



The Budget Control Act of 2011: The Effects on Spending and the Budget Deficit When the Automatic Spending Cuts Are Implemented

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Summary

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. In addition to including a mechanism to increase the debt limit, the BCA contained a variety of measures intended to reduce the budget deficit through spending reductions. Combined, these measures are projected to reduce the deficit by roughly \$2 trillion over the FY2012-FY2021 period.

There are two main groups of spending reductions in the BCA: (1) discretionary spending caps that came into effect in FY2012; and (2) a \$1.2 trillion automatic spending reduction process (sometimes referred to as the “trigger”) that will come into effect on January 2, 2013, unless new legislation is enacted to prevent it. H.R. 4966, the Sequester Replacement Act of 2012, and the President’s FY2013 Budget both propose eliminating the trigger and replacing it with alternative measures to reduce the deficit.

To provide context for this debate, this report discusses the effects of the BCA on spending and the deficit, assuming that the January 2013 automatic spending reductions proceed as scheduled. The BCA spending cuts mainly apply to discretionary spending—\$0.8 trillion in cuts to defense programs and \$0.7 trillion in cuts to non-defense programs over 10 years. Mandatory spending is cut by less than \$0.2 trillion over 10 years, with most of the savings from Medicare. Many mandatory programs are exempt from these cuts, as are certain types of discretionary programs. More than half of the spending cuts are through the “trigger” process, which has not yet come into effect. In FY2013, the first year of the “trigger,” defense discretionary budget authority subject to the BCA caps would decline by 11.5%, and non-defense would decline by 9.8%. In FY2013, real (inflation-adjusted) defense discretionary spending subject to the BCA caps is lower than its FY2005 levels, and real non-defense discretionary is lower than its FY2003 levels. After FY2013, the discretionary caps would rise by about the rate of inflation in subsequent years. As a result, discretionary spending subject to the caps does not return to its FY2011 level until FY2018 in *nominal terms* and will not return to its FY2011 levels in real terms at any point in the 10-year budget window. Defense and non-defense discretionary spending subject to the caps will also not return to FY2011 levels in *real terms* during the budget window.

The effects of the BCA on overall discretionary spending will depend on what levels of spending Congress chooses for categories of discretionary spending not subject to the caps, namely overseas contingency operations (OCO), disaster spending, and emergency spending. From FY2018 on, overall discretionary spending would be below its lowest share of gross domestic product (GDP) since data were first collected in 1962, assuming current levels of OCO and disaster spending. Mandatory spending, by contrast, is projected to continue to grow in nominal terms, real terms, and as a percentage of GDP over the next 10 years. Because of the projected growth in mandatory spending, total federal spending would be above its post-World War II average share of GDP at the end of the 10-year budget window.

When fully implemented, the BCA reduces deficits by about 1% of GDP each year. Under a current law baseline, the budget is on a sustainable path, in the sense that the publicly held debt would decline as a share of GDP (although it would continue to rise in dollar terms). Under a current policy baseline, where expiring tax cuts, the alternative minimum tax patch, and the Medicare “doc fix” are assumed to be extended, deficits are unsustainably large even after enactment of the BCA. This report does not explain the mechanics of the BCA. For an overview of the act, see CRS Report R41965, *The Budget Control Act of 2011*.

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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. In addition to including a mechanism to increase the debt limit, the BCA contained measures intended to reduce the budget deficit through spending reductions. Combined, these measures are projected to reduce the deficit by roughly \$2 trillion over the FY2012-FY2021 period.

The spending reductions in the BCA are achieved mainly through two mechanisms: (1) statutory discretionary spending caps covering 10 years that came into effect in 2012; and (2) a \$1.2 trillion automatic spending reduction process (sometimes referred to as the “trigger”) covering nine years that will come into effect on January 2, 2013, unless new legislation is enacted to prevent it.¹

Some Members of Congress have proposed repealing or modifying the trigger before it goes into effect. The President’s FY2013 Budget Proposal eliminates the automatic spending reductions for all nine years and replaces them with alternative measures to reduce the deficit. The House FY2013 Budget Resolution (H.Con.Res. 112), which passed the House on March 29, 2012, proposes eliminating the automatic spending reductions in 2013 and replacing them with alternative measures to reduce the deficit. H.R. 4966, the Sequester Replacement Act of 2012, generally proposes to replace the FY2013 sequestration, in part, with spending cuts achieved by lowering the current statutory discretionary cap for FY2013 and the enactment of a budget reconciliation measure, reducing mandatory spending over the period FY2012-FY2022, pursuant to the House-passed FY2013 budget resolution (Section 201 of H.Con.Res. 112).

To provide context for Members who are considering whether or not to maintain the January 2013 trigger in its current form, this report discusses the combined effects of the BCA on spending and the deficit, assuming that the automatic spending reductions proceed as scheduled. For information on the separate effects of the BCA’s discretionary caps and trigger on spending, see CRS Report R42013, *The Budget Control Act of 2011: How Do the Discretionary Caps and Automatic Spending Cuts Affect the Budget and the Economy?* by Marc Labonte and Mindy R. Levit. Other CRS reports provide additional analysis of the BCA.²

Background on the Budget Control Act of 2011

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 deficits became significantly larger in FY2009. That year, the deficit topped \$1 trillion for the first time ever, and it has remained above \$1 trillion through FY2011.³ The recent

¹ Unless otherwise noted, all budget data presented in this report are from Congressional Budget Office, *The Budget and Economic Outlook*, January 2012 (hereinafter referred to as “CBO baseline”); Congressional Budget Office, *Preliminary Analysis of the President’s Budget for FY2013*, March 2012; or Congressional Budget Office, *The Budget and Economic Outlook: Update*, August 2011.

² For an explanation of the BCA’s provisions and procedures, see CRS Report R41965, *The Budget Control Act of 2011*, by Bill Heniff Jr., Elizabeth Rybicki, and Shannon M. Mahan. For information on exemptions from sequestration, see CRS Report R42050, *Budget “Sequestration” and Selected Program Exemptions and Special Rules*, coordinated by Karen Spar. For information on the debt limit increases in the BCA, see CRS Report RL31967, *The Debt Limit: History and Recent Increases*, by D. Andrew Austin and Mindy R. Levit.

³ 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 sum of 1) debt held by the public and 2) the intragovernmental debt (the debt that one part of the federal government owes to another part of the government, mainly through government trust funds). For background (continued...)

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. These trends are largely due to the budgetary effects of the recent recession and policies implemented in response to it, including increased outlays and tax cuts.⁴

The BCA reduces spending through two primary mechanisms. First, the BCA placed statutory caps on most discretionary spending from FY2012 through FY2021. The caps essentially limit the amount of spending through the annual appropriations process for the next 10 years, with adjustments permitted for certain purposes. The limits could be adjusted to accommodate (1) changes in concepts and definitions; (2) appropriations designated as emergency requirements; (3) appropriations designated for Overseas Contingency Operations/Global War on Terrorism (such as for military activities in Afghanistan); (4) appropriations for continuing disability reviews and redeterminations; (5) appropriations for controlling health care fraud and abuse; and (6) appropriations designated as disaster relief. The last five of the listed adjustments effectively exempt those types of discretionary spending from the statutory caps, meaning that the caps do not limit total discretionary spending. The BCA limits adjustments for spending on disability reviews and controlling health care fraud abuse to relatively small amounts.

The adjustable caps are not placed on specific accounts or even on each of the appropriations bills; instead they are broad caps on the total amount of discretionary spending. In FY2012, separate caps exist on security and non-security spending.⁵ For FY2013 to FY2021, under the automatic process, there are separate caps for defense (Function 050) and non-defense spending. Decisions about how these caps will affect specific agencies or programs will be made by Congress and the President through the regular appropriations process.

Second, Title IV of the Budget Control Act established a Joint Select Committee on Deficit Reduction (hereafter Joint Committee), composed of an equal number of Senators and Representatives, and instructed it to develop a proposal that would reduce the deficit by at least \$1.5 trillion over FY2012 to FY2021. In order to ensure deficit reduction occurred if a Joint Committee bill was not enacted, Section 302 of the Budget Control Act of 2011 established an automatic process to reduce spending, beginning in 2013. On November 21, 2011, the co-chairs of the Joint Committee announced that they were unable to reach a deficit-reduction agreement before the committee's deadline. As a result, a \$1.2 trillion automatic spending reduction process has been triggered to begin in January 2013 unless new legislation is enacted to eliminate or change the process before then.

This automatic process affects both mandatory and discretionary spending, and is implemented through a combination of reductions in the original BCA discretionary caps and a sequestration

(...continued)

information on the debt and deficit, see CRS Report WKS0001_Overview, *Federal Debt and Deficit: Key Sources*, by Justin Murray.

⁴ 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 R41134, *The Impact of Major Legislation on Budget Deficits: 2001 to 2010*, by Marc Labonte and Margot L. Crandall-Hollick. For an analysis of the FY2013 budget debate, see CRS Report R42362, *The Federal Budget: Issues for FY2013 and Beyond*, by Mindy R. Levit.

⁵ 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).

process. Sequestration is the across-the-board cancellation of budgetary resources. Some programs are exempt by statute from the process, however, including most large mandatory programs.

Effects of the BCA on Overall Spending Levels

This section evaluates the effect of the BCA on spending, assuming that the January 2013 automatic spending reduction process proceeds as scheduled under current law.

This report analyzes the effects of the Budget Control Act on spending in terms of its effects on outlays or budget authority, depending on the context. The Budget Control Act sets new levels of budget authority, which eventually leads to changes in outlays. The difference between budget authority and outlays is discussed in the following text box.

Outlays and Budget Authority

Outlays are disbursed federal funds. Budget authority is what federal agencies can legally spend, and is granted by Congress through appropriation acts in the case of discretionary spending or through other acts in the case of mandatory spending. Budget authority gives federal officials the ability to spend. Until the federal government disburses funds to make payments, no outlays occur. Therefore, there is generally a lag between when Congress grants budget authority and outlays occur.

BCA Spending Cuts Relative to a Baseline Projection

For FY2012 to FY2021, the Budget Control Act (BCA; P.L. 112-25) is projected to reduce discretionary and mandatory spending for those years relative to baseline levels.⁶ Relative to a baseline using FY2011 appropriated levels adjusted for inflation,⁷ CBO projects that the combination of the Budget Control Act's caps and automatic spending reduction process would reduce defense discretionary outlays by \$15 billion in FY2012 and \$812 billion over 10 years, and non-defense discretionary outlays by \$12 billion in FY2012 and \$714 billion over 10 years, as shown in **Table 1**.⁸ These estimates require some assumptions to be made about the levels of discretionary spending that will occur in categories that are exempt from the caps. In this estimate, CBO assumes that emergency spending, which is exempt from the caps and designated at the discretion of Congress and the President, will be zero in the next 10 years; if any future spending is designated as emergency, discretionary savings from the Budget Control Act would be reduced dollar for dollar, all else being equal.

⁶ The baseline concept is explained in the following text box. For more information on how the spending cuts are determined, see CRS Report R42013, *The Budget Control Act of 2011: How Do the Discretionary Caps and Automatic Spending Cuts Affect the Budget and the Economy?*, by Marc Labonte and Mindy R. Levit. All of the reductions in spending discussed here would also lead to reductions in net interest because the federal debt would be lower than in the baseline. The effects on net interest are discussed in the section entitled "Effects of the BCA on the Budget Deficit."

⁷ This baseline is used because it was the official CBO baseline for discretionary spending until the enactment of the BCA. The amount of savings garnered by the Budget Control Act depends on the baseline to which it is being compared. For example, if it were being compared to a baseline based on 2010 levels of discretionary spending, the savings would be higher than if it were compared to 2011 levels.

⁸ Douglas W. Elmendorf, Director, Congressional Budget Office, "Overview: Discretionary Outlays, Security and Non-Security," testimony before U.S. Congress, Joint Committee on Deficit Reduction, October 26, 2011.

Table 1. Total Reductions in Outlays by Type from the Budget Control Act, FY2012-FY2021

(in \$ billion, + increase in spending/- decrease in spending)

	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2012- FY2021
Discretionary	-27	-103	-140	-156	-165	-174	-179	-186	-194	-202	-1,526
Defense	-15	-57	-74	-82	-87	-92	-95	-99	-103	-107	-812
Non-Defense	-12	-46	-66	-74	-78	-82	-84	-87	-91	-95	-714
Mandatory	+3	-6	-14	-19	-20	-20	-21	-22	-23	-25	-170
Student Loans	+3	+6	+3	-2	-2	-2	-2	-2	-2	-3	-5
Automatic Process	n/a	-12	-17	-17	-18	-18	-19	-20	-21	-22	-165
Medicare	n/a	-6	-11	-12	-13	-13	-14	-15	-16	-17	-117
Other Mandatory	n/a	-6	-5	-6	-5	-5	-5	-5	-6	-5	-48

Source: Congressional Budget Office, *Budget and Economic Outlook: Fiscal Years 2012 to 2022*, January 2012, Box 1-2; *Budget and Economic Outlook: Fiscal Years 2011 to 2021*, August 2011, Box 1-1; *Testimony Before the Joint Select Committee on Deficit Reduction*, U.S. Congress, October 26, 2011, Tables B-1 and B-2.

Notes: The reductions in discretionary spending illustrated in this table are the combined effects of the statutory limits on discretionary spending (i.e., discretionary caps) and the automatic spending reduction process. The savings from the cuts to discretionary spending are measured relative to the funding for 2011 adjusted for inflation. The reductions in mandatory spending are a result of BCA's student loan provisions and automatic spending reduction process. Allocation of the automatic spending reduction process between mandatory and discretionary programs are CBO projections based on baseline levels found in the *Budget and Economic Outlook*, January 2012. The allocation of the cuts could change over time based on actual spending levels. Totals may not sum due to rounding.

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—notably, tax provisions—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. For example, a baseline could assume that certain current policies will be extended; this is sometimes referred to as a *current policy* baseline. Projected deficits under a current law baseline and a current policy baseline are compared in **Table 5**.

As seen in **Table 1**, mandatory spending is projected to be cut by \$12 billion in FY2013 and \$165 billion over the FY2013 to FY2021 period under the automatic spending reduction process. Most of the mandatory spending cuts in dollar terms are to Medicare. The amount of the cuts to mandatory spending is lower than those to discretionary spending because much of mandatory spending is exempt from the BCA's automatic cuts and because mandatory spending is not subject to caps similar to those implemented for discretionary spending. Separate from the automatic process, the Budget Control Act also cuts mandatory spending on student loan programs by \$5 billion over 10 years.⁹

If Congress acts to prevent the automatic spending cuts from taking place beginning in January 2013, but leaves the original BCA discretionary caps in place, total discretionary spending would be reduced by \$778 billion over 10 years, assuming no other policy changes are made. In this scenario, mandatory spending would be cut by only \$5 billion, with the cuts solely affecting student loan programs.

Spending Trends: Historical and Projected Under the BCA

To understand how the BCA affects spending, this section compares the levels and percentage changes in spending under the BCA to historical data. Spending levels over time can be compared using a number of different measures, however, as discussed in the text box below.

To date, recent policies to reduce the deficit have primarily focused on reducing discretionary spending (spending that is provided and controlled through the appropriations process). This trend pre-dates the BCA. In terms of budget authority, overall discretionary spending declined from \$1.264 trillion in FY2010 to \$1.221 trillion in FY2011 and to an estimated \$1.199 trillion in FY2012, assuming no additional appropriations are provided before the fiscal year ends.¹⁰ These declines are in terms of nominal dollars; the decline would be larger if the figures were adjusted for inflation. In 2011, the decline is mostly the result of a reduction in non-defense discretionary spending, and in 2012 the decline is mostly caused by a reduction in spending on overseas contingency operations (OCO).

⁹ Congressional Budget Office, *Budget and Economic Outlook*, January 2012, p. 13.

¹⁰ Discretionary outlays declined from \$1.347 trillion in 2010 and \$1.346 trillion in 2011 to a projected \$1.308 trillion in 2012. Office of Management and Budget, *Budget for FY2013, Historical Tables*, Tables 5.6 and 8.1; Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2012 to 2022*, Table 3-5.

Measuring Spending Over Time

There are three main ways to measure changes in spending over time. Often, actual (nominal) dollar levels are used because that measure is most familiar. Over short periods of time when inflation is low, this measure can be useful; it has a number of drawbacks when making comparisons over long periods, however. The purpose of a comparison is to gauge the relative impact of spending over time, thereby making real or inflation-adjusted figures a more appropriate comparison. Real figures, which adjust for the increase in prices, account for the decline in the purchasing power of \$1 over time. For example, based on the consumer price index, \$1 in 1944 could buy the same amount of goods and services as \$12.75 in 2011. To buy a constant amount of goods and services over that period, the federal budget would have to increase by more than a factor of 12. Further, the relative impact of spending on households and the economy is eroded over time by economic growth, which provides households more income to spend on public and private goods. For example, at the height of World War II (1944), total federal spending was about \$91 billion, compared to \$3.6 trillion in 2011. But as a percentage of GDP, total federal spending was 44% of GDP in 1944, compared to 24% of GDP in 2011. This report compares spending levels using all three measures—nominal, real (inflation-adjusted), and as a percentage of GDP.

Table 2 shows the projected levels of discretionary budget authority and annual percentage changes, in real and nominal terms, subject to the BCA caps under the automatic spending reduction process (“trigger”). The levels in the table exclude funding for categories of spending (such as OCO, emergency, and disaster) for which cap adjustments are permitted. Since those categories of spending are effectively exempt from the caps, it is possible that the trend of growth in overall discretionary spending (spending subject to the cap plus exempt spending) could turn out to be higher than growth in discretionary spending subject to the BCA caps in future years, even if there is strict compliance with the caps. Alternatively, future Congresses could decide to appropriate an overall level of discretionary spending below the BCA caps, in which case the growth in actual spending could be lower than the growth in the caps.

Table 2. Discretionary Budget Authority Subject to BCA Caps Assuming “Trigger” Comes Into Effect, 2011-2021
(in \$ billion; percentage change from prior year)

	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
Nominal											
Defense	551.5	555.0	491.0	501.4	511.4	522.4	535.4	548.3	561.3	575.3	589.3
% Change	-0.3%	0.6%	-11.5%	2.1%	2.0%	2.2%	2.5%	2.4%	2.4%	2.5%	2.4%
Non-Defense	507.7	507.5	458.0	472.1	482.7	493.4	504.8	517.4	531.3	544.7	557.1
% Change	-6.0%	0.0%	-9.8%	3.1%	2.2%	2.2%	2.3%	2.5%	2.7%	2.5%	2.3%
Total	1,059.2	1,062.5	949.0	973.4	994.0	1,015.8	1,040.1	1,065.7	1,092.7	1,120.0	1,146.4
% Change	-3.1%	0.3%	-10.7%	2.6%	2.1%	2.2%	2.4%	2.5%	2.5%	2.5%	2.4%
Real (Inflation-Adjusted)											
Defense	485.0	479.2	417.0	419.1	419.9	421.4	424.2	426.2	428.0	430.2	432.1
% Change	-2.2%	-1.2%	-13.0%	0.5%	0.2%	0.3%	0.7%	0.5%	0.4%	0.5%	0.4%
Non-Defense	446.5	438.2	389.0	394.6	396.4	398.0	400.0	402.2	405.1	407.3	408.5
% Change	-7.8%	-1.8%	-11.2%	1.4%	0.5%	0.4%	0.5%	0.5%	0.7%	0.5%	0.3%
Total	931.4	917.4	806.0	813.6	816.3	819.4	824.1	828.4	833.1	837.5	840.6
% Change	-5.0%	-1.5%	-12.1%	0.9%	0.3%	0.4%	0.6%	0.5%	0.6%	0.5%	0.4%

Source: CRS calculations based on Office of Management and Budget, *Budget for Fiscal Year 2013, Historical Tables*, Table 5.6 and 10.1; OMB Report on Disaster Relief Funding to the Committees on Appropriations and the Budget of the U.S. House of Representatives and the Senate, September 1, 2011, Table 1; Congressional Budget Office, *Budget and Economic Outlook: Fiscal Years 2012 to 2022*, January 2012, Box 3-2, Table 3-5, and Table E-2.

Notes: The reductions in discretionary spending illustrated in this table are the combined effects of the statutory limits on discretionary spending (i.e., discretionary caps) and the automatic spending reduction process. Totals may not sum due to rounding. For FY2011, numbers are actual discretionary BA less disaster spending and OCO. For FY2012 to FY2021, numbers are BCA cap levels, and do not include adjustments to the caps allowed under BCA for categories of spending not subject to the caps. Real figures are adjusted by the GDP price index using 2005 dollars. See CBO Tables for additional notes.

In both nominal and real terms, the largest year-over-year percentage declines in spending over the FY2011 to FY2021 period are projected to take place in FY2013, largely as a result of the commencement of the BCA's automatic spending reductions. That year, discretionary budget authority subject to the caps falls by 10.7% in nominal terms and 12.1% in real terms compared to FY2012 levels.¹¹ As can be seen in **Table 2**, the cut that year is significantly larger than the cuts that occurred in 2011.

While there are no long-term historical data on spending subject to the caps available for direct comparison, since FY1977, overall discretionary budget authority only fell in eight other years in nominal terms, by less than 5% in each of those years except FY2010.¹² Unless offset by growth in exempt categories, the FY2013 decline would be larger than in any other year except FY2010.¹³ The decline in spending subject to the caps in FY2013 follows a nominal decline in FY2011 and a nominal increase in FY2012 that was less than the rate of inflation (resulting in a decline in real terms).¹⁴ In FY2013, real defense discretionary spending subject to the BCA caps is lower than FY2005 levels, and real non-defense discretionary is lower than FY2003 levels.

From FY2014 to FY2021, discretionary spending subject to the caps increases annually at a rate that is slightly higher than the projected rate of inflation. Since the BCA caps nominal spending, whether real spending increases or decreases from FY2014 to FY2021 is highly sensitive to the inflation rate. For example, if inflation turns out to be slightly higher than projected, spending would decline in real terms from FY2014 to FY2021 instead of the increase shown in **Table 2**.

As a result of the decline in discretionary spending subject to the caps in FY2011 and FY2013, followed by the rise in spending that is slightly faster than the rate of inflation from FY2014 to FY2021, spending subject to the caps does not return to its FY2011 level until FY2018 in nominal terms and will not return to FY2011 levels in real terms at any point in the 10-year budget window. Defense and non-defense discretionary spending subject to the caps will also not return to FY2011 levels in real terms during the budget window. Since the population is growing over the next 10 years, real or nominal declines would be greater on a per capita basis than the overall rates shown in **Table 2**.

To compare projections of discretionary spending under the BCA to historical trends, adjustments need to be made for types of discretionary spending not subject to the BCA caps, such as emergency spending, disaster spending, and OCO. **Table 3** makes this adjustment by excluding funding for OCO and disaster spending for FY2001 to FY2011. Emergency spending was not removed from spending totals for recent fiscal years.

Table 3 compares growth in discretionary spending (adjusted to remove OCO and disaster spending) in the past decade to the next decade, during which spending is projected to decline. In

¹¹ The percentage decline in overall discretionary budget authority will depend on the change in budget authority for exempt categories, such as OCO, disaster, and emergency spending. The percent reduction in 2013 budget authority will be spread over future years; outlays in 2013 subject to the caps are projected to decline by 7.1%.

¹² From 1977 to 2011, overall discretionary outlays only fell in two years in nominal terms, however.

¹³ The declines in spending in FY2010 largely reflects the previous year increase in discretionary BA caused by the American Reinvestment and Recovery Act (ARRA), popularly referred to as the "stimulus act." Non-defense budget authority was \$1.2 trillion in 2008, \$1.5 trillion in 2009, and \$1.3 trillion in 2010.

¹⁴ As noted above, overall discretionary budget authority fell in 2012, but mainly because of a decline in OCO spending, which is not subject to the caps.

real (inflation-adjusted) terms, adjusted discretionary spending grew at an annual rate of 4.1% for the FY2001 to FY2010 period, with the growth fairly evenly split between defense and non-defense discretionary. For the FY2011 to FY2021 period, cuts to discretionary spending prior to the BCA combined with the BCA caps and trigger cause spending to decline by an average of 1.4% annually, with the decline fairly evenly split between defense and non-defense discretionary spending.¹⁵ The first column of **Table 3** demonstrates the potential for overall discretionary spending growth to exceed the growth rate desired under the caps. In the 2001 to 2010 period, spending primarily related to Hurricane Katrina and operations in Iraq and Afghanistan caused OCO and disaster spending growth to exceed the growth rate of other discretionary spending.¹⁶

Table 3. Average Annual Real Growth Rate of Discretionary Spending, FY2001-FY2021

(Percentage change, adjusted for inflation)

	Overall	Subject to Caps	
	2001-2010 (actual)	2001-2010 (actual)	2011-2021 (projected)
Defense	6.6%	3.9%	-1.3%
Non-Defense	4.5%	4.3%	-1.5%
Total	5.6%	4.1%	-1.4%

Source: CRS calculations based on CBO and OMB data.

Notes: The projections of discretionary spending illustrated in this table assume that the statutory limits on discretionary spending (i.e., discretionary caps) and the automatic spending reduction process come into effect as scheduled. For historical data, numbers subject to caps are total discretionary BA less disaster spending and OCO. Data adjusted for inflation using GDP price deflator.

Figure 1 shows levels of total discretionary and mandatory spending as a percentage of GDP between FY1962 and FY2021. The levels between FY2012 and FY2021 are projected and assume that the discretionary caps and automatic spending cuts go into effect as scheduled under current law. As noted above, to compare historical data to projections, adjustments must be made for categories of discretionary spending exempt from the BCA caps. This figure uses CBO baseline levels for OCO, disaster, and emergency spending to compare to total discretionary spending in the past.¹⁷ In the figure, two CBO scenarios are illustrated. The first assumes that OCO budget authority is maintained at current levels (adjusted for inflation); the second scenario assumes a drawdown in troop levels in Afghanistan and other countries from 195,000 in FY2011 to 45,000 by FY2015. Under the latter scenario, OCO spending would be about 0.5% of GDP lower in FY2021 relative to what it would be under baseline levels. Both projections set emergency budget authority at zero and disaster spending at levels permitted under the BCA.¹⁸

¹⁵ Although defense discretionary spending receives a larger dollar reduction than non-defense discretionary under the BCA's automatic process, non-defense discretionary falls more in percentage terms over the 2011 to 2021 period because it declines more in 2011 and because defense is larger than non-defense discretionary in dollar terms.

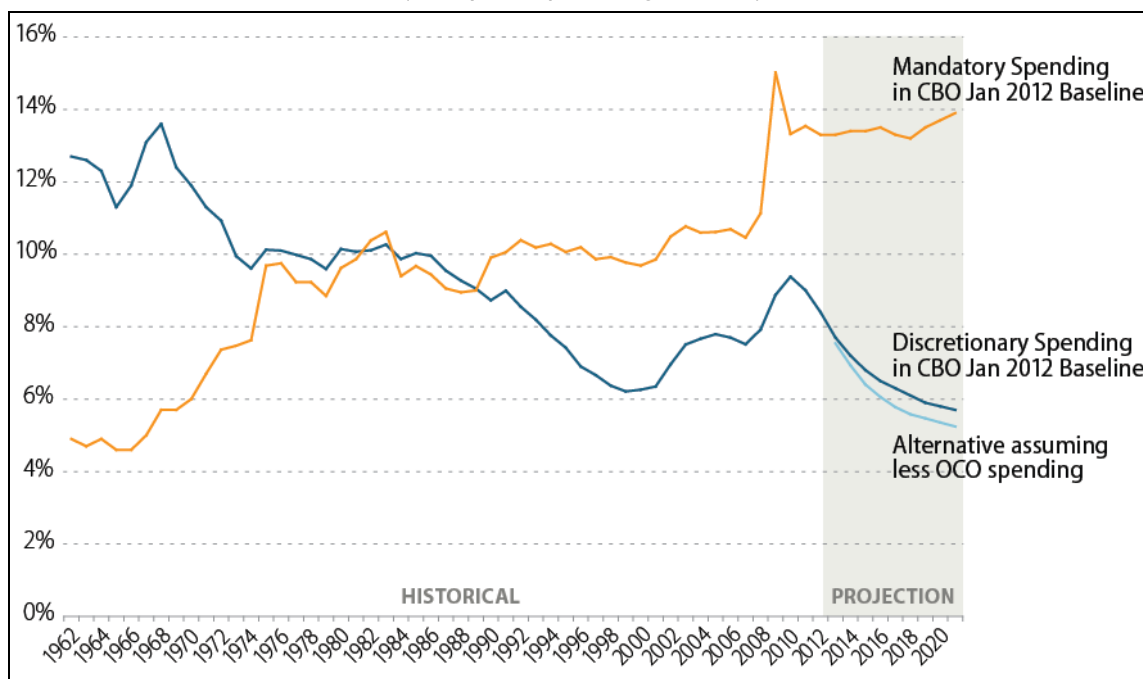
¹⁶ From 2001 to 2010, OCO BA averaged \$111 billion and disaster BA averaged \$13 billion.

¹⁷ For earlier years, data were not available to remove OCO and disaster spending from discretionary totals, as was done in **Table 3**.

¹⁸ The BCA allows annual disaster spending in amounts up to "the average funding provided for disaster relief over the previous 10 years, excluding the highest and lowest years" plus the difference between disaster spending in the preceding fiscal year and the applicable average funding level for that year. Disaster spending is defined in the BCA as spending classified in specified budget accounts

Figure 1. Discretionary and Mandatory Spending, FY1962-FY2021

(Outlays as a percentage of GDP)



Source: Office of Management and Budget, *Budget for FY2013, Historical Tables*, Table 8.4; Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2012 to 2022*, January 2012, Table F-3; CRS calculations.

Notes: The projection of discretionary spending illustrated in this table assumes that the statutory limits on discretionary spending (i.e., discretionary caps) and the automatic spending reduction process come into effect as scheduled. Federal spending data are categorized as discretionary and mandatory only back to FY1962.

Discretionary spending over the FY1962 to FY2011 period averaged 9.4% of GDP.¹⁹ As **Figure 1** shows, it rose relative to GDP from 2001 to 2011, but remained below the levels prevalent from FY1962 to FY1987.²⁰ In 2018, discretionary spending under the baseline would reach its lowest share of GDP since data were first available, at 6.1% of GDP, and would continue to decline thereafter. By FY2021, discretionary spending is projected to reach 5.7% of GDP or nearly 4 percentage points below the historical average. Under the alternative scenario, where OCO spending is lower, discretionary spending would reach its lowest share of GDP in this time frame in FY2016, and is projected to decline to 5.2% by FY2021. CBO's baseline projection assumes that defense discretionary spending will be equal to its lowest share of GDP in this time frame by FY2020 and non-defense discretionary spending will be equal to its lowest share of GDP in this time frame by FY2016.

What historical precedent is there for a sustained decline in discretionary spending as a share of GDP? There were two periods of sustained decline in discretionary spending as a percentage of GDP since 1962, occurring in FY1969-FY1974 and FY1987-FY2000, respectively. In both cases, the decline was driven mainly by a decline in defense spending as a percentage of GDP, in the former case because of a wind-down of operations in Vietnam and in the latter case by the "peace

¹⁹ Federal spending data are categorized as discretionary and mandatory only back to FY1962.

²⁰ Defense discretionary spending rose throughout the 2001-2011 period as a percentage of GDP. Non-defense discretionary spending showed no upward trend until 2009.

dividend” associated with the end of the Cold War. Non-defense discretionary spending fell as a percentage of GDP only in the second half of the latter period. In both cases, the decline in spending began from a higher starting point than today.

Mandatory spending under the BCA, by contrast, is projected to continue to grow in nominal terms, real terms, and relative to GDP over the next 10 years. For example, it is projected to increase from \$2.1 trillion (13.3% of GDP) in FY2012 to \$3.3 trillion (13.9% of GDP) in FY2021. This growth is primarily due to the projection that elderly entitlement spending (notably, Social Security and Medicare) will grow more quickly than GDP over the next 10 years. The BCA has a minimal effect on this trend—it reduces mandatory spending under the automatic spending reduction process by one-tenth of one percent of GDP annually. Social Security is exempt from the BCA’s automatic process, and most Medicare payments are reduced by no more than 2% relative to baseline levels. As can be seen in **Figure 1**, mandatory spending in FY2011 was at its second-highest share of GDP since data are first available (FY2009 was its highest share), and would exceed that share of GDP from FY2020 on. The cuts to Medicare under the BCA relative to current policy are not projected to prevent Medicare spending from growing in real terms and relative to GDP over the 10-year budget window.

Total spending is composed of discretionary spending, mandatory spending, and net interest on the federal debt. From FY2019 to FY2021, the growth in mandatory spending and net interest is greater than the decline in discretionary spending, resulting in a projected rise in total spending as a percentage of GDP. In FY2021, total spending is projected to equal 22% of GDP.²¹ This is well above the historical average; from FY1947 to FY2011, total outlays averaged 19.7%. Total outlays have been below 22% of GDP for most of the post World War II period, from FY1947 to FY1980, FY1987 to FY1990, and FY1993 to FY2008.

Effects of the BCA on the Budget Deficit

CBO estimates that the BCA will reduce the baseline deficit by \$2 trillion over 10 years. The estimated budgetary savings increase from \$24 billion in FY2012 to \$304 billion in FY2021 (shown in **Table 4**). Once the automatic spending reduction process is fully implemented, the BCA would reduce the deficit by about 1% of GDP each year overall. These figures include both the direct effect of lower spending on deficits, and the interest savings stemming from the lower deficits resulting from lower spending.

²¹ OCO spending is about 1% of GDP in this projection. If OCO spending were zero, spending in 2021 would still exceed the historical average.

Table 4. Budget Deficit Projections With and Without the BCA

	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2012- FY2021
Billions of \$											
Deficit Excluding BCA (Current Law)	1,195	724	540	438	460	422	416	483	515	541	5,734
Effects of BCA	-24	-112	-155	-181	-201	-221	-241	-259	-281	-304	-1,979
Baseline Deficit Including BCA (Current Law)	1,171	612	385	257	259	201	175	224	234	237	3,755
Deficit Including BCA (Current Policy)	1,194	938	861	781	826	822	859	980	1,071	1,158	9,490
% of GDP											
Deficit Excluding BCA (Current Law)	7.7	4.5	3.3	2.5	2.5	2.1	2.0	2.2	2.3	2.3	n/a
Effects of BCA	-0.2	-0.7	-0.9	-1.0	-1.1	-1.1	-1.2	-1.2	-1.2	-1.3	n/a
Baseline Deficit Including BCA (Current Law)	7.6	3.8	2.3	1.5	1.4	1.0	0.8	1.0	1.0	1.0	n/a
Deficit Including BCA (Current Policy)	7.7	5.9	5.2	4.4	4.4	4.2	4.2	4.5	4.7	4.9	n/a

Source: CRS calculations based on CBO data.

Notes: The effects of the BCA illustrated in this table assumes that the statutory limits on discretionary spending (i.e., discretionary caps) and the automatic spending reduction process come into effect as scheduled. Includes effects of lower debt service. Negative numbers reduce deficit, positive numbers increase deficit. Columns may not sum due to rounding. See **Table 5** for an explanation of how the deficit under current policy differs from the deficit under current law.

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 BCA was to match its deficit reduction provisions to 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 an intermediate goal, but not an ultimate goal of fiscal policy. Two other potential goals of deficit reduction could be to balance the budget or place the deficit on a sustainable path. In order to evaluate whether the BCA accomplishes either goal, it is first necessary to discuss the range of projections of future deficits.

Projections of future deficits depend on underlying assumptions, particularly the treatment of expiring provisions. In the "current law" baseline, certain policies set to expire under current law are assumed to do so as scheduled.²² 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.²³ Baseline deficits could potentially be projected under several other alternative assumptions. For example, **Table 5** illustrates how the extensions of "current policy" would change the deficit outlook relative to the current law baseline, by assuming that all tax cuts (except for the payroll tax cut) are extended, the AMT is indexed to inflation, and the doc fix is enacted. Under these assumptions, the budget deficit would be \$6.9 trillion greater over the FY2012-FY2021 period than under the current law baseline.²⁴

²² By statute, expiring 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. Expiring mandatory provisions enacted since 1997 and expiring tax provisions are assumed to expire as scheduled.

²³ 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 and Janemarie Mulvey. For more information on the AMT, see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Steven Maguire. For more information on expiring tax provisions, see CRS Report R42485, *An Overview of Tax Provisions Expiring in 2012*, by Margot L. Crandall-Hollick.

²⁴ U.S. Congressional Budget Office, *The Budget and Economic Outlook*, January 2012, Table 1-6.

Table 5. Current Law and Current Policy Baseline Deficit Projections

(billions of dollars)

	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2012- FY2021
Baseline Deficit (Current Law) ^a	1,171	612	385	257	259	201	175	224	234	237	3,755
+ Extend Bush Tax Cuts and Index AMT to Inflation	11	233	339	395	442	495	552	616	685	758	4,526
+ Extend Doc Fix	0	14	20	23	28	32	37	43	50	54	301
+ Extend Tax Extenders	12	79	117	106	97	94	95	97	102	109	908
= Deficit (Current Policy) ^a	1,194	938	861	781	826	822	859	980	1,071	1,158	9,490

Source: CRS calculations based on CBO data. Columns may not sum due to rounding.

Note: Includes effects of lower debt service. AMT = alternative minimum tax

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

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. Even under a current law baseline, the BCA's \$2 trillion in deficit reduction under current law would leave projected deficits of \$3.8 trillion over 10 years, compared to the \$5.7 trillion over 10 years prior to the enactment of the BCA (see **Table 4**). Because the budgetary savings in FY2012 is only \$24 billion (\$27 billion savings from the cap and \$3 billion cost of student loan provisions), the baseline deficit in FY2012 is still projected to exceed \$1 trillion.

Likewise, the \$2 trillion in deficit reduction relative to the baseline contained in the BCA does not mean that the total federal debt will decrease by \$2 trillion relative to today's levels. Rather, it means that the projected cumulative deficit over the FY2012-FY2021 period will be about \$2 trillion less than it otherwise would have been if the BCA had not been enacted. 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 \$10.1 trillion in FY2011 to \$14.7 trillion in FY2021 under the current law baseline.²⁵

While the BCA is not projected to result in a balanced budget, another policy goal may be to place the deficit on a sustainable path, 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 path since debt service cannot rise faster than income indefinitely.²⁶ Whether or not the BCA's forecast accomplishes this depends on what assumptions are used in the baseline.

Under the current policy baseline (incorporating the effects of the BCA), deficits are projected to be \$9.5 trillion—\$5.7 trillion larger than the current law deficits—over 10 years. Changing from a current law baseline to a current policy baseline increases the deficit by more than twice as much as the BCA reduces the deficit. Under the current policy baseline, deficits never get lower than 4.2% of GDP (rising to 4.9% of GDP by FY2021) and the debt continues to rise relative to GDP each year. Thus, 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.

Under current law, budget deficits fall below 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—placing the budget back on a sustainable path. (Indeed, even without the BCA, budget deficits were projected to have become low enough under current law to stabilize the debt relative to GDP over the budget window.) In other words, allowing expiring tax cuts, the AMT “patch,” and the “doc fix” to Medicare to expire would be one set of policy changes that would place the deficit on a sustainable basis. CRS does not take a position on whether these policy options are more or less desirable than various alternatives. Beyond the 10-year budget window, unsustainably large budget deficits are projected to reappear, primarily driven by the assumption that health care costs will continue to grow faster than GDP.²⁷

²⁵ The publicly held debt is the gross debt less the intragovernmental debt. In FY2011, the gross debt was \$14.8 trillion.

²⁶ For more information, see CRS Report R40770, *The Sustainability of the Federal Budget Deficit: Market Confidence and Economic Effects*, by Marc Labonte.

²⁷ For more information, see CRS Report RL32747, *The Economic Implications of the Long-Term Federal Budget Outlook*, by Marc Labonte.

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