts, blind to strategic priorities, will leave the U.S. military unable to implement effectively any credible national security strategy – whether President Obama's or any other one – because arbitrary reductions will have taken the place of deliberative planning. Cuts made in this fashion will eliminate almost all of DoD's discretion to preserve funding for the most important and efficient national security missions and capabilities.

As an example, consider the administration's *Strategic Guidance* issued in January 2012 and the capabilities that the Pentagon has deemed necessary. This new strategy highlights that "U.S. economic and security interests are inextricably linked to developments in the arc extending from the Western Pacific and East Asia into the Indian Ocean region and South Asia,"[17] and therefore, "we will of necessity rebalance toward the Asia-Pacific region." Accomplishing this, according to the Pentagon, will require the military to shift toward a leaner, more agile force – one that can effectively project its power across the vast distances of the Pacific Ocean. Accordingly, military planners have identified the need for greater investment in technologically-superior air-, sea- and cyber-power at the cost of heavy ground forces. Additionally, after 10 years of war, military leaders have made it clear that our troops need to recover and aging equipment needs to be repaired.

The Pentagon's budget request for FY 2013 reflects these priorities – increasing funding for weapons platforms that support power projection and other missions critical to the new strategy, and cutting money for programs that military leaders no longer have deemed to be as critical. As Secretary Panetta told an Asian security conference on June 2, 2012:

> We are investing specifically in those kinds of capabilities – such as an advanced fifth-generation fighter, an enhanced Virginia-class submarine, new electronic warfare and communications capabilities, and improved precision weapons – that will provide our forces with freedom of maneuver in areas in which our access and freedom of action may be threatened. We recognize the challenges of operating over the Pacific's vast distances.

Figure 10. Effect of the Sequester on the President's Strategy: Removes the Ability of the Pentagon to Shift Resources Into Capabilities They Deem More Critical

	Pentagon Request for FY 2013 (in millions)	CR at 2012 Levels (in millions)	FY 2013 Resources Post-Sequester (in millions)	Percentage Cut from FY 2013 Request
Warfighter Information Network-Tactical	$1,225	$1,063	$947	**-23%**
Depot Maintenance	$15,097	$13,049	$11,620	**-23%**
Force Readiness*	$137,760	$107,816	$96,010	**-30%**
DoD Cyber Operations	$3,400	$2,300	$2,048	**-40%**
DDG-51 Arleigh Burke Class Destroyers	$3,515	$2,081	$1,853	**-47%**
DHS Cyber Security	$770	$443	$403	**-48%**
KC-46A Refueling Tanker	$1,815	$877	$781	**-57%**
USS Abraham Lincoln Overhaul	$1,613	$515	$459	**-72%**

*Composed of O&M funding for Operating Forces, Mobilization and Training & Recruitment budget activities for all services.
Sources: The President's Budget for Fiscal Year 2013, DoD Fiscal Year 2013 Budget Request

> That is why we are investing in new aerial-refueling tankers, a new bomber, and advanced maritime patrol and anti-submarine warfare aircraft.[18]

DoD's budget request strives to meet the demands of the president's new defense strategy while roughly abiding by the original BCA cap levels for defense spending, lowering the base defense budget by about $5 billion compared to FY 2012, but without accounting for the sequester's further automatic cuts.

Our analysis, however, indicates that the sequester will greatly constrain the Pentagon's ability to execute any of these strategic shifts in its procurement, planning, and training.

Without meaningful reforms, inefficiencies in the defense budget are already eroding funds needed to train, equip, and deploy our forces. Now, the combination of continued FY 2012 funding, which does not reflect the president's new strategic priorities, and the indiscriminate 15 percent sequester cut mean that funds available to DoD on January 2, 2013, will differ greatly from those it requested. Indeed, some priority projects might receive as much as 75 percent less funding than the Pentagon determined was needed for FY 2013. Conversely, weapons systems for which DoD has requested reduced funding because of their lower priority in light of the new strategy could receive as much as nine times more funding than requested.

Figure 11. Effect of the Sequester on the President's Strategy: Removes the Ability of the Pentagon to Shift Resources Out of Capabilities They Deem Less Critical

	Pentagon Request for FY 2013 (in millions)	CR at 2012 Levels (in millions)	FY 2013 Resources Post-Sequester (in millions)	Percentage Cut from FY 2013 Request
Stryker Armored Vehicle	$332	$772	$687	**107%**
M-1 Abrams Tank	$74	$453	$403	**442%**
Heavy Expanded Mobility Tactical Truck	$56	$650	$579	**934%**

Sources: The President's Budget for Fiscal Year 2013, DoD Fiscal Year 2013 Budget Request

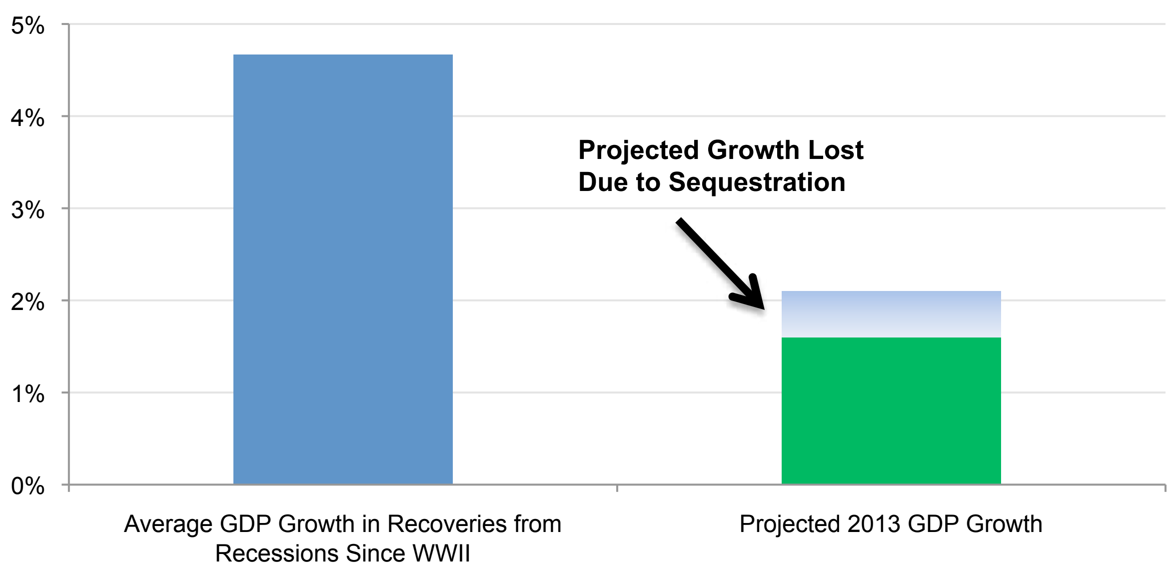
More specifically, our calculations indicate that refurbishment of the nearly 25-year-old *USS Abraham Lincoln* aircraft carrier, development and purchases of a new aerial refueling tanker, and funding for resetting and retraining troops could be cut by 72, 57, and 42 percent, respectively, relative to the Pentagon's FY 2013 request. Additionally, funding could fall roughly $1.7 billion short of the nearly $4 billion requested by DoD and Homeland Security for investments in the personnel, technology, and infrastructure needed to protect our sensitive computer networks by developing offensive cyber capabilities. Simultaneously, funding for Heavy Tactical Vehicles, the M-1 Abrams tank, and Stryker armored vehicles – all ground vehicles that serve little purpose in the Asia-Pacific region – could be increased by 934, 442, and 107 percent, respectively, over the Pentagon's request for FY 2013.

Thus, the sequester will leave military leaders with some combination of three options, each of which will increase risks and costs:

- Indefinitely delay implementation of the new strategy, and accept the strategic risks that would flow from not moving to address the threats identified in the *Strategic Guidance.*
- Attempt to pursue the new strategy with fewer of the new capabilities and weapons platforms than the Pentagon has deemed necessary, and accept the operational risks that come from not having enough of the right tools for the job and lower force readiness.
- Make do with the older weapons systems that DoD already possesses, and accept the tactical and safety risks of using outdated technology that does not fulfill the requirements of current missions, and is also more likely to fail.

The first two options cause contract delays, reductions, and renegotiations, contributing to increases in per-unit costs. The last option will result in increased maintenance costs, as antiquated planes, ships, and helicopters are pushed beyond their expected service lives. Either way, the military eventually will need some of the weapons that the sequester will keep us from purchasing today. Indeed, nearly one-quarter of our ships failed inspection last year. The average age of our fighter jets is 22 years, our bombers 35 years, and our aerial refueling tankers 47 years. The longer we put off modernizing our armed forces, the greater the risk to our troops and the greater the eventual procurement costs will be, defeating the very logic of deficit reduction.

Figure 12. FY 2013 Sequester Cuts Will Further Diminish What Little Economic Growth We Have



Note: Historic recovery growth was calculated by averaging growth from the four years following each recession since WWII (up to 2001), excluding years in which the country quickly experienced another recession. This selection of years is meant to represent what a modest to strong recovery has looked like in the past.

Source: BPC calculations based on St. Louis Federal Reserve data (FRED II) and CBO projections and economic multipliers

Meanwhile, although China's military power is still inferior to that of the United States, Beijing's actions – and fear of its intentions – have already led many regional countries to look to the United States for security guarantees and cooperation. If U.S. commitment to these alliances is perceived to be weakening, or our ability to defend them waning, our partners could feel pressured to accommodate China's growing ambitions.

At a time when the military is reconstituting itself as two major land wars wind down, being called upon to reorient its missions to new strategic priorities and seeking to modernize its forces, across-the-board cuts will make it significantly more difficult to properly ensure readiness, procure new weapons systems, and invest in new technology to meet emerging threats. As a result, the U.S. military will be left in a holding pattern, trying to make do with yesterday's military to fight tomorrow's wars.

Sequester as Economic Policy

The economy is mired in a lackluster recovery from the largest recession since the Great Depression. Employment growth has slowed over the past two months, with only 73,000 new jobs added per month, sending a stark signal that this country's economic recovery continues to fall short of what we need.[19] Long-term unemployment figures remain near their record highs, economic growth remains tepid at best, and businesses continue to hold back on their investments.

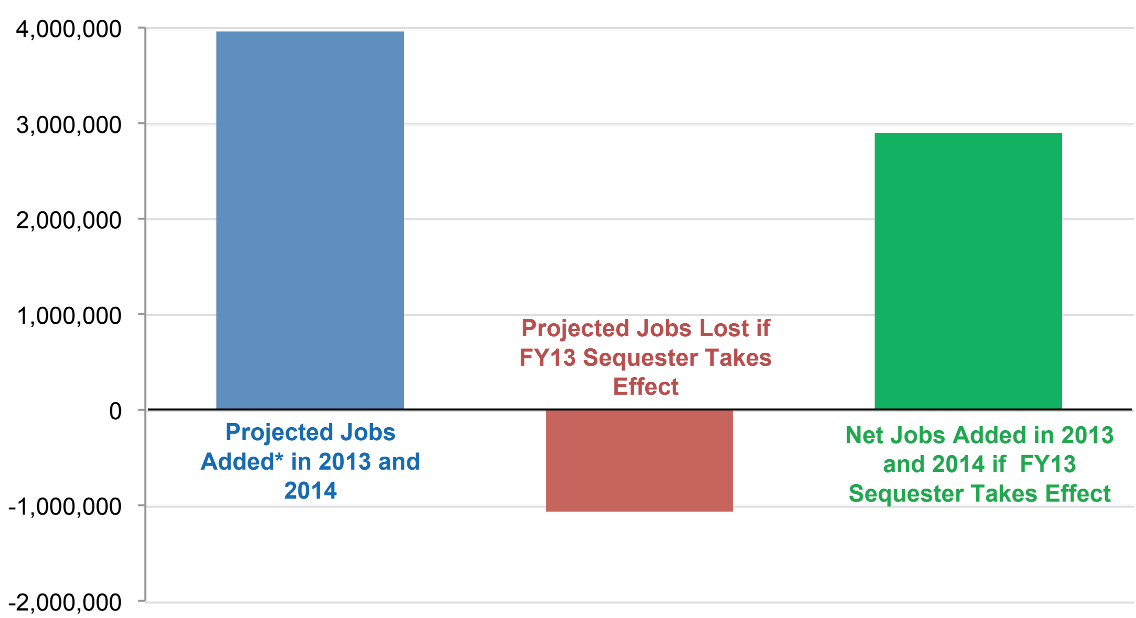
Thus, the government must be careful not to take actions that might stall growth and exacerbate our current struggles. Yet, the nature and immediacy of the sequester's cuts to defense and non-defense spending – indiscriminate and by 15 and 12 percent, respectively, in FY 2013 – will do precisely that: cause harmful repercussions throughout the economy.

Using CBO multipliers[20] and accounting for the haphazard and overnight nature of the cuts, we estimate that the full defense and non-defense sequester will **reduce GDP by roughly half a percentage point** in calendar year (CY) 2013. For reference, CBO projects real GDP to grow at only 2.1 percent next year[21] under a set of plausible policy assumptions.[22]

Moreover, this analysis implies that the sequester cuts could **cost the economy more than one million jobs** over two years at a time when the unemployment rate is still stuck above 8 percent.[23] Everyone from Federal Bureau of Investigation (FBI) and border patrol agents, to civilian DoD employees, to doctors, to teachers will face the axe. Further, because the federal government is much more reliant on contractors today than it was a few decades ago, a large majority of the layoffs will come from the private sector.

To make things worse, the effects of the sequester are already starting to be felt in certain sectors of the economy. Government contracts expert Professor Dan Gordon[24] notes that while the sequester "may look like a slow-motion train wreck to the public, industry may start to experience the

Figure 13. The Sequester Will Cost the Economy Over 1 Million Jobs in 2013 & 2014



* The projection for jobs added averages the first five months of job growth in 2012 – 165,000 jobs/month – and assumes that level of growth continues through the end of 2014.
Sources: BPC calculations based on Bureau of Labor Statistics data and CBO projections and economic multipliers

impact well before January 2." Contractors cannot assume that the sequester will be replaced and must plan ahead.

Unable to plan accurately, these businesses will begin making guesses about where they think cuts will hit so that they can tighten their belts accordingly. In a highly uncertain environment, contractors will have to make personnel, investment, and other significant decisions.

Given the realities of compliance with the Worker Adjustment and Retraining Notification (WARN) Act, however, businesses do not have the luxury of postponing some of these major decisions. The WARN Act mandates that employers with 100 or more employees provide notification 60 calendar days in advance of mass layoffs. Therefore, on November 3, only days before the election, if lawmakers still have not acted to resolve the sequester, many companies likely will begin announcing their plans to fire large numbers of workers. In fact, Booz Allen Hamilton has already declared that it is taking "a more conservative approach" to hiring in order to preempt some of the potential damage.[25]

The effects of this uncertainty and the sequester itself will trickle down to smaller subcontractors, many of them small veteran- and women-owned businesses, which are less able to withstand a substantial loss in revenue. Such businesses are more likely to lay off a higher percentage of their workers or worse: simply go out of business. In its latest report, CBO confirmed that the sum total of these actions will begin to have tangible consequences for the U.S. economy this year.[26] The detrimental impacts will become more pronounced as months go by with no definitive action by policymakers.

The arbitrariness of the FY 2013 sequester, by forcing cuts to even the most important and efficient federal programs, also has the potential to harm the nation's long-term growth. Some of the weapons programs that sequestration delays or cancels now will have to be, in one form or another, purchased later on. As previously noted, our fleet of ships and planes is aging, with many of them already in service for longer than originally planned. We cannot rely on them for our national security indefinitely.

Once new acquisition is halted, however, even if its funding is restored in future years, we cannot simply restart the programs that are designing and building the next generation of fighter jets, bombers, aircraft carriers, submarines, and communications systems. There will be significant new costs to bear. The engineers who design, the skilled workers who assemble, and the plants that produce defense products are not easily replaced. Once laid off or shuttered, they require time and money to educate, hire, train, or build.

Moreover, some contractors will begin to search more aggressively for buyers of their products abroad.[27] This would result in American engineering jobs being sent overseas, and new technological capabilities being delivered to other nations, potentially unfriendly ones.

Heading off the economic shockwaves from the sequester will require action soon, rather than waiting for the lame duck congressional session following the November elections. While the U.S. must begin to get its fiscal house in order, and discretionary programs should not be immune from reforms, the immediacy and indiscriminate nature of these cuts threaten to derail the fragile recovery.

Sequester as Domestic Policy

Given the fact that few domestic discretionary programs are exempt from the sequester, the cuts will directly hit people and activities that are critical to American society. The 12 percent across-the-board cut will be indiscriminately applied, affecting National Institutes of Health (NIH) grants to research cures for cancer, diabetes, and Alzheimer's;

scientific research; mental health services; special education programs; the safety of our food and drugs; the Centers for Disease Control and Prevention (CDC); and many other programs. Indeed, the director of NIH has stated that the agency's support for medical research will be severely curtailed.[28] Low-income rental assistance and financial support to local governments for the education of our most disadvantaged children will be similarly slashed. Inevitably, many air traffic controllers, FBI agents, and doctors will be laid off. Even fundamental government operations, such as patent approval, will be slowed as the sequester cuts resources for those functions.

Sequester as Fiscal Policy

Despite the immense pain, disruption, and uncertainty that will be caused by the sequester, it will have little impact on the trajectory of our debt. In fact, the estimated savings will delay U.S. debt from reaching 100 percent of GDP by only two years. We note "estimated savings" here because our analysis indicates that unintended cost increases, such as higher per-unit procurement costs, additional unemployment insurance benefits, and rising maintenance costs associated with maintaining older equipment all will detract from the sequester's net deficit reduction.

Figure 14. Select Domestic Programs Facing a 12 Percent Cut in 2013

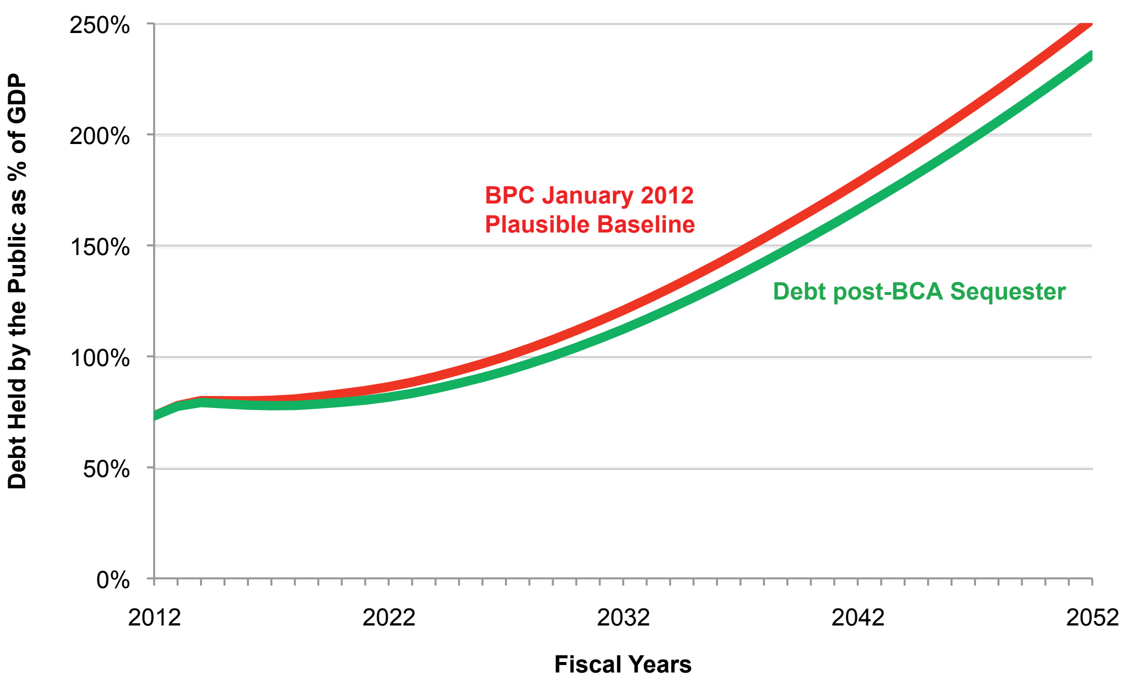
Program	CR at FY 2012 Levels ($B)	Funds Available after January 2nd ($B)	12 Percent Sequester Cut ($B)
National Institutes of Health (NIH)	$30.7	$23.0	**$2.8**
Section 8 Rental Assistance	$27.4	$20.6	**$2.5**
Air Transportation Security and Traffic Control	$17.8	$13.4	**$1.6**
Education for the Disadvantaged	$15.7	$11.8	**$1.5**
Special Education	$11.9	$8.9	**$1.1**
Scientific Research	$11.8	$8.9	**$1.1**
Disaster Relief	$7.1	$5.3	**$0.7**
Disease Control	$5.5	$4.1	**$0.5**
Food and Drug Safety	$3.5	$2.6	**$0.3**
Mental Health Services	$3.3	$2.5	**$0.3**

Sources: OMB, BPC calculations

Our unsustainable fiscal situation is driven by health care inflation, the retirement of the baby boomers, and an inefficient tax code that raises too little revenue. Yet the sequester does nothing to address these problems, instead cutting almost exclusively from defense and non-defense discretionary spending, which are already projected to decline substantially as a percentage of the economy over the coming decade.

The sequester was meant as a stick to motivate the work of the super committee. Their good-faith efforts came to naught, and now we are faced with a senseless measure that fails to address the root causes of our debt dilemma.

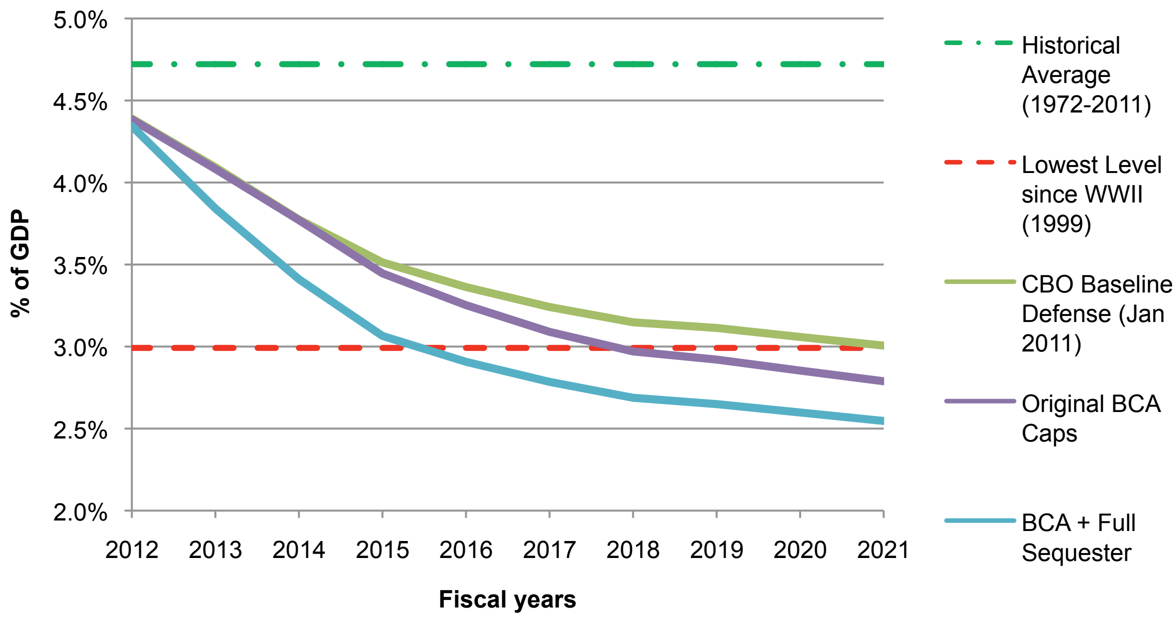
Figure 15. Sequester Delays National Debt Reaching 100 Percent of GDP by Only Two Years



Note: BPC's January 2012 Plausible Baseline assumes that the 2001, 2003, and 2010 tax cuts are extended permanently, Medicare physician payments are frozen (the "doc fix"), the AMT is indexed to inflation, and overseas combat operations wind down.

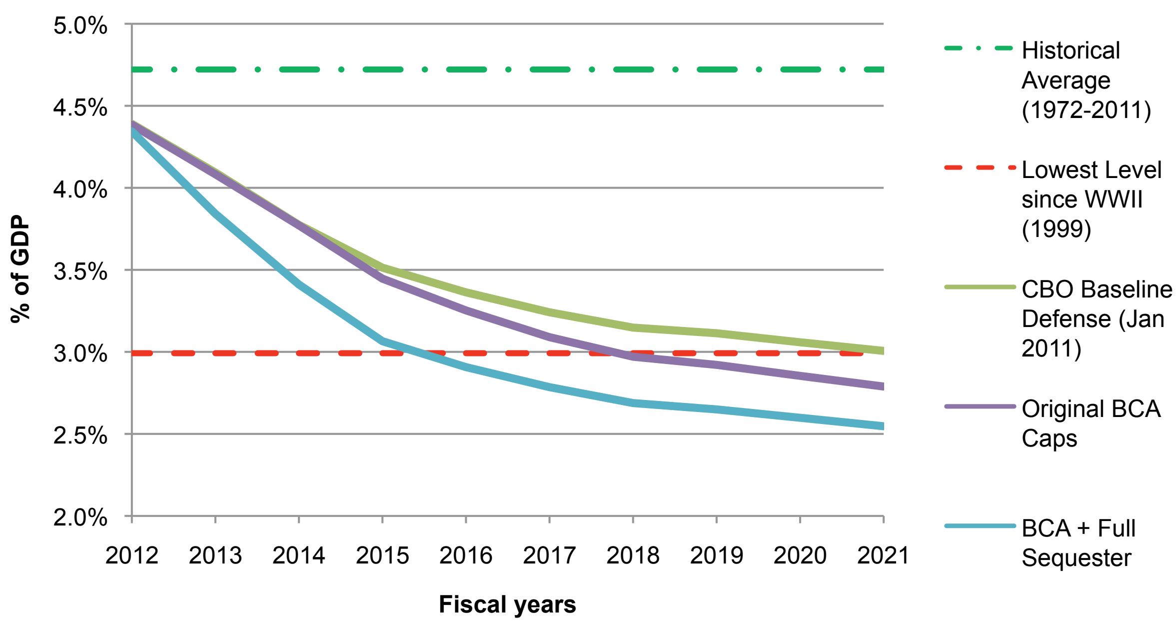
Source: CBO; BPC projections

Figure 16. The Sequester Will Cut Defense Spending to Historic Lows



Source: CBO

Figure 17. The Sequester Will Cut Domestic Discretionary Spending to Historic Lows



Source: CBO

Economic Policy Program | **National Security Program**

Economic Policy Project | *Foreign Policy Project*

Chapter 4: Recommendations

The sequester, as structured in FY 2013, will have repercussions on our national security and economy, without any appreciable progress in taming our national debt. And the consequences stemming from its uncertainty are already being felt.

Given the confusion and unfamiliarity of the situation, **we recommend that OMB release, before August 20, 2012, an account-by-account analysis of the expected impacts of the sequester, and the likely ramifications** to personnel, procurement contracts, operations and maintenance, and research, development, and training accounts. OMB should also work with DoD to determine impacts on military readiness and capabilities. This analysis will help lawmakers, analysts, and the public understand the ramifications of allowing the sequester to proceed as scheduled.

The analysis would also demonstrate that dealing with the sequester is an urgent matter. There is no excuse to leave agencies, contractors, and most importantly, our military troops in limbo. With that in mind – even prior to any OMB release – **Congress should begin taking serious action now** to form a viable solution that eliminates the massive uncertainty stemming from the FY 2013 sequester.

It is the longest-telegraphed punch in history, yet most policymakers have suggested that it will not be resolved until the lame duck session of the 112th Congress. That session, however, is already slated to be a busy one. Many controversial legislative items that should have been dealt with over the past 18 months have been set aside. In what is likely to be no more than 45 working days, it is unrealistic to expect Congress to find time to address the sequester, amidst all these other debates. Some have dubbed this imposing agenda looming over Congress "taxmageddon," while others have referred to it as a "fiscal cliff."[29]

September 2012

9/30/12. Appropriations to fund the government for Fiscal Year 2013

9/30/12. Expiration of the Temporary Assistance for Needy Families (TANF) authorization

November 2012

11/3/12. 60-day advance notification deadline for layoffs due to the sequester under the WARN Act

11/6/12. Election Day

December 2012

12/31/12. Expiration of the Bush tax cuts

12/31/12. Expiration of the Sustainable Growth Rate "Doc Fix"

12/31/12. Expiration of extended Unemployment Insurance benefits

12/31/12. Expiration of the Alternative Minimum Tax 'Patch'

12/31/12. Expiration of the current estate and gift tax rates

12/31/12. Deadline for addressing tax extenders

January 2013

1/2/13. Sequestration

February 2013

Estimated breach of the $16.394 trillion debt ceiling (post-extraordinary measures)

If the full consequences of the sequester are to be averted, action must be taken before the lame duck session. But what is to be done? The simplest approach would be to waive the sequester, sparing the defense and domestic budget the pain of cuts. But this is neither a politically viable nor wise course. With budget deficits rising and the national debt reaching dangerous levels, policymakers must take action to begin decreasing the gap between government revenues and expenditures; Americans expect nothing less. Discarding the sequester without replacing it with similar or larger savings is not an option.

The ideal solution, therefore, would be the sort of comprehensive, bipartisan deficit reduction package that the super committee was meant to produce and that the sequester was created to incentivize. Such a deal would have to reduce spending, reform entitlement programs, and raise revenues, as did the plans put forward by Domenici-Rivlin and Simpson-Bowles.

We recognize, however, that the chances are slim that Congress will pass such a long-term solution while facing an upcoming election and a jam-packed lame duck session. There is no good approach for Congress to navigate the confluence of substantive, procedural, and political challenges facing it between now and the end of the year. And, although existing processes stipulated in Gramm-Rudman-Hollings could mitigate some of the sequester's arbitrariness, we strongly urge lawmakers not to let it come to that.

Thus, negotiating a sensible path forward is urgent. The plan must protect the nation's strategic interests while establishing a strong, binding procedure – consistent with the congressional reconciliation process – that forces policymakers to confront these challenges in the next Congress. The plan must temporarily resolve the end-of-year issues, and replace the looming FY 2013 sequester with an implementable framework that focuses and forces action on the true fiscal issues facing the nation.

A CR – ideally the one at the start of the fiscal year – seems to be the most logical, "must-pass" vehicle within which to include this legislative language. While a solution along these lines would not be perfect, it would remove the threat of the fiscal cliff, while still maintaining America's commitment to getting its fiscal house in order.

Providing for the common defense is one of the chief constitutional responsibilities of our federal government. To do so, the U.S. government must be able to assess future threats, weigh their risks, develop a strategy for mitigating them, decide upon the capabilities needed to execute that strategy, appropriate the funds needed to procure those capabilities, and maintain a military that is trained and equipped to meet those threats to our security. By allowing the sequester to go into effect, our national leaders will have effectively ceded those responsibilities, leaving our nation without a viable defense strategy and overly vulnerable to circumstance.

Economic Policy Program | **National Security Program**
Economic Policy Project | *Foreign Policy Project*

Endnotes

1. *Restoring America's Future.* Bipartisan Policy Center. Nov. 2010. Available at http://bipartisanpolicy.org/sites/default/files/BPC%20FINAL%20REPORT%20FOR%20PRINTER%2002%2028%2011.pdf *The Moment of Truth: Report Of The National Commission on Fiscal Responsibility and Reform.* The National Commission on Fiscal Responsibility and Reform. Dec. 2010. Available at http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf
2. Carden, Army Sgt. 1st Class Michael J. "Debt Is Biggest Threat to National Security, Chairman Says." *U.S. Department of Defense*, American Forces Press Service, 22 September 2011, http://www.defense.gov/news/newsarticle.aspx?id=65432
3. There is a significant amount of spending that occurs through the tax code in the form of provisions that are commonly referred to as tax expenditures. Special preferences of this type have been established for policies ranging from home ownership, to energy development, to retirement accounts, often in lieu of conventional spending programs. Each of these preferences reduces the revenue that the government would otherwise collect from individuals and corporations through the federal income tax. We strongly believe that tax expenditures must receive the same congressional oversight that is given to other forms of spending, and they should be included in any comprehensive and reasonable depiction of the federal budget.
4. *Budget Control Act of 2011.* Public Law 112-25. 2011. Available at http://www.gpo.gov/fdsys/pkg/PLAW-112publ25/pdf/PLAW-112publ25.pdf
5. Lynch, Megan. *Statutory Budget Controls in Effect Between 1985 and 2002, R41901*. Congressional Research Service. Washington DC: Library of Congress. 1 July 2011 (p.3). Available at http://www.fas.org/sgp/crs/misc/R41901.pdf
   Oral and written testimony of the Honorable Phil Gramm, former member of the House of Representatives from 1979-1985 and U.S. Senator from 1985-2002, before the Senate Finance Committee at the hearing on Budget Enforcement Mechanisms. 4 May 2011. Available at http://finance.senate.gov/hearings/hearing/?id=f47f0466-5056-a032-526c-15196aea18d1
6. For an explanation of why the sequester will not, in fact, achieve $1.2 trillion in deficit reduction over the decade, see "Three Reasons Why $1.2 Trillion Isn't Really $1.2 Trillion." Available at http://bipartisanpolicy.org/blog/2012/01/three-reasons-why-12-trillion-isn%E2%80%99t-really-12-trillion
7. Even though most of the federal budget consists of spending on domestic programs, many of the large mandatory ones would be safeguarded from the sequester. The specified exemptions include Social Security, federal (including military) retirement programs, veteran's benefits, Medicaid, and a host of other programs (mostly those benefitting individuals with low incomes). Furthermore, while Medicare would be subject to the sequester in the form of provider payment cuts, those cuts could not exceed two percent. The result is that, not entirely unlike defense, a significant majority of the domestic cuts will come from reductions to annually appropriated spending. For more detail on exemptions, see Section 11 of the *Statutory Pay-as-You-Go Act of 2010* available at http://cardoza.house.gov/uploads/PAYGO.pdf
   A clean list of sequester exemptions is also available at http://www.law.cornell.edu/uscode/html/uscode02/usc_sec_02_00000905----000-.html
8. The reason that we estimate a $39 billion cut to non-defense discretionary spending in FY 2013 from the sequester, rather than the $43 billion projected by CBO, is due to a peculiarity in the law with regard to the treatment of the Medicare cuts. As highlighted by CBO, the sequester of Medicare does not begin until February 1, 2013, and therefore the 2 percent cut to providers and MA plans achieves less savings than if it was in effect for the entire fiscal year. Due to a provision in the Statutory Pay-As-You-Go Act of 2010 that the BCA references, however, the amount cut from Medicare over a full 12-month period beginning in February counts toward reaching the $55 billion that must be sequestered from non-defense programs in FY 2013. Therefore, the actual cut to non-defense discretionary spending will be roughly $4 billion less than estimated by CBO.
9. This figure is the BCA cap for discretionary spending under function 050 of the federal budget, which includes other defense-related activities (such as Department of Energy nuclear spending) in addition to the base defense budget.
10. Several of our assumptions, including the exemption of Military Personnel accounts and Overseas Contingency Operations (OCO) from the sequester, assume actions taken by the President or the Congress to exempt spending categories that otherwise would be subject to the sequester. In particular, if OCO remains subject to the sequester (as the Office of Management and Budget has stated that it currently is), the percentage cut to defense programs would be reduced from 15 percent to 11 percent. Under that scenario, however, policymakers would run the risk of being unable adequately fund our troops in harm's way in Afghanistan.
11. United States General Accounting Office, *GAO/OCG-86-2 Compliance Report for FY 1986*, 31 March 1986 (p. 1). Available at http://www.gao.gov/assets/210/208294.pdf
12. Or, if unspecified, how OMB interprets the PPAs for those accounts.
13. Letter to The Honorable John McCain and The Honorable Lindsey O. Graham, November 2011, Armed Services Committee, from the U.S. Secretary of Defense Leon Panetta. 14 Nov. 2011 (enclosure p. 1). Available at http://armedservices.house.gov/index.cfm/files/serve?File_id=ae72f319-e34f-4f78-8c88-b8e7c9dee61f
14. U.S. Office of Personnel Management. "*Summary of Reduction in Force Under OPM's Regulations,*" The Employee's Guide to Reduction in Force Under OPM's Regulations, Available at http://www.opm.gov/rif/general/rifguide.asp
15. U.S. House of Representatives. "Division D- Department of Homeland Security Appropriations Act, 2012." Committee on Rules Report (p.0554). Available at http://rules.house.gov/Media/file/PDF_112_1/legislativetext/HR2055crSOM/psConference%20Div%20D%20-%20SOM%20OCR.pdf
16. There are two conventional means (i.e., they have been used for many years and are not applicable solely due to the sequester) by which departments have some capability to redistribute the pain. The first is titled "reprogramming" and is defined by the Government Accountability Office (GAO) as "shifting funds *within* an appropriation or fund account to use them for purposes other than those contemplated at the time of appropriation" [emphasis added]. This procedure occurs on a routine basis, and the request does not need to pass both houses of Congress; it merely needs signatures of approval from chairmen of the relevant congressional committees.
    The second avenue is called "transfer authority" because it allows a limited amount of funds to be transferred across budget accounts. This authority and the particular amounts are granted by Congress in Appropriations Acts and allow departments some flexibility in carrying out the instructions of Congress. DoD is normally allocated the most transfer authority out of all federal agencies.
    For more information on these maneuvers, see pp. 85 and 97 of this GAO report available at http://www.gao.gov/new.items/d05734sp.pdf
17. U.S. Department of Defense. *Sustaining U.S. Global Leadership: Priorities for 21st Century Defense.* Jan. 2012 (p. 2). Available at http://www.defense.gov/news/Defense_Strategic_Guidance.pdf
18. Secretary of Defense Leon E. Panetta. "Shangri-La Security Dialogue." US Department of Defense, 2 June 2012. Available at http://www.defense.gov/speeches/speech.aspx?speechid=1681

19. "Employment Situation Summary," *U.S. Bureau of Labor Statistics*, United States Department of Labor, 20 July 2012. Available at http://www.bls.gov/news.release/empsit.nr0.htm
20. This is not an official CBO estimate. Rather, this estimate is based off of their published economic multipliers, which detail projections of how much economic growth is caused and how many jobs are created by different policies. See *Policies for Increasing Economic Growth and Employment in 2012 and 2013* available at http://cbo.gov/sites/default/files/cbofiles/attachments/11-15-Outlook_Stimulus_Testimony.pdf
    Also, Estimated Impact of the America Recovery and Reinvestment Act on Employment and Economic Output from October 2011 Through December 2011. Available at http://cbo.gov/sites/default/files/cbofiles/attachments/02-22-ARRA.pdf
21. Congressional Budget Office. *Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013*. March 2012 (p.6). Available at http://cbo.gov/sites/default/files/cbofiles/attachments/FiscalRestraint_0.pdf
22. CBO's Alternative Fiscal Scenario incorporates the assumptions that: expiring tax provisions (other than the payroll tax reduction) are extended; the AMT is indexed for inflation after 2011; Medicare's physician payment rates are maintained at their current level; and the sequester does not occur. For more information, see *Updated Budget Projections: Fiscal Years 2012-2022* (p. 3) Available at http://www.cbo.gov/sites/default/files/cbofiles/attachments/March2012Baseline.pdf
23. Spending cuts hurt jobs and growth in the near term when the economy is depressed and interest rates are at the zero bound. It should be noted, however, that CBO estimates that the effect on growth becomes positive after a few years, largely due to the size of our debt burden and crowding out of private saving and investment.
24. Gordon, Daniel. "Federal Government Contract Law." Personal interview. 1 May 2012.
    Daniel Gordon is the Associate Dean for Government Procurement Law at the George Washington University Law School, who spent many years working at the GAO.
25. Censer, Marjorie. "Booz Allen Cautious on Hiring." *WashingtonPost.com*. The Washington Post, 3 June 2012. Available at http://www.washingtonpost.com/business/capitalbusiness/following-layoffs-booz-allen-takes-cautious-approach-to-hiring/2012/06/01/gJQAp5O7BV_story.html
26. Congressional Budget Office. *Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013*. May 2012. Available at http://www.cbo.gov/sites/default/files/cbofiles/attachments/FiscalRestraint_0.pdf
27. Ratnam, Gopal. "U.S. Defense Companies Look Abroad as Pentagon Budget Slows." *Bloomberg Businessweek*, 3 February 2012. Available at http://www.businessweek.com/news/2012-02-03/u-s-defense-companies-look-abroad-as-pentagon-budget-slows.html
28. "Countdown to Federal Budget Sequestration: What You Need to Know." Arent Fox, 2 May 2012. Available at http://www.arentfox.com/publications/index.cfm?fa=legalUpdateDisp
29. Montgomery, Lori, and Rosalind S. Helderman. "Taxmageddon Sparks Rising Anxiety." *WashingtonPost.com*. The Washington Post, 15 May 2012. Available at http://www.washingtonpost.com/business/economy/taxmageddon-sparks-rising-anxiety/2012/05/14/gIQAUxAAQU_story.html
    Also, "Highlights: Bernanke's Q&A Testimony to House Panel." *Reuters.com*. Reuters, 29 Feb. 2012. Available at http://www.reuters.com/article/2012/02/29/us-usa-fed-bernanke-idUSTRE81S1DO20120229

Founded in 2007 by former Senate Majority Leaders Howard Baker, Tom Daschle, Bob Dole and George Mitchell, the Bipartisan Policy Center (BPC) is a non-profit organization that drives principled solutions through rigorous analysis, reasoned negotiation and respectful dialogue. With projects in multiple issue areas, BPC combines politically balanced policymaking with strong, proactive advocacy and outreach.

BIPARTISAN POLICY CENTER

1225 Eye Street NW, Suite 1000
Washington, DC 20005
(202) 204-2400

WWW.BIPARTISANPOLICY.ORG