The Budget Control Act of 2011: Effects on Spending Levels and the Budget Deficit

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Summary

The Budget Control Act of 2011 (BCA) was signed into law by President Obama on August 2, 2011 (P.L. 112-25). In addition to increasing the debt limit, the BCA contained a variety of measures intended to reduce the deficit by at least $2.1 trillion over the FY2012-FY2021 period, including statutory caps on discretionary spending and the establishment of a Joint Select Committee on Deficit Reduction to identify further budgetary savings of at least $1.2 trillion over 10 years.

The BCA discretionary spending caps are projected to result in $917 billion in deficit reduction over the FY2012-FY2021 period. Several adjustments to the caps are permitted, including for spending on Overseas Contingency Operations and emergencies. The precise programmatic impact of these reductions in discretionary spending will be determined in the annual appropriations process. Under the Congressional Budget Office's (CBO's) August 2011 baseline, which incorporates the effects of the BCA, the discretionary spending caps result in a decline in spending in nominal dollar terms. Discretionary spending has fallen in nominal terms only three times since FY1962, most recently in FY1996. Discretionary spending under the caps is projected to decline from 9.0% of GDP in FY2011 to 6.2% of gross domestic product (GDP) in FY2021. Since FY1962, the first year for which data are available, discretionary spending has only been that low in one other year (FY1999).

Beyond the BCA's deficit reduction achieved via the discretionary spending caps, the Joint Committee was created to find an additional $1.2 trillion in deficit reduction by January 15, 2012. If the Joint Committee cannot agree to deficit reduction legislation or it is not enacted, then an automatic spending reduction process would be triggered beginning in FY2013. The automatic reduction would be divided evenly between defense and non-defense spending. CBO estimates that if no Joint Committee legislation is enacted, the automatic reduction in spending for non-exempt accounts in FY2013 would be 10% for defense, 2% for Medicare, and 7.8% for other mandatory and non-defense discretionary, resulting in further deficit reduction of $1.1 trillion between FY2013 and FY2021. Any cuts to discretionary spending through the automatic reduction would be in addition to those resulting from the discretionary spending caps.

While the BCA is projected to reduce the deficit, it does not eliminate budget deficits or growth in the federal debt over the 10-year budget window. Using the CBO current law baseline (where a series of tax cuts are assumed to expire and controls on Medicare payments to doctors are allowed to take effect), budget deficits are estimated to total $3.5 trillion and the federal debt is projected to increase by $4.3 trillion over the next 10 years. Under what some call a more realistic baseline (where a series of tax cuts are extended and controls on Medicare payments to doctors are not allowed to take effect), deficits over the next 10 years total $8.5 trillion and the debt would continue to rise faster than GDP. Since the debt cannot perpetually rise faster than GDP, additional spending cuts or revenue increases would eventually be needed.

Since deficit reduction under the BCA's discretionary caps is relatively small in FY2012, the short-term effects on the economy should be limited. Were Congress to enact a Joint Committee plan that reduced the deficit significantly in FY2012, this would increase the BCA's contractionary effects on the economy. In the long run, economic theory suggests that large deficits would have negative effects on interest rates, investment spending, trade deficits, and GDP.

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Following a lengthy debate over raising the debt limit, the Budget Control Act of 2011 (BCA; P.L. 112-25) was signed into law by President Obama on August 2, 2011.[1] In addition to including a mechanism to increase the debt limit, the BCA contained a variety of measures intended to reduce the deficit, including caps on discretionary spending and the establishment of a Joint Select Committee on Deficit Reduction (Joint Committee) to identify further budgetary savings.[2]

According to estimates by the Congressional Budget Office (CBO), the BCA will reduce discretionary spending by $741 billion over the FY2012-FY2021 period, achieved via savings of $756 billion as a result of caps on discretionary spending and $15 billion in increased program integrity spending. Further reductions are achieved in mandatory spending through $16 billion in savings from program integrity initiatives (if the maximum allowable adjustment is subsequently provided) and $5 billion from student loan programs (through higher Pell grant spending and eliminating certain subsidies and incentives for Stafford loans) over 10 years.[3] In addition, all of these changes will lower future debt service costs by $156 billion over 10 years for total spending reductions of $917 billion over the FY2012-FY2021 period. The CBO score also contained a placeholder for further deficit reduction of $1.2 trillion for the savings to be achieved through legislation enacted as a result of the work of the Joint Committee or through an automatic spending reduction process. Together, these savings were estimated by CBO to total $2.1 trillion over the FY2012-FY2021 period.[4]

The BCA was enacted in response to congressional concern about unsustainable growth in the federal debt and deficit. The federal budget has been in deficit (spending exceeding revenue) since FY2002, but became significantly larger in FY2009. That year, the deficit topped $1 trillion for the first time ever, and it is estimated to remain above $1 trillion in FY2011.[5] Relative to the overall size of the economy, budget deficits from FY2009 to FY2011 have been significantly larger than in any other year since World War II. From FY1946 to FY2008, budget deficits averaged 1.7% of gross domestic product (GDP) and exceeded 5% of GDP only three times

[1] For an overview of changes to the debt limit in the Budget Control Act, see CRS Report RL31967, *The Debt Limit: History and Recent Increases*, by D. Andrew Austin and Mindy R. Levit.

[2] For an overview of the Budget Control Act, see CRS Report R41965, *The Budget Control Act of 2011*, by Bill Heniff Jr., Elizabeth Rybicki, and Shannon M. Mahan.

[3] Student loan provisions of the BCA are analyzed in CRS Report R41965, *The Budget Control Act of 2011*, by Bill Heniff Jr., Elizabeth Rybicki, and Shannon M. Mahan. For more information on student loan programs, see CRS Report R40122, *Federal Student Loans Made Under the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program: Terms and Conditions for Borrowers*, by David P. Smole and CRS Report R41437, *Federal Pell Grant Program of the Higher Education Act: Background, Recent Changes, and Current Legislative Issues*, by Shannon M. Mahan.

[4] These savings are measured relative to the March 2011 Adjusted Baseline as detailed in Congressional Budget Office, CBO Analysis of August 1 Budget Control Act Letter to the Honorable John Boehner and the Honorable Harry Reid, August 1, 2011, Table 3, available at http://www.cbo.gov/ftpdocs/123xx/doc12357/BudgetControlActAug1.pdf. For details on the effects of specific provisions of the BCA on the deficit, see **Table 6**.

[5] All budget data presented in this report are from Congressional Budget Office, *The Budget and Economic Outlook: An Update*, August 2011 (hereinafter referred to as "CBO baseline"), *Preliminary Analysis of the President's Budget for FY2012,* March 2011 and *The Budget and Economic Outlook: Fiscal Years 2011 to 2021*, January 2011, or Office of Management and Budget, *FY2012 Budget of the U.S. Government*, February 2011. The budget deficit is the excess of outlays over revenues in a given year, broadly similar to the amount borrowed from the public that year. The debt held by the public is the accumulation of all past borrowing from the public. The gross debt is the debt held by the public and the intragovernmental debt (the debt that one part of the federal government owes to another part of the government, mainly government trust funds). For background information on the debt and deficit, see CRS Report WKS0001_Overview, *Federal Debt and Deficit: Key Sources*, by Justin Murray.

(7.2% in FY1946, 6.0% in FY1983, and 5.1% of GDP in FY1985). From FY2009 to FY2011, budget deficits will average roughly 9.4% of GDP. The federal debt held by the public has grown from 40% of GDP in FY2008 to an estimated 69% of GDP in FY2011. The recent growth in deficits is the result of spending reaching its highest level as a share of GDP since FY1945 and revenues reaching their lowest level as a share of GDP since FY1950. This has occurred largely due to the budgetary effects of the recent recession and policies implemented in response to it.[6]

This report focuses on how the BCA will affect spending and the budget deficit through the "first round" effects, related to discretionary spending caps and student loan provisions, and the "second round" effects of additional deficit reduction, related to the work of the Joint Committee. The report also examines short and long run effects of deficit reduction on the economy. The **Appendix** compares the BCA to past deficit-reduction legislation.

Statutory Limits on Discretionary Spending

The BCA sets in statute specific discretionary spending caps on new budget authority between FY2012 and FY2021.[7] Upward revisions to the caps are permitted for purposes of future legislation providing spending designated as "emergency," Overseas Contingency Operations (OCO), program integrity initiatives to curb fraud and abuse in Social Security and federal health programs, and disaster relief.[8] Revisions to the caps for program integrity initiatives are limited to $15 billion over 10 years. Disaster relief funding (defined by the BCA as activities carried out under section 102(2) of the Stafford Act[9]) likewise cannot exceed the average funding provided for disaster relief over the 10 previous fiscal years, excluding the highest and lowest funding years. The levels of emergency and OCO spending are not limited by the BCA.[10] Exempting emergency spending from the caps offers flexibility to future Congresses to respond to unforeseen circumstances, but it also offers a potential avenue for future Congresses to diminish the spending reductions intended by the BCA. Although the BCA allowed for certain policy related adjustments to the caps, the legislation did not allow for any economic adjustments, specifically if inflation turns out to be higher or lower than expected. This means that a higher (lower) than expected rate of inflation would reduce (increase) the purchasing power of discretionary spending permitted under the caps. The BCA did not place similar caps on mandatory spending, which amounted to 55% of total spending in FY2010.

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[6] For an overview of causes of large deficits and policy options to reduce them, see CRS Report R41778, *Reducing the Budget Deficit: Policy Issues*, by Marc Labonte and CRS Report R41685, *The Federal Budget: Issues for FY2011, FY2012, and Beyond*, by Mindy R. Levit.

[7] Appropriations acts provide new budget authority. The budget deficit represents the level of spending, as measured by outlays, in excess of revenues. The outlays for a fiscal year result from the budget authority provided in that fiscal year as well as some budget authority provided in previous fiscal years. Included in the outlay level are all types of spending (i.e., emergency, non-emergency, overseas contingency operations) occurring during the fiscal year.

[8] Revisions are also permitted to be made once a year by the Office of Management and Budget (OMB), which can adjust the discretionary caps to reflect changes in budget concepts and definitions in consultation with the Committees on Appropriations and Budget.

[9] For more information, see CRS Report RL33053, *Federal Stafford Act Disaster Assistance: Presidential Declarations, Eligible Activities, and Funding*, by Francis X. McCarthy.

[10] Section 101 of the BCA defines emergency spending to be spending that "the Congress designates as emergency requirements in statute on an account by account basis and the President subsequently so designates." Section 101 of the BCA also defines Overseas Contingency Operations as spending that "the Congress designates for Overseas Contingency Operations/Global War on Terrorism in statute on an account by account basis and the President subsequently so designates."

Between FY2012 and FY2013, there are specific caps on new budget authority for the categories of security and non-security spending. For purposes of the discretionary caps, security spending is defined by the BCA as discretionary appropriations associated with agency budgets for the Departments of Defense, Homeland Security, Veterans Affairs, the National Nuclear Security Administration, the intelligence community management account, and all budget accounts in the budget function for international affairs (Function 150).[11] Non-security spending comprises the portion of discretionary spending outside the security category. The largest amounts of spending in the non-security category are tied to the Departments of Health and Human Services, Education, and Housing and Urban Development. In FY2014 and beyond, one cap covers overall discretionary spending.[12]

Outside of the separate caps on security and non-security spending in FY2012 and FY2013, the BCA does not otherwise restrict spending for specific appropriation subcommittees, budget accounts, or functional categories. The Obama Administration stated that the caps would cut approximately $420 billion in security spending over 10 years. Further,

> Assuming roughly proportional cuts, we project that of that $420 billion, $350 billion would be from the budget category of defense, and approximately $330 billion of that would be specifically from the Department of Defense. In sum, this agreement would be consistent with the President's goal for security and Department of Defense savings as laid out in his fiscal framework in April.[13]

However, the BCA does not specify how spending will be allocated across appropriations bills, and which specific programs will be cut to achieve the required savings under the caps, particularly beyond FY2014. This authority is reserved for Congress. If the appropriations process does not result in spending levels that adhere to the cap levels and the cap levels are breached, the BCA stipulates automatic cuts to non-exempt discretionary programs through a sequestration process. Actual total discretionary spending levels over the next 10 years will be determined partly by future Congress's commitment to adhering to the caps and partly by the level at which spending occurs in categories excluded from the caps, such as OCO or emergency spending.[14]

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[11] The security/non-security division of discretionary spending was first used by President George W. Bush and was continued under the Obama Administration. However, the Obama Administration changed the definition of security spending. The definition used by the Obama mirrors the definition used in the BCA, though it does not include the intelligence community management account, which totaled approximately $700 million in discretionary budget authority FY2010. CBO has not regularly reported discretionary spending in terms of security and non-security spending. For more information, see CRS Report RL34424, *Trends in Discretionary Spending*, by D. Andrew Austin and Mindy R. Levit.

[12] Upward revisions to the discretionary spending caps in FY2014 and beyond are also permitted as discussed above. If further deficit reduction legislation tied to the work of Joint Committee (as discussed later in the report) is not enacted or, if enacted, does not reduce the deficit by at least $1.2 trillion, and an automatic spending reduction takes place as a result, spending is categorized into defense and non-defense groupings from FY2014 onward, rather than the security/non-security split discussed here.

[13] U.S. Office of Management and Budget, Security Spending in the Deficit Agreement, OMBlog, August 4, 2011, available at http://www.whitehouse.gov/blog/2011/08/04/security-spending-deficit-agreement.

[14] Emergency spending received a similar exemption from discretionary spending caps in earlier deficit reduction legislation, and after remaining relatively low in the first eight years that this legislation was in effect, emergency budget authority averaged $38.5 billion per year from 1999 to 2002. U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2003 to 2013*, January 2003, Table A-2.

What Happens to Discretionary Spending Under the BCA Relative to Historical Trends?

The BCA was enacted after a period of rapid growth in discretionary spending. (Mandatory spending had also grown and revenue had fallen rapidly relative to GDP over that period.) Between FY2000 and FY2009, discretionary spending rose by 8.0% per year, on average. Discretionary spending rose by 8.9% in FY2010.[15] Increases in discretionary spending since FY2000 can be attributed primarily to a rise in defense spending throughout the decade, and an increase in spending as a result of economic stimulus programs since 2009.[16] The discretionary funding in the economic stimulus programs was designed such that most discretionary outlays under the act will occur by FY2012.

Below, **Table 1** summarizes the discretionary outlay levels in CBO's August 2011 baseline, which incorporate the BCA discretionary spending caps as well as baseline OCO levels and other small adjustments to provide a projection of total discretionary spending.[17] These levels are shown in nominal and real (adjusted for inflation) dollars. Since some categories of discretionary spending are exempt from the caps, total discretionary spending over the next 10 years is unlikely to match the cap levels. Under the August 2011 baseline, discretionary spending in nominal dollars (real dollars) declines by 2.8% (4.0%) in FY2012 and 1.1% (2.4%) in FY2013, but increases (decreases) annually by 1.5% (0.3%), on average, for the rest of the 10-year budget window.

[15] U.S. Congressional Budget Office, *The Budget and Economic Outlook: An Update*, August 2011, p. 17.

[16] For more information, see CRS Report RL34424, *Trends in Discretionary Spending*, by D. Andrew Austin and Mindy R. Levit.

[17] Because the level of OCO funding was not specified in the BCA, the current CBO baseline maintains OCO funding at FY2011 levels in inflation-adjusted terms. As a result, current baseline levels are likely to differ from actual spending levels since OCO spending is not anticipated to remain equal to FY2011 real levels for the next 10 years. The August 2011 baseline does not include spending permitted under the BCA on disasters, emergency, or program integrity initiatives.

Table 1. Discretionary Spending Levels and BCA Caps

(Outlays in billions of dollars, unless noted, and as a percentage of GDP)

	2008 Actual	2011 Actual	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
BCA Spending Caps, Nominal Dollars	n/a	n/a	$1,241	$1,170	$1,148	$1,149	$1,164	$1,179	$1,196	$1,226	$1,252	$1,278
BCA Spending Caps, Real 2011 Dollars	n/a	n/a	$1,226	$1,141	$1,104	$1,089	$1,085	$1,078	$1,072	$1,078	$1,079	$1,080
Total Discretionary, Nominal Dollars	$1,135	$1,353	$1,315	$1,300	$1,301	$1,311	$1,332	$1,350	$1,370	$1,404	$1,434	$1,464
Yr-Yr, Percent Change			-2.8%	-1.1%	0.1%	0.8%	1.6%	1.4%	1.5%	2.5%	2.1%	2.1%
Per Capita (dollars)		$4,319	$4,158	$4,071	$4,035	$4,027	$4,053	$4,068	$4,089	$4,152	$4,201	$4,249
Total Discretionary, Real 2011 Dollars	$1,174	$1,353	$1,299	$1,268	$1,252	$1,243	$1,241	$1,235	$1,228	$1,234	$1,236	$1,237
Yr-Yr, Percent Change			-4.0%	-2.4%	-1.3%	-0.7%	-0.2%	-0.5%	-0.6%	0.5%	0.2%	0.1%
Per Capita (dollars)		$4,319	$4,107	$3,971	$3,883	$3,818	$3,776	$3,722	$3,666	$3,649	$3,621	$3,590
Total Discretionary, Percent of GDP	7.9%	9.0%	8.4%	8.0%	7.7%	7.2%	7.0%	6.7%	6.5%	6.4%	6.3%	6.1%

Source: CRS calculations based on Congressional Budget Office, *CBO Analysis of August 1 Budget Control Act*, Letter to the Honorable John Boehner and the Honorable Harry Reid, August 1, 2011; Congressional Budget Office, *Budget and Economic Outlook: An Update*, August 2011; U.S. Census Bureau, *Projections of the Population and Components of Change for the United States: 2010 to 2050*.

Notes: Spending caps adjusted for inflation using GDP deflator (FY basis). The August 2011 baseline discretionary spending levels are current law, including the spending caps, OCO, and other adjustments. Baseline spending is higher than the cap levels because of the inclusion of current OCO levels and other adjustments.

Examining levels of discretionary spending going forward may not provide the full picture of changes over time. Between FY2008 and FY2011, total discretionary spending rose from $1,135 billion to $1,353 billion in nominal terms. In nominal terms, total discretionary spending between FY2012 and FY2021 would be above FY2008 levels even if all spending not limited by the caps (such as OCO spending) were zero. Total discretionary spending under the baseline would also be below FY2011 levels until FY2018, in nominal terms. Since FY1962, the first year for which data are available, discretionary spending has fallen in nominal terms only three times, most recently in FY1996. In each case, the previous spending level was surpassed in the following year. If a drawdown of troops occurs as proposed in certain overseas operations, future spending levels will be lower than the baseline levels, absent any other policy changes. Alternatively, if future OCO funding exceeds the levels assumed in the baseline or if there is rapid growth in spending not subject to the caps (such as emergency spending), the overall level of discretionary spending could exceed the level in the baseline over the next 10 years, absent other policy changes.

However, a comparison of nominal spending levels over time arguably understates the effects of the discretionary caps on policy for a number of reasons. First, projected inflation over the next 10 years means that a dollar will have less purchasing power in 2021 than it does today. The BCA's nominal discretionary caps do not account for inflation so the declines in spending are larger when converted to real terms (see **Table 1**). If actual inflation turns out to be higher (lower) than projected, real spending cuts will be greater (smaller).

Relative to FY2011, projected spending under the caps in real (inflation-adjusted) terms falls each year until FY2017, and then stays roughly constant. In real terms, total discretionary spending under the baseline, which includes the spending caps and current real levels of OCO, will remain above its FY2008 level but never regain its FY2011 level over the next 10 years.[18] Since FY1997, discretionary spending has only fallen in real terms in one year (FY2007). Since FY1962, there were only two periods where real discretionary spending fell for several years in a row–FY1969-FY1974 and FY1992-FY1996. In the FY1969-FY1974 period, sustained high inflation masked (in real terms) relatively large annual nominal increases. Between FY1992 and FY1996, discretionary spending caps were included as part of the Omnibus Budget and Reconciliation Acts of 1990 and 1993, which contributed to lower overall discretionary spending during that period.

The second reason why the growth in nominal spending levels may understate the effects of the discretionary spending caps is that the population of the United States is projected to rise over the next 10 years. Therefore, the caps will lead to lower discretionary spending per capita than nominal growth rates would indicate for certain functional categories, such as education, training, housing assistance, or health. For these categories, per capita spending would arguably give a better sense of the potential impact of the caps on services than overall spending because it indicates the change in benefits or services available to each individual. However, it remains unknown how any specific program will be impacted by the discretionary spending caps.

As shown in **Table 1**, per capita discretionary spending in nominal terms decreases by 0.2% per year, on average, over the FY2012-FY2021 period. Throughout this period, discretionary spending per capita never regains its FY2011 level and falls from $4,319 in FY2011 to $4,249 in

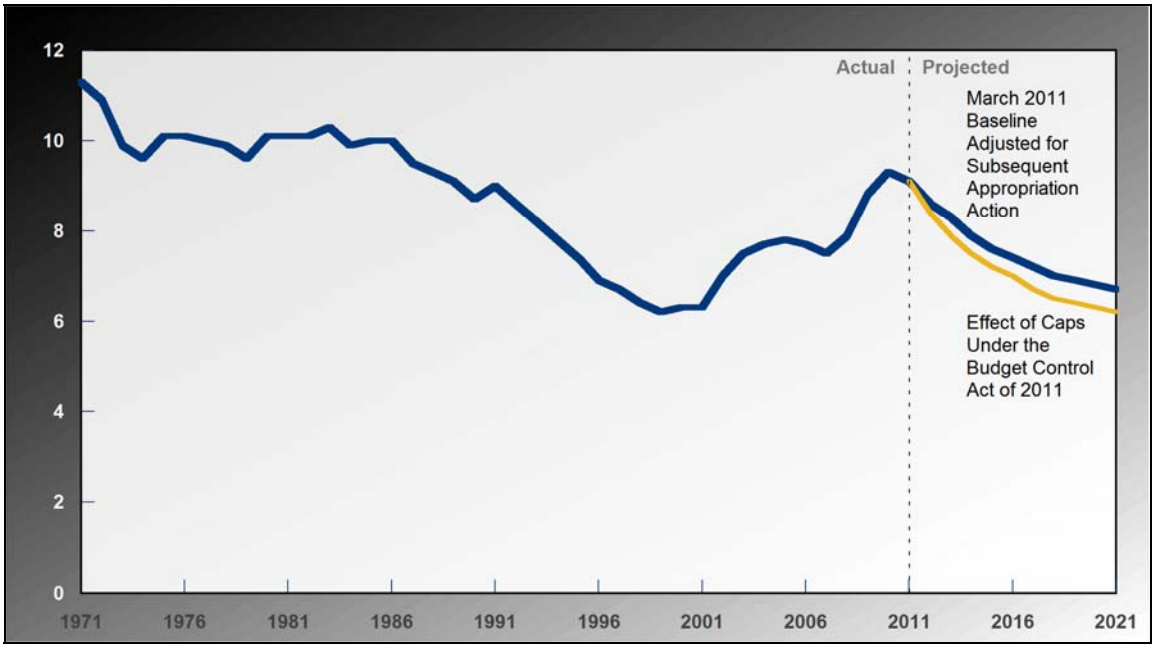
[18] If spending outside the caps, notably OCO spending, were very low, then total discretionary spending in real terms would remain below FY2008 levels for the next 10 years.

FY2021. After adjusting for inflation and population growth, per capita discretionary spending declines by 1.8% annually, on average, from $4,319 in FY2011 to $3,590 in FY2021.

Finally, the cuts in discretionary spending over the next 10 years would be much larger if discretionary spending is measured as a share of GDP, or relative to the size of the economy. As a percentage of GDP, discretionary spending in FY2008 stood at 7.9%, rising to 9.0% in FY2011.[19] As a percentage of GDP, discretionary spending falls below the FY2008 level in FY2014 and remains below it through FY2021. By FY2021, discretionary spending as a percentage of GDP would be at its lowest level since FY1999.

In the last decade, discretionary spending grew rapidly relative to GDP, taking it back to pre-1990s levels. **Figure 1** illustrates that discretionary spending under the caps is projected to decline from 9% of GDP in FY2011 to 6.2% of GDP in FY2021, assuming that OCO outlays (which are not subject to the cap) remain at FY2011 levels in real terms. This would reverse the preceding growth in discretionary spending, taking discretionary spending back down to the historically low levels that prevailed in the late 1990s. Since FY1962, the first year for which data are available, discretionary spending has only been as low as 6.2% of GDP in one other year (FY1999), when OCO spending was nearly zero. If OCO spending declines sufficiently relative to FY2011 levels, at some point during the projection period, discretionary spending would reach its lowest share of GDP ever.

Figure 1. Discretionary Spending as a Percentage of GDP, 1971-2021



Source: Congressional Budget Office Director's Blog, *Discretionary Spending Under the Budget Control Act of 2011*, August 8, 2011.

Notes: For illustrative purposes, the figure assumes that discretionary outlays will be equal to the BCA cap amount plus $160 billion to $190 billion each year for overseas contingency operations (which are not subject to the cap).

[19] Discretionary spending as a percentage of GDP peaked in FY2010 at 9.3%.

Most of the decline in discretionary spending as a percentage of GDP was projected to have occurred in the baseline anyway, even in the absence of the BCA caps, due to the baseline assumption that discretionary spending in future years grows at the rate of inflation, which is less than the growth in nominal GDP. Thus, the BCA spending caps represent a reduction in discretionary spending that is in addition to the reductions shown in the current law baseline, which would have already shown a significant drop in discretionary spending relative to its current share of GDP. Compared to a baseline where discretionary spending grew at the same rate as GDP, the reduction in discretionary spending as a result of the BCA caps would be greater than in the CBO score.

If discretionary spending is cut further through the second round of BCA cuts (either through the adoption of the Joint Committee's deficit reduction legislation or through an automatic spending reduction if legislation is not enacted to sufficiently reduce the deficit[20]), discretionary spending will be lower than the amounts shown in **Table 1**.

Comparing Discretionary Savings Relative to Other Measures

Baseline projections of spending, revenue, and the deficit are used as a benchmark to provide an indication of how new legislation, if enacted, would change the projected level relative to current law. For example, when a policy is enacted to cut spending in FY2012, the reduction is measured relative to the baseline projection of spending for FY2012, as opposed to the actual spending level for FY2011. Savings are generally not measured relative to previous year totals since, particularly for mandatory programs and revenue provisions, those levels can change from year to year with no change in law, while discretionary spending is generally subject to the enactment of annual appropriations.[21]

Baselines are used because decisions on the level of discretionary spending are made annually through the appropriations process and it is impossible to know what level of spending will be enacted from one future year to the next. For purposes of the baseline, CBO generally assumes that the level of discretionary spending in future years increases at the rate of inflation.[22] For example, the baseline assumes overseas contingency operations will remain at a constant inflation-adjusted level each year for 10 years. If discretionary spending actually increases at rates above inflation, which it has historically done, then the amount of discretionary spending above inflation is recorded as an increase to discretionary spending relative to the baseline. Other baselines would be equally valid conceptually, such as ones that freeze discretionary spending in nominal terms or as a percentage of GDP, but are not generally used to score the cost of legislation before Congress.

[20] See the section entitled "Additional Policy Changes Resulting from the Joint Select Committee on Deficit Reduction".

[21] For more information regarding baselines and how they are constructed, see CRS Report 98-560, *Baselines and Scorekeeping in the Federal Budget Process*, by Bill Heniff Jr. and CRS Report R41778, *Reducing the Budget Deficit: Policy Issues*, by Marc Labonte.

[22] As a result of the BCA, the new baseline discretionary spending levels are set as the discretionary spending caps created in the legislation, with modifications made for exempt categories such as overseas contingency operations. Going forward, the costs of future policy proposals will be evaluated against this new baseline. Prior to the enactment of the BCA, CBO utilized the baseline rules contained in Section 257 of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended (Title II of P.L. 99-177).

Compared to the adjusted March 2011 CBO baseline, which accounted for the final FY2011 enacted appropriations bills, the BCA makes relatively small cuts to outlays in FY2012. Discretionary spending cuts rise every year thereafter such that the reduction in outlays is nearly five times larger in nominal terms in FY2021, relative to FY2012. However, it is also possible to measure the impact of changes in spending relative to other measures. **Table 2** also provides comparisons to the January 2011 CBO baseline, the FY2012 House Budget Resolution (H.Con.Res. 34), and the President's FY2012 budget request. (For each comparison, OCO outlays are excluded.) The comparison to the January 2011 CBO baseline gives a rough estimate of the combined effects on discretionary spending of the final appropriations for FY2011 and the BCA. For that reason, the spending cuts relative to the January 2011 CBO baseline are somewhat larger than relative to the adjusted March 2011 CBO baseline.

The larger size of the spending cuts relative to President's budget is partly attributable to the final FY2011 appropriations and to the BCA. The President requested similar levels of discretionary spending, in terms of budget authority (excluding OCO), compared to the January 2011 CBO baseline levels between FY2012 and FY2016, and lower levels between FY2017 and FY2021. The BCA cap levels are lower than the President's request for each year. The House Budget Resolution (H.Con.Res. 34) called for lower spending levels than those imposed by the BCA caps each year. Thus, were the levels of spending called for in the House Budget Resolution to be enacted, spending would decline further than it would under the BCA.

What is a baseline?

Baselines provide a benchmark for comparing how proposed budget policy changes would affect existing policies. The calculation of a baseline can be instrumental to the evaluation of these policies. Conventional scoring procedures would measure a legislative proposal relative to CBO's official baseline, which is a current law baseline. In the current law baseline, CBO assumes that certain policies set to expire under current law will do so as scheduled.

However, changes in policy can also be measured relative to other proposals and baselines. Several of these alternative proposals and their effects are illustrated in **Table 2**. Other baselines, sometimes referred to as a *current policy* baseline, assume that certain popular policies are likely to be extended. Measuring proposals relative to this baseline are demonstrated in **Table 3**.

Table 2. Reductions in Discretionary Spending from the BCA Relative to Selected Alternatives

(Outlays in billions of dollars and as a percentage of GDP)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
BCA Discretionary Caps	$1,241	$1,170	$1,148	$1,149	$1,164	$1,179	$1,196	$1,226	$1,252	$1,278
Dollar Difference from:										
CBO January 2011 Baseline	-$33	-$60	-$76	-$84	-$93	-$101	-$110	-$118	-$126	-$134
CBO Adjusted March 2011 Baseline	-$25	-$47	-$59	-$67	-$74	-$81	-$89	-$97	-$104	-$112
House FY2012 Budget Resolution	$73	$56	$53	$60	$71	$81	$91	$99	$107	$110
President's FY2012 Budget[a]	-$73	-$91	-$92	-$89	-$95	-$95	-$98	-$100	-$107	-$101
Percent Difference from:										
CBO January 2011 Baseline	-2.6%	-4.9%	-6.2%	-6.8%	-7.4%	-7.9%	-8.4%	-8.8%	-9.1%	-9.5%
CBO Adjusted March 2011 Baseline	-2.0%	-3.9%	-4.9%	-5.5%	-6.0%	-6.4%	-6.9%	-7.3%	-7.7%	-8.1%
House FY2012 Budget Resolution	6.3%	5.0%	4.8%	5.5%	6.5%	7.4%	8.2%	8.8%	9.3%	9.4%
President's FY2012 Budget[a]	-6.6%	-8.0%	-7.9%	-7.6%	-7.9%	-7.8%	-7.8%	-7.8%	-8.1%	-7.6%

Source: CRS calculations based on U.S. Congressional Budget Office, CBO Analysis of August 1 Budget Control Act Letter to the Honorable John Boehner and the Honorable Harry Reid, August 1, 2011, Table 1; U.S. House of Representatives, Budget Committee, Path to Prosperity, Table S-3; Office of Management and Budget, Budget of the U.S. Government FY 2012, February 2011, Table S-11.

Notes: A negative change indicates a decrease from the comparison point (i.e., in FY2012, the CBO January 2011 Baseline level of discretionary spending was $33 billion higher than the FY2012 BCA discretionary cap level). A positive change indicates an increase from the comparison point. All comparisons omit OCO spending.

a. The President's Budget only provides a level of discretionary budget authority, not outlays, that excludes OCO. Therefore, the figures in the table showing the level of change in discretionary spending between the BCA discretionary caps and the President's Budget are in terms of terms of budget authority.

Additional Policy Changes Resulting from the Joint Select Committee on Deficit Reduction

In addition to the deficit reduction achieved through the statutory caps on discretionary spending discussed above, the BCA calls for the Joint Committee,[23] composed of 12 Members of Congress, to propose legislation that reduces the deficit by at least $1.5 trillion over 10 years, from FY2012-FY2021. If legislation reducing the deficit by at least $1.2 trillion over 10 years is not enacted, an automatic spending reduction process, which is discussed in the next section, goes into effect.

Whether or not the Joint Committee achieves the required level of deficit reduction depends on what baseline is used to measure the impact of their legislation. Conventional scoring procedures would measure the Joint Committee's deficit reduction proposal (or any legislative proposal) relative to CBO's official baseline, which is a current law baseline. In the current law baseline, CBO assumes that certain policies set to expire under current law will do so as scheduled.[24] For example, the baseline assumes that expiring tax provisions, such as the 2001/2003/2010 ("Bush") tax cuts that are set to expire at the end of calendar year 2012, will expire as scheduled. Other provisions, such as the indexing of the alternative minimum tax (AMT) to inflation and the "doc fix" that Congress has enacted annually to prevent significant cuts to Medicare physician payments, are also assumed to expire as scheduled.[25] Policy changes could potentially be measured under several other alternative assumptions. For example, **Table 3** illustrates how the extensions of "current policy" would change the deficit outlook relative to the current law baseline, by assuming that the tax cuts are extended, the AMT is indexed to inflation, and the doc fix is enacted. Under these assumptions, the budget deficit would be $4.6 trillion greater over the FY2012-FY2021 period than under the current law baseline.[26]

[23] The Committee's website can be accessed at http://deficitreduction.senate.gov/public/.

[24] Mandatory programs enacted on or before the date of enactment of the Balanced Budget Act of 1997 and with estimated outlays of greater than $50 million are assumed to continue in the current year and the outyears for purposes of the baseline.

[25] For more information on the "doc fix" and the cost of extending it, see CRS Report R40907, *Medicare Physician Payment Updates and the Sustainable Growth Rate (SGR) System*, by Jim Hahn.

[26] U.S. Congressional Budget Office, *The Budget and Economic Outlook: An Update*, August 2011, Table 1-8. Besides these changes, other modifications to the baseline to account for current policy are possible. Besides the AMT and tax cuts, extending other expiring tax provisions would add an additional $920 billion to the budget deficit over 10 years. The baseline could also have included disaster spending at current levels, adjusted for inflation.

Table 3. Current Law and Current Policy Baseline Deficit Projections

(billions of dollars)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	FY2012-FY2021
Current Law Baseline[a]	$973	$510	$265	$205	$278	$231	$211	$259	$277	$279	$3,487
+ Extend Tax Cuts and Index AMT to Inflation	$11	$241	$348	$402	$453	$510	$570	$633	$702	$778	$4,648
+ Extend Doc Fix	$12	$19	$24	$27	$32	$36	$41	$46	$53	$59	$349
= Current Policy Baseline	$996	$770	$637	$634	$763	$777	$822	$938	$1,032	$1,116	$8,485
Cost of Extending Tax Cuts and Indexing AMT Relative to Current **Law** Baseline	$11	$241	$348	$402	$453	$510	$570	$633	$702	$778	$4,648
Cost of Extending Tax Cuts and Indexing AMT Relative to Current **Policy** Baseline	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0

Source: CRS calculations based on Congressional Budget Office, *The Budget and Economic Outlook: An Update*, August 2011, Tables 1-1 and 1-8.

Note: AMT = alternative minimum tax

a. Includes the effects of the deficit reduction provisions of the Budget Control Act.

Any spending reduction or revenue increase could potentially count toward achieving the Joint Committee's deficit reduction goal, but certain policy options would yield much different budgetary effects depending what baseline they are measured against. For example, a proposal to extend the tax cuts when measured against the current law baseline would show a cost of $4.6 trillion over 10 years, whereas the same policy proposal would have no cost when measured relative to a "current policy" baseline. Further, relative to the current law baseline, any partial extension of the Bush tax cuts, AMT patch, and "doc fix" would count as increasing the deficit, even if these provisions were modified to yield more revenue/less spending than in their current form, because current law assumes they expire and have no budgetary cost in future years. Allowing any of these three policies to expire as scheduled would neither increase nor decrease the deficit relative to the current law baseline. Likewise, a proposal to reduce or end OCO spending would be counted as reducing the deficit against the current law baseline, since the August baseline includes current (inflation-adjusted) levels of OCO spending.

The Joint Committee appears to have discretion to decide whether or not to use the official CBO score for purposes of whether enough deficit reduction has been achieved to avoid the automatic spending reduction or reduce the automatic spending reduction amount. The BCA requires that the report accompanying the Joint Committee's legislation contains an official CBO score made under conventional scoring procedures, but for purposes of calculating the Joint Committee proposal's effects on the deficit, and thus the automatic spending reduction amount, Congress may choose other conventions. The BCA specifies that interest savings resulting from the proposal can count toward the total deficit reduction of the proposal.

Automatic Spending Reduction Process

As mentioned above, the BCA specifies that an automatic spending reduction process would be triggered if legislation from the Joint Committee reducing the deficit by at least $1.2 trillion is not enacted by January 15, 2012.[27] This process could be triggered as a result of the Joint Committee not proposing legislation, any legislation proposed by the Joint Committee not being enacted, or legislation being enacted that reduces the deficit by less than $1.2 trillion. Congress could also take future actions to repeal or amend the automatic spending reduction process.

The amount of the automatic spending reduction will be determined by how much deficit reduction results from the work of the Joint Committee. If no deficit reduction legislation is enacted, the amount required from the automatic spending reduction process will be $1.2 trillion. If a deficit reduction measure of less than $1.2 trillion is enacted, the amount required from the automatic spending reduction will be equal to $1.2 trillion less the amount of deficit reduction in the legislation. After the calculation of the amount of required deficit reduction, the BCA calls for 18% of that total to be credited to debt service savings that would result from the spending reduction.[28] Therefore, the amount of the automatic spending reduction would equal the remaining 82% of the required deficit reduction total.

[27] As discussed in the section "Effects of the BCA on the Budget Deficit," since the BCA's automatic spending reduction process specifies a specific reduction in budgetary resources, not outlays, CBO projects that a $1.2 trillion automatic spending reduction of budgetary resources would reduce the deficit by modestly less than $1.2 trillion over the budget window.

[28] The actual amount of debt service savings will depend on future interest rates and the timing of the deficit reduction; 18% was set by the BCA.

The automatic spending reduction process is meant to ensure that Congress takes action regarding the budget deficit in the event that legislation is not enacted as a result of the work of the Joint Committee. However, the automatic spending reduction process is not meant to ensure that a certain actual deficit or spending level is attained over time or that deficit saving accomplished by the automatic spending reduction is not undone by future legislation. The amount of automatic spending reduction does not change if future budget deficits turn out to be larger or smaller than projected at the time the automatic spending reduction is determined. Future budget deficits could turn out to be larger or smaller than projected because of subsequent legislative changes or because of forecasting errors, which have historically been large.[29]

The amount of the automatic spending reduction under the BCA is spread evenly over the nine years from FY2013 to FY2021 and applied to defense (defined as budget function 050) and non-defense spending categories and applied to discretionary and mandatory programs. For example, a $1.2 trillion automatic spending reduction would amount to $109.3 billion each year for nine years, with $54.7 billion of the reduction to be applied to defense and $54.7 billion applied to non-defense programs. Within the defense and non-defense categories, some programs are exempted from an automatic spending reduction and the cuts to other programs are limited by statute.[30] For example, an automatic spending reduction to Medicare is limited to 2% of total program spending.[31] While the annual amount of the total automatic spending reduction would not be revised in subsequent years, the amount applied to any given budget account could be recalculated, if the relative size of budget accounts changes or the exempt/non-exempt status of an account changes.

In FY2013, the automatic spending reduction is carried out through an across-the-board sequester (cancellation) of previously authorized budgetary resources. After the first year (FY2013), the automatic spending reduction is carried out through a sequester for mandatory spending and through reductions in the overall discretionary caps, rather than by automatic spending cuts, for discretionary spending. The sequester is applied proportionately to all non-exempt accounts, while it is left to future Congresses to determine how to apply the reductions to discretionary accounts within the caps. For purposes of the caps, the distinction between exempt and non-exempt discretionary accounts does not apply. Any cuts to discretionary programs as a result of the automatic spending reduction process would be in addition to the cuts resulting from the BCA discretionary caps.

Figure 2 shows the projected percentage of budgetary resources tied to each major programmatic area in FY2014, the first year for which the automatic spending reduction is carried out through revisions to the discretionary caps. Of total gross budgetary resources for FY2014, 51% are mandatory spending that is exempt from the automatic reduction. The other 49% of budgetary resources is subject to the automatic spending reduction process. The mandatory share of non-

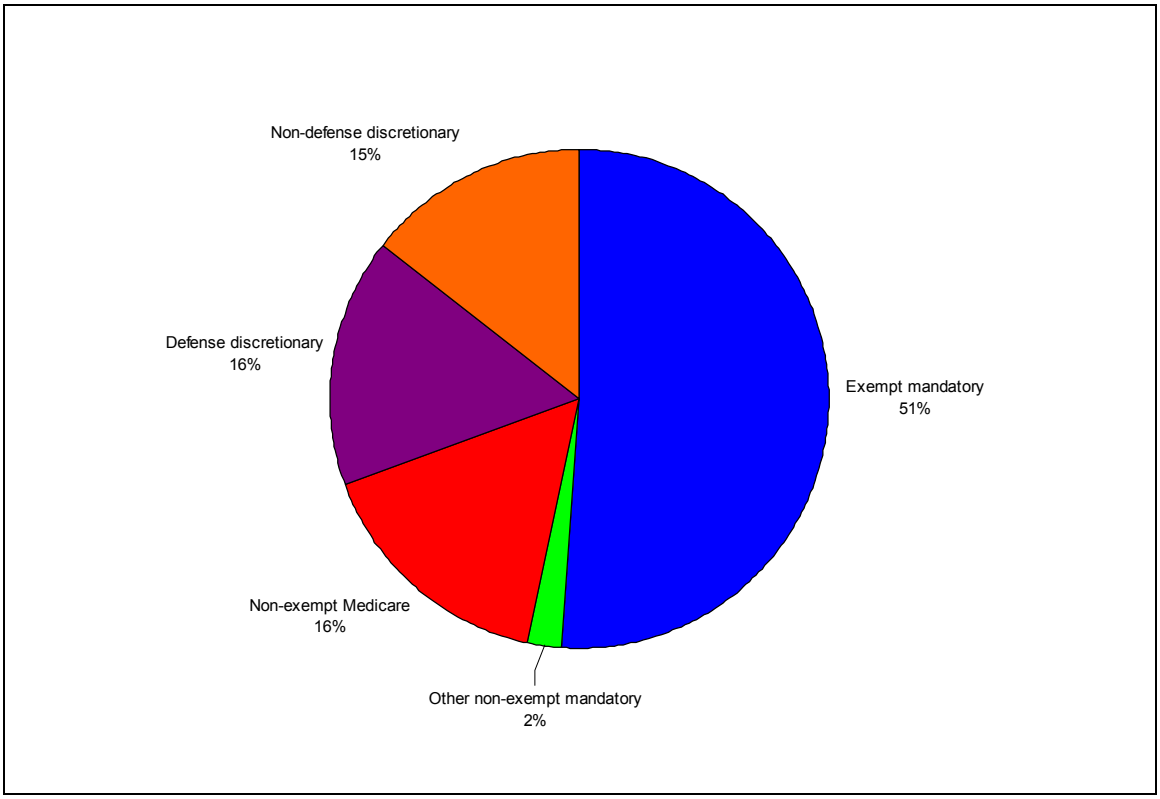
[29] For more information on the accuracy of projections, see Congressional Budget Office, *CBO's Economic Forecasting Record: 2010 Update*, July 2010, available at http://www.cbo.gov/ftpdocs/115xx/doc11553/ForecastingAccuracy.pdf. CRS Report R41134, *The Impact of Major Legislation on Budget Deficits: 2001 to 2010*, by Marc Labonte and Margot L. Crandall-Hollick also examines the reasons why the budget balance changed over time between FY2001, when surpluses were projected by CBO throughout the decade, and FY2010, when the budget deficit was large.

[30] These exemptions and special sequester rules are found in 2 USC 905 and 2 USC 906, Section 255 of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended.

[31] Some Medicare spending is exempt from automatic spending reductions including Medicare Part D low-income and catastrophic subsidies and qualified individual (QI) premiums. For more information see 2 USC 906(d)(7).

exempt budgetary resources is subject to an automatic reduction (known as a sequester), and the discretionary share is subject to reduction as a result of lower discretionary spending caps. Overall, only $71 billion, or 3%, of gross mandatory budgetary resources in FY2014 is subject to a sequester without limits, the majority falling into the non-defense category. The non-exempt portion of Medicare, which also falls into the non-defense category and accounts for 16% of total gross budgetary resources in FY2014, is capped at a maximum reduction of 2% by the BCA.

Figure 2. Percentage of Budgetary Resources Subject to an Automatic Spending Reduction, FY2014

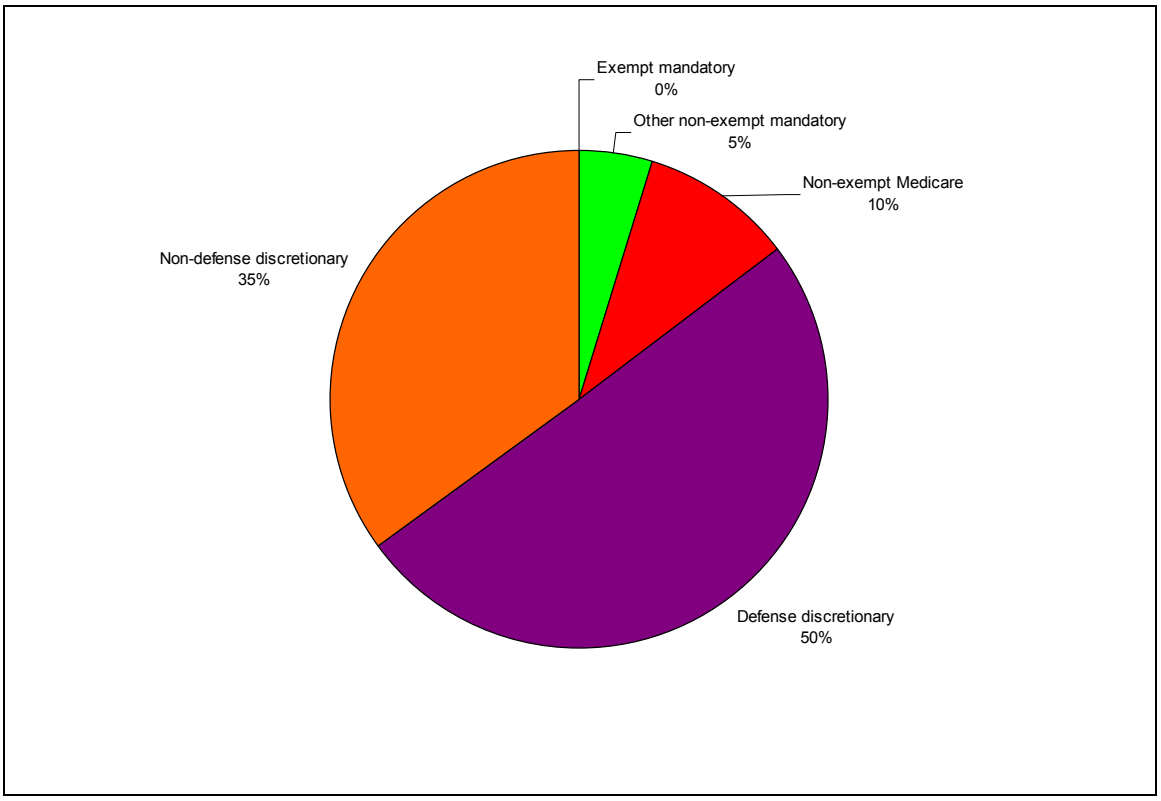


Source: CRS Calculations based on Congressional Budget Office, *Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act*, September 12, 2011, Table 2.

Note: Categories labeled exempt are not subject to a spending reduction. Other categories are subject to a spending reduction.

If an automatic spending reduction of $1.2 trillion over nine years were to occur, **Figure 3** shows the percentage share of the reduction in FY2014 for each category shown in **Figure 2**. Most exempt spending is within the non-defense mandatory category, so the automatic spending reductions would fall most heavily, in percentage terms, on discretionary programs. In 2014, discretionary spending accounts for 33% of budgetary resources, but receives 85% of spending reductions in the **Figure 3** example, where an automatic spending reduction of $1.2 trillion is required. Defense discretionary spending would be particularly affected because the defense spending category would receive 50% of all automatic cuts (see **Figure 3**) but accounts for 16% of total gross budgetary resources (see **Figure 2**) and 33% of total non-exempt budgetary resources. By contrast, mandatory programs account for 69% of budgetary resources in 2014, but, in this example, would bear 15% of the spending reduction.

Figure 3. Percentage of Automatic Spending Reduction in Each Major Programmatic Area for a $1.2 Trillion Reduction, FY2014



Source: CRS Calculations based on Congressional Budget Office, *Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act*, September 12, 2011, Table 3.

Table 4 shows the reductions in spending from FY2013 to FY2021 to different portions of the budget in dollar terms and percentage terms, if an automatic reduction of $1.2 trillion over nine years comes into effect. Exempting large parts of the budget from an automatic reduction means that the effect on non-exempt programs is much larger than if the same cut were spread over all programs (i.e., there were no exemptions). For example, in **Table 4**, total spending (gross outlays) would be reduced by about 2.5% in FY2014, but it would reduce discretionary caps for defense by 9.8% and non-defense by 7.4% in FY2014. It would reduce non-exempt mandatory outlays by 2% for Medicare (because of the BCA 2% limit) and 7.4% for other non-defense mandatory accounts in FY2014. (The reduction in non-exempt defense mandatory would be less than $1 billion.)[32]

[32] Data from CBO referenced in this section can be found in Congressional Budget Office, *Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act*, September 12, 2011. Two other estimates of the cuts under a $1.2 trillion automatic spending reduction by non-governmental organizations can be found at Bipartisan Policy Center, *How the Sequester Works if the Joint Select Committee Fails*, August 5, 2011, available at http://www.bipartisanpolicy.org/blog/2011/08/how-sequester-works-if-joint-select-committee-fails; Center on Budget and Policy Priorities, *How the Potential Across-the-Board Cuts in the Debt Limit Deal Would Occur*, August 8, 2011, available at http://www.cbpp.org/cms/index.cfm?fa=view&id=3557.

Table 4. Automatic Spending Reductions Under the Provisions of the BCA by Major Category

(Under a $1.2 trillion automatic spending reduction between FY2013 and FY2021)

	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
Amount of Reduction in Billions of Dollars									
Defense Reduction[a]	$55	$55	$55	$55	$55	$55	$55	$55	$55
Non-Defense Reduction									
Medicare (Mandatory)	$11	$11	$12	$13	$13	$14	$15	$16	$17
Other Mandatory	$5	$5	$6	$6	$5	$5	$5	$5	$5
Discretionary	$39	$38	$37	$36	$36	$36	$34	$33	$33
Total Non-Defense Reduction	$55	$55	$55	$55	$55	$55	$55	$55	$55
Percentage Reduction									
Defense Reduction	10.0%	9.8%	9.7%	9.5%	9.3%	9.1%	8.9%	8.7%	8.5%
Non-Defense Reduction									
Medicare (Mandatory)	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Other Mandatory	7.8%	7.4%	7.1%	6.8%	6.6%	6.4%	6.1%	5.8%	5.5%
Discretionary	7.8%	7.4%	7.1%	6.8%	6.6%	6.4%	6.1%	5.8%	5.5%

Source: Congressional Budget Office, *Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act*, September 12, 2011, Table 3.

Notes: Totals may not sum due to rounding.

a. Mandatory reductions of defense spending account for less than $500 million.

Medicare spending is projected to rise in dollar terms over the next 10 years and therefore, any automatic spending reduction that reaches or exceeds 2% cap, will result in an increase in dollar terms of the amount of the automatic spending reduction being borne by Medicare. Since the total dollar amount of the automatic reduction affecting the non-defense category would be the same each year from FY2013 to FY2021 and the dollar amount borne by Medicare rises, the dollar amount of the reduction that would be borne by the other non-exempt, non-defense programs would fall over the course of the budget window. In the example illustrated by **Table 4**, cuts to Medicare rise from $11 billion in FY2013 to $17 billion in FY2021, while cuts to other non-defense categories fall from $44 billion to $38 billion in those years.

Table 5 provides a list of some of the largest exempt programs and activities and their FY2010 spending levels, the last year of historical data available for these programs. The programs and activities are classified into defense and non-defense categories. Budget authority for each line item is further classified by type of spending, mandatory or discretionary. For purposes of the automatic spending reduction process, Veterans Programs, for example, are classified as non-defense spending, with $71.2 billion in mandatory budget authority and $53.1 billion in discretionary budget authority in FY2010. Within the defense category, the President has the discretion to exempt or include budget authority for military personnel in the automatic spending reduction process.

Table 5. Selected Programs and Activities Exempt from an Automatic Spending Reduction

(FY2010 budget authority in billions of dollars and percentage of category total)

Program or Activity	Mandatory	Discretionary	% of Total Defense (050)	% of Total Non-Defense
Defense (050) Programs:				
Military Personnel[a]		$121.3	16.8%	
Non-Defense Programs:				
Social Security	$701.0			25.4%
Tier I Railroad Retirement Benefits	$6.9			0.3%
Veterans Programs	$71.2	$53.1		4.5%
Refundable Income Tax Credits	$108.9			3.9%
GSE Preferred Stock Purchase Agreements[b]	$52.3			1.9%
Federal Retirement and Disability Accounts and Activities	$151.7	$5.7		5.7%
Child Nutrition Programs (with the exception for special milk programs)	$16.9	$0.2		0.6%
Children's Health Insurance Fund	$12.6			0.5%
Family Support Programs	$4.7			0.2%
Grants to States for Medicaid	$292.7			10.6%
Supplemental Nutrition Assistance Program	$69.0	$0.4		2.5%
Supplemental Security Income Program	$47.1	$3.5		1.8%

Program or Activity	Mandatory	Discretionary	% of Total Defense (050)	% of Total Non-Defense
Temporary Assistance to Needy Families	$17.1			0.6%
Federal-Aid Highways[c]	$39.7			1.4%

Source: Office of Management and Budget, Budget of the U.S. Government, Fiscal Year 2012, *Budget Appendix*, available at http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/appendix.pdf; *Public Budget Database*, available at http://www.whitehouse.gov/omb/budget/Supplemental; and *Historical Tables*, Table 5.1, available at http://www.whitehouse.gov/omb/budget/Historicals/. For a full list of exempt programs and special sequester rules, see 2 USC 905 and 2 USC 906, Section 255 of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended.

Notes: The total percentage of exempt budget authority for all programs and activities would likely exceed the levels shown in this table. Figures in this table are expressed in terms of budget authority because that is what would be automatically reduced if reductions occurred. The table illustrates total spending for each program unless otherwise noted, not necessarily the exempt portion of a program.

a. Military personnel accounts can be made exempt from an automatic spending reduction only if the President notifies Congress of their exemption before August 10 for the budget year. The accounts can be made entirely exempt or can be reduced by a lower uniform percentage than would otherwise apply.

b. This figure is in terms of outlays, rather than budget authority because budget authority for this program was not limited by statute.

c. Funding for Federal-Aid Highways (account 69-8083-0-7-401) is exempt to the extent that the budgetary resources of the program are subject to obligation limitations in the appropriations bill. The figure shown here is the obligation limitation for FY2010 for this account.

The BCA gives the Office of Management and Budget sole authority for allocating the automatic spending reduction across non-exempt accounts. Were the spending reduction to occur, the cuts to non-exempt account would most likely differ from current estimates because projections of program spending levels will change between now and then because of both future policy decisions and technical adjustments.

Effects of the BCA on the Budget Deficit

CBO estimates that the discretionary caps in the BCA will reduce the baseline deficit by $917 billion over 10 years. The estimated budgetary savings increase from $27 billion in FY2012 to $153 billion in FY2021 (shown in **Table 6**).[33] The effects of the education provisions of the BCA on the deficit are negligible, slightly increasing the deficit in the first three years and then decreasing it for the rest of the projection. Since the Joint Committee has not yet produced a plan for how to achieve the other $1.2 trillion in deficit reduction, CBO assumes in the baseline that it will be distributed evenly over nine years beginning in FY2013. Under this assumption, spending is reduced or revenues are raised by $111 billion each year, and additional deficit reduction is achieved through lower debt service.

[33] Cutting spending or raising taxes causes the government to borrow less, which results in lower interest payments on the debt. **Table 6** includes the effects of lower debt service on the deficit for each policy change; for the discretionary caps, $778 billion of deficit reduction comes from lower discretionary spending and $140 billion comes from lower debt service over 10 years.

Should a Joint Committee proposal fail to become law, CBO estimated that the automatic spending reduction process would reduce the deficit by $1.1 trillion over nine years, rather than the $1.2 trillion called for in the BCA. The distribution of deficit reduction over the nine years would be somewhat different than the baseline placeholder shown in **Table 6**, rising from $68 billion in 2013 to $148 billion in 2021. The difference in amount and timing from what is called for in the BCA is due to three issues. First, the automatic spending reduction process reduces budget authority, but the deficit is influenced by outlays. A change in budget authority leads to a gradual change in outlays because of the time lag between when spending is authorized and when it occurs. As a result, CBO projects some reduction in outlays after 2021. Second, CBO projects that the interest savings would be less than the $216 billion (18% of $1.2 trillion) assumed in the BCA. Third, "reductions in budgetary resources for some programs and activities … would have effects that would offset some of the original savings.…"[34]

[34] Congressional Budget Office, *Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act*, September 12, 2011.

Table 6. Budget Deficit Projections With and Without the BCA

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	FY2012-FY2021
					Billions of $						
Baseline Deficit Excluding BCA (Current Law)	$997	$667	$441	$399	$489	$462	$462	$529	$570	$596	$5,615
Effects of Discretionary Caps on Deficit	-$27	-$50	-$64	-$74	-$85	-$97	-$110	-$122	-$137	-$153	-$917
Effects of Education Provisions on Deficit	+$3	+$6	+$3	-$2	-$2	-$2	-$2	-$2	-$2	-$3	-$5
Effects of Hypothetical Joint Committee Plan on Deficit	$0	-$113	-$115	-$118	-$124	-$132	-$139	-$146	-$154	-$161	-$1,200
Baseline Deficit Including BCA (Current Law)	$973	$510	$265	$205	$278	$231	$211	$259	$277	$279	$3,487
Deficit Including BCA (Current Policy)	$996	$770	$637	$634	$763	$777	$822	$938	$1,032	$1,116	$8,485
					% of GDP						
Baseline Deficit Excluding BCA (Current Law)	6.4%	4.1%	2.6%	2.2%	2.6%	2.3%	2.2%	2.4%	2.5%	2.5%	n/a
Effects of Discretionary Caps on Deficit	-0.2%	-0.3%	-0.4%	-0.4%	-0.4%	-0.5%	-0.5%	-0.6%	-0.6%	-0.6%	n/a
Effects of Education Provisions on Deficit	*	*	*	*	*	*	*	*	*	*	n/a
Effects of Hypothetical Deficit Committee Plan/Automatic Spending Reduction on Deficit	0%	-0.7%	-0.7%	-0.7%	-0.7%	-0.7%	-0.7%	-0.7%	-0.7%	-0.7%	n/a
Baseline Deficit Including BCA (Current Law)	6.2%	3.2%	1.6%	1.1%	1.5%	1.2%	1.0%	1.2%	1.2%	1.2%	n/a
Deficit Including BCA (Current Policy)	6.4%	4.8%	3.8%	3.5%	4.0%	3.9%	3.9%	4.3%	4.5%	4.7%	n/a

Source: CRS calculations based on CBO data.

Notes: Includes effects of lower debt service. Negative numbers reduce deficit, positive numbers increase deficit. Since the Joint Committee had not proposed a deficit reduction plan at the time of the August baseline, CBO included a placeholder that assumed that the deficit would be reduced by $111 billion each year from 2013-2021, plus interest savings. Columns may not sum due to rounding. Deficit effect of caps is calculated here using CBO's August baseline; the original score was calculated using CBO's adjusted March baseline and was $890 billion over 10 years. * = <0.1% of GDP. See **Table 3** for bridge from Current Law Baseline to Current Policy Baseline.

Is the deficit reduction achieved by the BCA insufficient, requiring additional policy changes in the future to further reduce the deficit? Or does it reduce deficits excessively? It depends on the policy goal. A goal of the deficit savings in the BCA was to match the BCA's multi-step increase in the debt limit, although the savings is over a different timeframe than the debt limit increase and the deficit reduction achieved in the BCA in isolation would not prevent the need for future debt limit increases. In any case, matching deficit reduction with debt limit increases is a intermediate goal, but not an ultimate goal of fiscal policy.

If the ultimate policy goal is a balanced budget or budget surpluses or to avoid increasing the federal debt, then the BCA does not reduce deficits enough to achieve that goal. The BCA's $2.1 trillion in deficit reduction under current law would leave projected deficits of $3.5 trillion over 10 years, relative to the $5.6 trillion over 10 years prior to the enactment of the BCA (see **Table 6**). Because the budgetary savings in FY2012 is only $24 billion ($27 billion savings from the cap and $3 billion cost of student loan provisions) prior to action by the Joint Committee, the baseline deficit in FY2012 is still projected to be $1 trillion.

Likewise, the $2.1 trillion in spending cuts relative to the baseline contained in the BCA, if the cuts were to be achieved, does not mean that the total debt of the U.S. will decrease by $2.1 trillion relative to today's levels. Rather, it means that the cumulative deficit over the FY2012-FY2021 period will be $2.1 trillion less than it otherwise would have been. Since the budget is projected to remain in deficit after the BCA, the publicly held debt will continue to rise in dollar terms each year, from a projected $10.2 trillion in FY2011 to $14.5 trillion in FY2021 under a current law baseline.

As discussed above, the current law baseline projection assumes that certain policies ("Bush tax cuts," AMT "patch," and Medicare "doc fix") will expire as scheduled. If those policies are instead extended, deficits after the BCA are projected to be $8.5 trillion—$5 trillion larger than the current law deficits—over 10 years. This scenario is referred to as the current policy baseline.

Under the current policy baseline, deficits never get lower than 3.9% of GDP (rising to 4.7% of GDP by FY2021) and the debt continues to rise relative to GDP each year, reaching 82% of GDP by FY2021.[35] If one believes that current policies will be maintained, additional policy changes beyond the BCA would be required to put the deficit on a sustainable path. Stated differently, allowing the "Bush tax cuts," AMT "patch," and "doc fix" to Medicare to expire would be one set of policy changes that would place the deficit on a sustainable basis. (As noted above, allowing these three policies to expire would not be counted as reducing the deficit under a current law baseline.) CRS cannot recommend whether these policy options are more or less desirable than various alternatives.

While the BCA is not projected to result in a balanced budget, another policy goal would be to place the deficit on a sustainable basis, meaning a level that would stabilize the debt as a share of GDP. Economists believe that the budget will eventually need to be placed on a sustainable basis since debt service cannot rise faster than income indefinitely.[36] Whether or not the BCA's forecast accomplishes this depends on what assumptions are used in the baseline.

[35] Congressional Budget Office, *Budget and Economic Outlook: Update*, August 2011, p. xv.

[36] For more information, see CRS Report R40770, *The Sustainability of the Federal Budget Deficit: Market Confidence and Economic Effects*, by Marc Labonte.

Under current law, budget deficits fall to 1% of GDP in FY2018 (rising slightly thereafter) and the publicly held debt falls as a share of GDP over the next 10 years–although it will still remain at levels that are historically high for the post-World War II period. (Indeed, even without the BCA, budget deficits were projected to have become low enough under current law to temporarily stabilize the debt relative to GDP.) In the long run, unsustainably large budget deficit projections are primarily driven by the assumption that health care costs will continue to grow faster than GDP.[37] Unless the result of the Joint Committee is the enactment of policies that would change this assumption, unsustainably large deficits would eventually reappear.

Effects of the BCA on the Economy

Gross domestic product, the total output of the economy, consists of spending on consumption, investment, net exports, and by government. In the short run, policy changes that reduce the budget deficit by reducing government spending would directly reduce that component of gross domestic product.[38] As a result, in an economy that is significantly below full employment (as is the case today), standard macroeconomic theory predicts that reducing the deficit would reduce spending and employment in the overall economy, all else equal. To fully offset these effects, other spending in the economy would need to rise. Yet in an economy where overall spending is already too low to fully employ all available labor and capital resources, other spending is unlikely to increase sufficiently.[39] Theory predicts that, in an open economy, the short-term effects of changes in the budget deficit on overall spending in the economy would be diminished by cross-border capital flows.[40] Theory also predicts that these effects would be temporary–eventually, market forces would return the economy to full employment. This would happen more slowly if the budget deficit were reduced, compared to if the budget deficit were maintained.[41] CBO is projecting that the economy will be back to full employment around 2016.

This analysis assumes that investors will continue to be willing to finance large budget deficits at low interest rates in the short term regardless of whether the budget deficit is reduced. If the United States entered a "debt spiral," the standard macroeconomic analysis may no longer apply. A "debt spiral" is a scenario similar to that recently experienced in Greece, where investors lose faith in the government's ability to service its debt, and therefore require much higher interest rates to be willing to hold government debt. In this scenario, policy changes to reduce the budget deficit could potentially stimulate the economy, if it restored investor confidence and, as a result, interest rates declined. There is no evidence that the United States is about to enter a debt spiral at this time, and most economists consider the likelihood of a debt spiral to be small. While investors may be willing to finance large budget deficits at low interest rates for several more

[37] For more information, see CRS Report RL32747, *The Economic Implications of the Long-Term Federal Budget Outlook*, by Marc Labonte.

[38] Economists refer to these policy changes as reducing the structural budget deficit, as opposed to cyclical reductions in the deficit caused by more rapid economic growth.

[39] Reducing the deficit through higher taxes would be expected to have a similar effect on the overall economy.

[40] Theory predicts that the increase in spending from the change in the deficit would be offset by a change in the balance of trade caused by capital flows. By accounting identity, capital flowing into (out of) a country must enter (exit) in the form of a trade deficit (surplus).

[41] For more information, see CRS Report R41849, *Can Contractionary Fiscal Policy Be Expansionary?*, by Jane G. Gravelle and Thomas L. Hungerford.

years, the risk of a crisis remains for as long as the United States continues to run unsustainably large budget deficits.[42]

Reducing the budget deficit through spending cuts would also be expected to affect the economy in the long run. In standard macroeconomic theory, budget deficits "crowd out" private investment spending on plant and equipment by pushing up interest rates. In other words, the government's borrowing places upward pressure on all interest rates, leading private businesses to undertake fewer investment projects. Lower investment spending would reduce long run GDP relative to if the budget were balanced, all else equal. Alternatively, standard theory predicts that higher interest rates could be avoided if the government or private sector increases its borrowing from abroad. By accounting identity, this borrowing from abroad comes to the United States in the form of a trade deficit.[43] Chronically low domestic savings rates and chronically high trade deficits in the past two decades suggest that the crowding out problem could become an issue once investment demand rebounds from the economic downturn, if large deficits remain. Reducing budget deficits would reverse such crowding out effects.[44] In addition to the deficit channel, reductions in spending could have positive or negative effects on long-term growth, depending on what type of spending is cut. For example, reducing public investment spending could have negative effects on long-term growth.

The magnitudes of both the short-run and long-run effects described in this section depend mostly on the size of the deficit reduction. Relatively small spending reductions would be expected to have a relatively small effect on the economy, and larger ones would have a larger effect. The magnitude of the short-run effects would also depend on timing. For example, if spending cuts were enacted today but did not go into effect until future years, they would not be expected to have any effect on the economy this year.[45] If the economy were closer to full employment by the time a phased-in spending reduction went into effect, the effects on overall spending in the economy would be expected to be smaller. Eventually, the budget deficit can be restored to sustainability only through spending cuts, tax increases, or both. In that sense, a comparison between reducing the deficit and the status quo is a false comparison in the long run. The size of current deficits should make crowding out effects greater than they have been historically; the weakness in the economy and financial system should make them smaller than historically for the time being.

For determining the short-run macroeconomic effects, the magnitude of the incremental change in the structural deficit each year is a relevant measure. As seen in **Table 6**, the "first round" cuts relative to the baseline caused by the discretionary spending caps and student loan provisions reduce the deficit by $24 billion in FY2012. They rise around $20 billion each year after that, reaching $156 billion by FY2021. A spending cut of $24 billion amounts to about two-tenths of one percent of GDP in FY2012. Thus, the first round cuts would be expected to be too small to have a noticeable effect on the economy. JPMorgan Chase estimates that the first round cuts

[42] These issues are discussed in more detail in CRS Report R40770, *The Sustainability of the Federal Budget Deficit: Market Confidence and Economic Effects*, by Marc Labonte.

[43] The trade deficit increases because one country can only borrow from another by buying more of the creditor country's goods and services than the creditor buys from the debtor country.

[44] These issues are discussed in more detail in CRS Report R40770, *The Sustainability of the Federal Budget Deficit: Market Confidence and Economic Effects*, by Marc Labonte.

[45] Reducing the deficit could have positive effects on household and business confidence about the sustainability of fiscal policy that helped the economy. It is not clear that households and businesses currently lack confidence because of future deficits, however, since interest rates on federal debt are unusually low.

would reduce GDP growth by 0.14 percentage points in FY2012.[46] The $1.2 trillion to $1.5 trillion second round cuts could potentially be larger each year. Depending on how quickly they are phased in, they could potentially have a larger short-term effect on the economy in FY2012. As an example, if the full automatic spending reduction went into effect and $1.2 trillion of spending cuts were distributed evenly across the nine year FY2013-FY2021 budget window, spending would be cut by $133 billion each year (in addition to the first round cuts). The two rounds combined amount to about 1% of GDP in FY2013. JPMorgan assumes that the deficit committee will agree to phase in the second round reduction in the deficit over time, in which case they estimate that the overall effect on the first and second round policy changes would be to reduce GDP growth by 0.3 percentage points in FY2012–this is relatively small compared to the expected rate of GDP growth that year. On the other hand, GDP growth was already expected to be too slow to significantly reduce the high rate of unemployment in FY2012. Further, some economists fear that the U.S. may be heading back into a recession. If so, deficit reduction in FY2012 could make a recession more likely.[47] If phased in more slowly, the economy could be near or at full employment by the time they are fully implemented, and the short-term effect on the economy would be less of an issue.

The deficit-reduction effects of the Budget Control Act are occurring at the same time that other temporary fiscal stimulus measures are being withdrawn. Thus, the overall stance of current fiscal policy is more contractionary than the BCA viewed in isolation. J.P. Morgan Chase estimates that the structural deficit (adjusting for the business cycle) will decline by 2.3% of GDP in FY2012 overall, and this will reduce GDP growth by 1.7 percentage points, all else equal. In other words, even before the BCA was enacted, the tightening of fiscal policy would have reduced GDP growth by 1.4 percentage points of GDP in FY2012.[48] Similarly, Goldman Sachs estimates that fiscal policy will contract by 1.7% of GDP overall in FY2012, mostly because of expiring provisions.[49]

For determining the long-run macroeconomic effects, the magnitude of the overall decline in the deficit is a relevant measure. As seen in **Table 6**, the "first round" cuts reduce the baseline deficit by 0.2% of GDP in FY2012, rising to 0.6% of GDP in FY2021. This would reduce the crowding out effects, but leave unsustainably large deficits in place using a current policy baseline. Including the second round effects would further reduce the deficit, but one cannot determine whether the debt would be stabilized relative to GDP until a proposal is made. Under the automatic spending reduction scenario, the deficit would still be above a sustainable level under a current policy baseline. Thus, the Budget Control Act would be expected to reduce the long-term crowding out problem, but under a current policy baseline the problem would still be significant, and some risk of a debt spiral would remain. By contrast, under a current law baseline, crowding out would remain, but it would be smaller, and the deficit would appear sustainable over 10 years (although large deficits would eventually be projected to reappear in the long run), further reducing the risk of a debt spiral.

[46] JPMorgan, "Let the Pea-Eating Begin," *North America Economic Research*, newsletter, August 2011. JPMorgan assumes a multiplier of 1 in this calculation, meaning GDP would increase by the same amount as the change in the deficit.

[47] For more information, see CRS Report R41444, *Double-Dip Recession: Previous Experience and Current Prospect*, by Craig K. Elwell.

[48] J.P.Morgan, "Let the Pea-Eating Begin," *North America Economic Research*, newsletter, August 2011. J.P. Morgan assumes a multiplier of 1 in this calculation, meaning GDP would increase by the same amount as the change in the deficit.

[49] Goldman Sachs, "Some Early Thoughts on Upcoming Fiscal Proposals," *U.S. Daily Newsletter*, August 19, 2011.

Appendix. The Relative Size of the Deficit Reduction in the Budget Control Act Compared to Earlier Acts

The BCA is not the first piece of legislation that has attempted to reduce the budget deficit. Since the early 1980s, there have been six major deficit reduction packages which are summarized below.

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA 1982; P.L. 97-248) had various provisions that on net increased tax revenue and reduced entitlement spending. It was projected to reduce the deficit by an estimated $116 billion over three years; CRS was unable to locate a five year estimated effect on the deficit.

The Deficit Reduction Act of 1984 (DRA 1984; P.L. 98-369) had various provisions that on net increased tax revenue and reduced outlays. It was projected to reduce the deficit by $125 billion over five years.

The Omnibus Budget and Reconciliation Act of 1990 (OBRA, P.L. 101-508) had various provisions that on net increased tax revenue and reduced mandatory spending. In addition, it set discretionary spending targets below baseline levels for future years with enforcement mechanisms to ensure the targets were met. It was projected to reduce the deficit by an estimated $423 billion over five years.

The Omnibus Budget and Reconciliation Act of 1993 (OBRA, P.L. 103-66) had various provisions that on net increased tax revenue and reduced mandatory spending. In addition, it set discretionary spending targets for 1996-1998 below baseline levels for future years, using the same enforcement mechanisms put in place in 1990. It was projected to reduce the deficit by an estimated $386 billion over five years.

The Balanced Budget Act of 1997 (BBA 1997; P.L. 105-33) had various provisions that, on net, reduced mandatory spending and reduced the deficit through asset sales. The legislation also contained caps on discretionary spending through FY2002. The BBA was projected to reduce the deficit by an estimated $127 billion over five years.

The Deficit Reduction Act of 2005 (DRA; P.L. 109-171) had various provisions that on net reduced mandatory spending and was projected to reduce the deficit by an estimated $39 billion over five years.

Table A-1 and **Table A-2** compare the amount of estimated/projected deficit reduction relative to the baseline achieved by various legislation enacted since the 1980s. Over five years, the amount of "first round" deficit reduction contained in the Budget Control Act of 2011 is projected to be smaller in nominal dollars than two previous deficit reduction packages, the Omnibus Budget Reconciliation Act of 1990 and the Omnibus Budget Reconciliation Act of 1993. (The five-year deficit reduction total from the BCA will be determined by the outcome of the work of the Joint Committee.) The BCA is larger in nominal dollars than deficit reduction packages in 1982 and 2005 over three years. The first round effects of the BCA are larger over five years than deficit reduction legislation enacted in 1984, 1997, and 2005. However, when expressed as a share of GDP, only the 2005 Deficit Reduction Act is smaller.

Table A-1. Effects on Budget Deficit of Selected Legislation in Billions of Dollars

	Year 1	Year 2	Year 3	Year 4	Year 5	5 Year Total	Deficit in Year of Enactment
TEFRA 1982	$25	$40	$51	n/a	n/a	n/a	$128
DRA 1984	$15	$21	$28	$29	$32	$125	$185
OBRA 1990	$32	$65	$79	$114	$133	$423	$221
OBRA 1993	$32	$53	$75	$104	$122	$386	$255
BBA 1997	$13	$35	$18	$62	$45	$162	$22
DRA 2005	$5	-$4	$5	$21	$12	$39	$318
BCA 2011 (First Round)	$22	$41	$56	$69	$77	$265	$1,284

Source: CRS Report RS22098, *Deficit Impact of Reconciliation Legislation Enacted in 1990, 1993, 1997, and 2006*; Congressional Budget Office, *Effects of Changes in Taxes and Benefit Payments Resulting from the Tax Equity and Fiscal Responsibility Act of* 1982, Staff Memorandum, July 1982; Congressional Budget Office, *Budget and Economic Outlook: An Update*, Congressional Budget Office, *Budgetary Implications of the Balanced Budget Act of 1997*, Staff Memorandum, Dec. 1997; Congressional Budget Office, *S. 1932 Deficit Reduction Act of 2005*, Cost Estimate, January 27, 2006.

Notes: Table does not include effects of debt service savings on the budget deficit. Table does not include "second round" effects related to the work of the Joint Committee proposal or the automatic spending reduction process, which could potentially further reduce the deficit over the next five years. Positive numbers indicate an decrease in the deficit. Negative numbers indicate a increase in the deficit. Deficit reduction in the BCA is projected.

Table A-2. Effects on Budget Deficit of Selected Legislation as a Percentage of GDP

	Year 1	Year 2	Year 3	Year 4	Year 5	5 Year Average	Deficit in Year of Enactment
TEFRA 1982	0.7%	1.0%	1.2%	n/a	n/a	n/a	4.0%
DRA 1984	0.4%	0.5%	0.6%	0.6%	0.6%	0.5%	4.8%
OBRA 1990	0.5%	1.0%	1.2%	1.6%	1.8%	1.3%	3.9%
OBRA 1993	0.5%	0.7%	1.0%	1.3%	1.4%	1.0%	3.9%
BBA 1997	0.2%	0.4%	0.2%	0.6%	0.4%	0.4%	0.3%
DRA 2005	*	*	*	0.2%	0.1%	0.1%	2.6%
BCA 2011 (First Round)	0.2%	0.3%	0.4%	0.4%	0.4%	0.3%	8.5%

Source: CRS Report RS22098, *Deficit Impact of Reconciliation Legislation Enacted in 1990, 1993, 1997, and 2006*; Congressional Budget Office, Effects of Changes in Taxes and Benefit Payments Resulting from the Tax Equity and Fiscal Responsibility Act of 1982, Staff Memorandum, July 1982; Congressional Budget Office, Budget and Economic Outlook: An Update, Congressional Budget Office, Budgetary Implications of the Balanced Budget Act of 1997, Staff Memorandum, Dec. 1997; Congressional Budget Office, *S. 1932 Deficit Reduction Act of 2005*, Cost Estimate, January 27, 2006.

Notes: Table does not include effects of debt service savings on the budget deficit. Table does not include "second round" effects related to the work of the Joint Committee proposal or the automatic spending reduction process, which could potentially further reduce the deficit over the next five years. Positive numbers indicate an decrease in the deficit. Negative numbers indicate a increase in the deficit. Deficit reduction in the BCA is projected. * = < 0.1%

Table A-1 provides estimates of the deficit effects of this legislation relative to the baseline, in isolation of other legislation enacted in the same year that increased or decreased the deficit. (**Table A-2** shows the effects of the deficit reduction legislation in terms of GDP.) Whether the actual deficit rose or fell compared to the previous year following the enactment of this legislation depends on the other legislation enacted at the time, as well as factors outside of congressional control, such as economic conditions or increases in mandatory spending as a result of demographic changes.

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