Deficit, Debt and Debt Limit

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EXECUTIVE SUMMARY

Deficit and National Debt

The federal deficit and the national debt are two different things, but they are related. The deficit is the annual fiscal year difference between what the United States government takes in from taxes and other revenues (called receipts) and the amount of money the government spends (called outlays). The total national debt is accumulated federal deficits year after year. Simply, the federal government runs a deficit when spending (mandatory, discretionary and interest payments on the debt) is greater than revenues (taxes and fees). The national debt is the total money we owe.

Prior to World War II, the federal budget was in surplus about as often as it was in deficit. Some of the largest increases in the debt resulted from wartime spending. From fiscal year (FY) 1998 to FY 2011, the federal government ran budget surpluses. Since then, the budget has returned to deficit and the debt has risen. Deficits became significantly larger in 2009 when the federal budget deficit exceeded $1 trillion for the first time and it has remained above $1 trillion since.

The federal budget has been in deficit since 2002, and deficits became significantly larger in 2009. In 2009, the federal budget deficit exceeded $1 trillion for the first time and it has remained above $1 trillion since. The 2010 deficit came in at $1.6 trillion – the largest deficit ever in our nation's history. At 10.9 percent of gross domestic product (GDP), it was and is also the largest deficit as a share of the economy since World War II – from 1946 to 2008, the budget deficit averaged 1.7 percent of GDP. It is projected to continue to remain above $1 trillion throughout 2012 for the fourth year in a row.

The federal government runs a budget deficit when its annual spending exceeds its annual revenue. To finance the shortfall, the government generally has to borrow funds from the public by selling Treasury securities (bonds, notes and bills). That additional borrowing increases the total amount of federal debt held by the public, which for the most part reflects the accumulation of past budget deficits offset by past budget surpluses.

The United States, as organized under the U.S. Constitution in 1789, has almost always held some level of national debt. In fact, the nation has been free of debt for only two years: 1834 and 1835. In its first year, 1790, the country faced a debt of $75 million. As of this writing, our national debt is more than $15 trillion. You can find out what the debt is to the penny by going here.

The ever-increasing debt is a serious threat to the American economy. Over the long-term, the costs of federal borrowing will be borne by tomorrow's workers and taxpayers. Persistent deficits and rising levels of debt reduce funds available for private investment. Over time, lower productivity and economic growth ultimately may reduce or slow the growth of the living standards of future generations. The national debt left on its current trajectory will result in rising inflation, higher interest rates and the potential unwillingness of foreign investors to invest in a weakening American economy.

"Debt held by the public" is all federal debt held by nonfederal investors, including the Federal Reserve System. "Total outstanding debt" counts the total value of outstanding notes, bonds, bills and other debt instruments issued by the Treasury and other federal agencies and so, includes the debt held by the public as well as debt held by government accounts (trust funds like Social Security, deposit insurance funds, etc.).

Who Do We Owe?

The makeup of those who hold our national debt through U.S. Treasury securities is a diverse group ranging from individual investors, corporations and pension funds to governments including state, federal and foreign. The largest holder of Treasury debt is actually the U.S. government itself through investments by the Federal Reserve (Fed) and major government trusts and accounts.

For a number of years, there has been growing concern over foreign ownership of our national debt. A growing proportion of the federal debt is held by foreign investors and governments. The two largest foreign creditors are currently (as of this writing) Mainland China and Japan. There is also a large portion owned by a group identified as Oil Exporters which includes Ecuador, Venezuela, Indonesia, Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates, Algeria, Gabon, Libya and Nigeria.

Legitimate concern arises over countries, China in particular, that own our debt that may have national priorities or strategic objectives that run counter to those of the United States. Further concern arises over the possibility of these nations using their ownership of the debt as leverage against U.S. policy they might oppose. Others simply believe that foreign ownership of U.S. debt is a vote of confidence in the U.S. economy.

Debt Limit

The statutory debt limit (debt limit) is the maximum amount of money the government is allowed to borrow without receiving additional authority from Congress. Prior to 1917, Congress approved each issuance of debt. In 1917, to facilitate planning in World War I, the law established a dollar ceiling for federal borrowing which has been raised periodically over the years.

The debt limit applies to almost all federal debt – roughly 0.5 percent of total debt is excluded from debt limit coverage. The Treasury specifically defines "Total Public Debt Subject to Limit" as "the Total Public Debt Outstanding less Unamortized Discount on Treasury Bills and Zero-Coupon Treasury Bonds, old debt issued prior to 1917, and old currency called United States Notes, as well as Debt held by the Federal Financing Bank and Guaranteed Debt." In simpler terms, the debt limit applies to federal debt held by the public (again, that is debt held outside the federal government itself) and to federal debt held by the government's own accounts. Federal trust funds, like Social Security, Medicare, Transportation and Civil Service Retirement accounts, hold most of this internally held debt.

Raising the Debt Limit

On May 16, 2011, U.S. Treasury Secretary Timothy Geithner announced that the federal debt had reached its statutory limit and declared a debt issuance suspension period, unless Congress acted beforehand, which would allow certain extraordinary measures to extend Treasury's borrowing capacity until about Aug. 2, 2011. On May 31, 2011, the House failed to pass H.R. 1954, a "Clean" Debt Limit Increase, by a vote of 97 to 318. H.R. 1954 would have increased the federal debt limit by $2.5 trillion from $14.294 trillion to $16.7 trillion. This vote was expected to fail and was taken in order to show President Obama and Congressional Democrats that the House would not vote to increase the federal debt limit with significant concessions on spending and budgetary reforms.

On Aug. 2, 2011, following a months-long debt limit standoff, the House passed S. 365, the Budget Control Act of 2011 (BCA), on Aug. 1, 2011. The Senate passed it on Aug. 2, 2011, and President Obama signed it into law (P.L. 112-25) on the same day. In brief, the plan permitted continued government borrowing into 2013 and allowed the debt limit to be increased by up to $2.4 trillion in three tranches. It also required a vote be taken in both the House and Senate on a balanced budget amendment (BBA) to the U.S. Constitution and created a temporary joint select House-Senate committee, or the Joint Select Committee on Deficit Reduction (Joint Committee), to recommend budgetary changes to reduce the deficit. In addition to this, 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 FY 2012 to FY 2012 period.

Some of the automatic spending reductions associated with the BCA are of great concern to many, particularly the cuts to defense spending set to take place in FY 2013. House Republicans offered and passed a plan to replace these cuts with offsets, but this plan has moved no further in the legislative process.

THE FEDERAL DEFICIT

The federal deficit and the national debt are two different things, but they are related. The deficit is the annual fiscal year difference between what the United States government takes in from taxes and other revenues (called receipts) and the amount of money the government spends (called outlays). The items included in the deficit are considered either "on-budget" or "off-budget."

You can think of the total national debt as accumulated federal deficits year after year. These on-budget deficits require the U.S. Treasury to borrow money to raise cash needed to keep the government operating. Treasury borrows the money by selling securities like Treasury bills, notes, bonds and savings bonds to the public. The Treasury securities issued to the public and to the government trust funds (Intragovernmental Holdings) then become part of the total debt.

Editor's Note: *Intragovernmental Holdings are Government Account Securities held by government trust funds, revolving funds and special funds; and federal financing bank securities.*

The federal government runs a deficit when spending (mandatory, discretionary and interest payments on the debt) is greater than revenues (taxes and fees).

Editor's Note: *For more information on federal budget terminology, please refer to the Budget and Federal Spending chapter of the 2012 NRCC Issues book.*

Prior to World War II, the federal budget was in surplus about as often as it was in deficit. Some of the largest increases in the debt resulted from wartime spending. There were large increases in the debt held by the public related to the Civil War and also to World War I. Since World War II, the federal budget has been in deficit most of the time and the debt has steadily grown. From fiscal year (FY) 1998 to FY 2001, the federal government ran budget surpluses. Since then, the budget has returned to deficit and the debt has risen.

Current Federal Deficit Situation

The federal budget has been in deficit since 2002, and deficits became significantly larger in 2009. In 2009, the federal budget deficit exceeded $1 trillion for the first time and it has remained above $1 trillion since. The 2010 deficit came in at $1.6 trillion – the largest deficit ever in our nation's history. At 10.9 percent of gross domestic product (GDP), it was and is also the largest deficit as a share of the economy since World War II – from 1946 to 2008, the budget deficit averaged 1.7 percent of GDP. It is projected to continue to remain above $1 trillion throughout 2012 for the fourth year in a row.

CBO's Budget Projections: Each January, the Congressional Budget Office (CBO) releases its report, "The Budget and Economic Outlook," which details its baseline projections of the budgetary effects of recently enacted legislation and updated technical assumptions based on any new information such as data about spending and revenues so far this year. This report is periodically updated throughout the year. You can view the January 2012 report here.

When CBO does its budget projections, it provides two different projections: a baseline budget projection based on current law assumptions and an alternative fiscal scenario. For example, a baseline budget projection assuming current law would assume, for one, the scheduled expirations of tax provisions such as the scheduled expiration of the 2001 and 2003 Bush tax cuts at the end of 2012. Current law has them expiring at the end of this year without further legislative action to extend them.

An alternative fiscal scenario incorporates the assumptions that almost all expiring tax provisions are extended, etc. As we all know, tax cuts, and other tax policies, have an effect on the economy as a whole, as well as the federal deficit – with less revenue coming into the Treasury due to the reduced tax rates, this can increase the deficit unless paired with lower spending.

Projected Deficit: According to the March 2012 update of this CBO report, the federal budget is projected (under the budget baseline projection) to show a deficit of nearly $1.2 trillion in 2012. This estimate is about $93 billion larger than the deficit projected in the January 2012 report. Relative to our GDP, that shortfall will equal 7.6 percent – about one percentage point less than the recorded deficit last year, but still higher than any deficit between 1946 and 2008.

At the same time, though, CBO projected that the cumulative deficit over the 10-year period of 2013 to 2022 is $186 billion smaller than the amount projected in January – a decrease equal to about 0.1 percent of GDP over that timeframe. In CBO's baseline projection, deficits are projected to drop markedly in the next few years and to average 1.4 percent of GDP over the 2013 to 2022 period.

Much of this projected decline occurs because, under current law CBO projects that revenues would rise considerably as a share of GDP – from 15.8 percent in 2012 to 19.8 percent in 2014 and 21.2 percent in 2022 – due to current law assumptions that the scheduled expirations of tax cuts (including, but not limited to just the 2001 and 2003 Bush tax cuts, the extension of the reduced Social Security payroll tax rate, etc.) will occur AND the imposition of new taxes, fees and penalties scheduled to go into effect.

Conversely, CBO's alternative fiscal scenario would incorporate several assumptions of its own including expiring tax provisions are extended, the Alternative Minimum Tax (AMT) is again indexed for inflation (for 2012, etc.), etc. Under this scenario, deficits over the 2013 to 2022 period would be much higher than those under CBO's budget baseline projection, averaging 5.3 percent of GDP rather than the 1.4 percent reflected in CBO's baseline projections.

But, CBO is very clear that the fundamental story about the federal budget has not changed:

> "Although the deficit is starting to shrink, it remains very large by historical standards. How much and how quickly it declines will depend in part on how well the economy performs over the next few years. Probably more critical, though, will be the fiscal policy choices made by lawmakers as they face the substantial changes to tax and spending policies that are slated to take effect within the next year under current law."[1]

CBO also goes on to say that even if the fiscal policies under current law or those under the alternative fiscal scenario do, the aging of the population and rising costs for health care will continue to push spending for Social Security, Medicare, Medicaid and other federal health care programs considerably higher as a percentage of GDP. Essentially, CBO concludes that even if the above-mentioned tax and revenue policies are extended or not extended, it does not matter over the long term because to prevent an outcome of

[1] "Updated Budget Projections: Fiscal Years 2012 to 2022," Congressional Budget Office (CBO), http://www.cbo.gov/sites/default/files/cbofiles/attachments/March2012Baseline.pdf, March 2012

resulting deficits that would push federal debt to "unsupportable levels," policymakers would have to do one of three things:

1) "substantially restrain the growth of spending for those programs;"

2) "raise revenues above their historical share of GDP; or

3) "pursue some combination of those two approaches." [2]

Below is a chart prepared by CBO showing the projected deficits according to CBO's March 2012 report:

Deficits Projected in CBO's Baseline and Under an Alternative Fiscal Scenario

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total 2013-2017	Total 2013-2022
In Billions of Dollars													
CBO's March 2012 Baseline													
Revenues	2,456	2,968	3,283	3,589	3,838	4,066	4,272	4,484	4,719	4,962	5,218	17,744	41,398
Outlays	3,627	3,580	3,668	3,846	4,097	4,267	4,447	4,708	4,953	5,200	5,520	19,457	44,285
Deficit	**-1,171**	**-612**	**-385**	**-257**	**-259**	**-201**	**-175**	**-224**	**-234**	**-237**	**-303**	**-1,713**	**-2,887**
Debt Held by the Public at the End of the Year	11,347	12,068	12,556	12,909	13,263	13,560	13,820	14,123	14,432	14,741	15,115	n.a.	n.a.
Alternative Fiscal Scenario													
Revenues	2,432	2,660	2,873	3,147	3,378	3,583	3,760	3,943	4,139	4,341	4,550	15,641	36,374
Outlays	3,627	3,660	3,826	4,030	4,312	4,520	4,739	5,046	5,338	5,635	5,999	20,348	47,105
Deficit	**-1,195**	**-1,000**	**-953**	**-883**	**-934**	**-936**	**-979**	**-1,104**	**-1,199**	**-1,294**	**-1,449**	**-4,707**	**-10,731**
Debt Held by the Public at the End of the Year	11,370	12,479	13,536	14,515	15,545	16,577	17,641	18,823	20,098	21,462	22,983	n.a.	n.a.
As a Percentage of Gross Domestic Product													
CBO's March 2012 Baseline													
Revenues	15.8	18.7	19.8	20.4	20.5	20.6	20.7	20.7	20.9	21.0	21.2	20.0	20.5
Outlays	23.4	22.5	22.1	21.8	21.9	21.7	21.5	21.8	21.9	22.0	22.4	22.0	22.0
Deficit	**-7.6**	**-3.8**	**-2.3**	**-1.5**	**-1.4**	**-1.0**	**-0.8**	**-1.0**	**-1.0**	**-1.0**	**-1.2**	**-1.9**	**-1.4**
Debt Held by the Public at the End of the Year	73.2	75.8	75.8	73.3	70.9	68.8	66.9	65.3	63.9	62.4	61.3	n.a.	n.a.
Alternative Fiscal Scenario													
Revenues	15.7	16.7	17.3	17.9	18.1	18.2	18.2	18.2	18.3	18.4	18.5	17.7	18.0
Outlays	23.4	23.0	23.1	22.9	23.1	22.9	22.9	23.3	23.6	23.9	24.3	23.0	23.4
Deficit	**-7.7**	**-6.3**	**-5.8**	**-5.0**	**-5.0**	**-4.8**	**-4.7**	**-5.1**	**-5.3**	**-5.5**	**-5.9**	**-5.3**	**-5.3**
Debt Held by the Public at the End of the Year	73.3	78.4	81.7	82.4	83.1	84.1	85.4	87.1	88.9	90.9	93.2	n.a.	n.a.

[2] "Updated Budget Projections: Fiscal Years 2012 to 2022," Congressional Budget Office (CBO), http://www.cbo.gov/sites/default/files/cbofiles/attachments/March2012Baseline.pdf, March 2012

Why Large Federal Deficits Are Bad

The recent growth in deficits is the result of spending reaching its highest level as a share of GDP since 1945 and revenues reaching their lowest level as a share of GDP since 1950. Large budget deficits can result in a budgetary crisis for two main reasons:

1) As deficits persist, government incurs debt and as a nation's debt grows, so too do interest payments on that debt, limiting spending on other parts of the budget.

2) Increasing deficits and debt can also trigger fear among creditors about a government's ability to repay its debts, resulting in unwillingness by creditors to lend at affordable rates.

The U.S. fiscal outlook is not a purely long-term issue, however – deficits are already at unsustainable high levels today. Many experts believe that deficits must be reduced to "sustainable" levels in order to avoid a budgetary crisis. A budget deficit can be "sustainable" if deficits are small enough so that the accumulation of annual deficits – the debt – does not grow faster than GDP. But, of course, people differ on what is the exact size of a sustainable budget deficit, but in general, below three percent of GDP is what is cited. For example, the FY 2012 House Republican Budget Resolution (or, the FY 2012 Ryan Budget), as analyzed by CBO, would lower the deficit to two percent of GDP by 2022. Prior Congressional Research Service (CRS) analysis estimated that annual budget deficits would need to be no larger than 2.5 percent to 3.0 percent of GDP over the next 10 years in order to stabilize the debt as a share of GDP at its projected 2011 level (69 percent of GDP).

THE NATIONAL DEBT

The federal government runs a budget deficit when its annual spending exceeds its annual revenue. To finance the shortfall, the government generally has to borrow funds from the public by selling Treasury securities (bonds, notes and bills). That additional borrowing increases the total amount of federal debt held by the public, which for the most part reflects the accumulation of past budget deficits offset by past budget surpluses.

The United States, as organized under the U.S. Constitution in 1789, has almost always held some level of national debt. In fact, the nation has been free of debt for only two years: 1834 and 1835. In its first year, 1790, the country faced a debt of $75 million. As of this writing, our national debt is more than $15 trillion. You can find out what the debt is to the penny by going here.

Editor's Note: *The first fiscal year for the U.S. Government started Jan. 1, 1789. Congress changed the beginning of the fiscal year from Jan. 1 to July 1 in 1842, and finally from July 1 to Oct. 1 in 1977 where it remains today.*

The ever-increasing debt is a serious threat to the American economy. For most of the history of the United States, federal debt was closely linked to war finance. In more recent decades, the growing costs of federally financed health care and other entitlement spending have played an important role in the government's fiscal situation. Higher spending on defense and other security costs, as well as tax cuts and other tax policy decisions have also influenced the size of federal deficits and the accumulation of debt.

The federal government ran very large deficits during the 1940s – hitting 30 percent of GDP in 1943 – to finance military activities during World War II. Deficit finance, however, played little role in funding the Koran War or the early stages of the Vietnam War. In the 1970s, deficits as a share of GDP grew as economic growth slowed due to sharp increases in oil and other commodity prices, slower productivity growth, turmoil in the international financial system, expanded regulatory activity and stiffer competition in international produce markets, while federal spending due to health care and other domestic programs grew faster than federal revenues. In the 1980s, cuts in domestic programs were too small to offset large tax cuts and increases in military spending, which led to large increases in federal deficits.

Over the long-term, the costs of federal borrowing will be borne by tomorrow's workers and taxpayers. Persistent deficits and rising levels of debt reduce funds available for private investment. Over time, lower productivity and economic growth ultimately may reduce or slow the growth of the living standards of future generations. The national debt left on its current trajectory will result in rising inflation, higher interest rates and the potential unwillingness of foreign investors to invest in a weakening American economy.

The CBO puts it this way:

> "Debt held by the public can grow faster than gross domestic product (GDP) for a limited time, but it cannot do so indefinitely. If the ratio of debt to GDP continues to rise, lenders may become concerned about the financial solvency of the government and demand higher interest rates to compensate for the increasing riskiness of holding government debt.
>
> Eventually, if the debt-to-GDP ratio keeps increasing and the budget outlook does not improve, both foreign and domestic lenders may not provide enough funds for the government to meet its obligations. By then, whether the government resolves the fiscal

crisis by printing money, raising taxes, cutting spending, or going into default, economic growth will be seriously disrupted."[3]

And, according to CRS:

"Should the federal government be unable to find private sector buyers, either domestic or foreign, for its securities there are two possible outcomes.

"First, the federal government could simply find itself unable to meet all of its obligations. In that case outlays would have to fall unless taxes were increased enough to eliminate the shortfall. Second, rather than allow the government to default, the Federal Reserve might buy the securities that otherwise the government would be unable to sell.

"Although subject to congressional oversight, the Federal Reserve is independent and under no legal obligation to ensure the sale of government securities. But should it decide to do so, then the threat is no longer one of government insolvency, but rather of inflation.

"When the Federal Reserve buys Treasury securities, it increases the stock of reserves to commercial banks. Those increased reserves, in turn, increase the banks' capacity to lend money and create demand deposits, increasing the stock of money in circulation. The historical record demonstrates that continued financing of large government budget deficits by "printing money" runs a substantial risk of rapidly accelerating inflation."[4]

Debt Held by the Public vs. Total Outstanding Debt

"Debt held by the public" is all federal debt held by nonfederal investors, including the Federal Reserve System.

Editor's Note: *For more information regarding the Federal Reserve, please refer to the Economy and Jobs chapter of the 2012 NRCC Issues Book.*

"Total outstanding debt" counts the total value of outstanding notes, bonds, bills and other debt instruments issued by the Treasury and other federal agencies and so, includes the debt held by the public as well as debt held by government accounts (trust funds like Social Security, deposit insurance funds, etc.).

Who Owns the Debt?

The makeup of those who hold our national debt through U.S. Treasury securities is a diverse group ranging from individual investors, corporations and pension funds to governments including state, federal and foreign.

The largest holder of Treasury debt is actually the U.S. government itself through investments by the Federal Reserve (Fed) and major government trusts and accounts. Most of the government's

[3] "Long Term Budget Outlook," CBO, June 2009
[4] Brian W. Cashell, "The Federal Government Debt: It's size and economic significance," Congressional Research Service (CRS), Jan. 27, 2006

holdings are massive savings accounts for programs like Social Security and Medicare. Just as an investor may prefer to keep retirement savings in Treasury bonds due to their traditionally perceived safety, those managing the Social Security Trust Fund are looking for a secure investment, too.

A graph prepared by the Congressional Research Service (CRS) can be found below (**Figure 1**) showing the dollar breakdown of the federal debt in 2010. Below is a descending list, beginning with the largest holder of U.S. government debt:

Editor's Note: *This list is based on the most recently available data for each respective debt-holder, at the time of this writing. The rankings in this list can change from time to time, so please keep that in mind.*

Federal Reserve and Intragovernmental Holdings: At the time of this writing, the biggest single holder of U.S. debt is inside the United States and includes the Fed and other intragovernmental holdings at a total of about $6.3 trillion. Of this amount, the Fed's system of banks owns approximately $1.65 trillion in U.S. Treasury securities. Other U.S. intragovernmental holdings – which include large funds like the Medicare Trust Fund, the Social Security Trust Fund and the Unemployment Trust Fund – hold the rest. The breakdown of the debt can be found in the Treasury Bulletin in which both are combined into one category and the total accounts for the $6.3 trillion in holdings. Approximately 10 years ago, the total government holdings were "only" $2.5 trillion.

China: The largest foreign holder of U.S. Treasury securities, and the second biggest holder of U.S. debt, is China with $1.145 trillion (as of April 2012) in American debt. This amount is actually down from all-time highs of $1.173 trillion in July 2011.

Other Investors/Savings Bonds: This extremely diverse group includes individuals, government-sponsored enterprises, brokers and dealers, bank personal trusts, estates, savings bonds, corporate and noncorporate businesses for a total of $1.102 trillion (as of December 2011).

Japan: Currently the second biggest foreign holder of U.S. Treasury Securities (as of April 2012), Japan holds approximately $1.066 trillion in American debt.

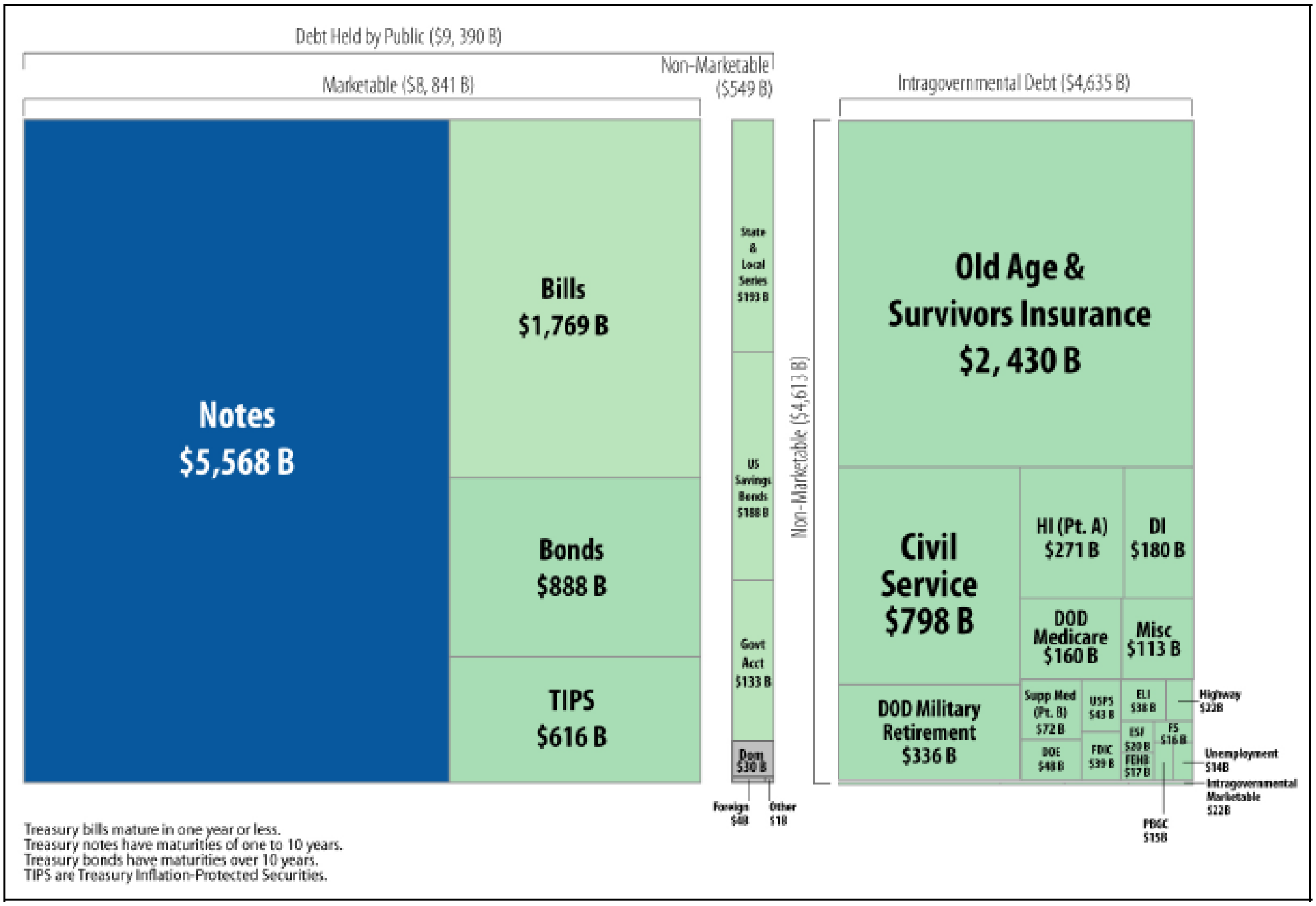
Pension Funds: Pension funds control large amounts of money reserved for personal retirements. This group, which includes private and local government pension funds, holds $903.4 billion (as of December 2011).

Mutual Funds: Mutual funds hold the sixth-largest amount of U.S. debt compared to any other group even though mutual fund holdings have diminished by more than $105 billion since 2008. Including money market funds, mutual funds and closed-end funds, this group of investments managed about $797 billion as of December 2011.

State and Local Governments: The current U.S. debt holdings of state and local governments (as of December 2011) are $444.6 billion.

Depository Institutions: As of December 2011, depository institutions hold approximately $286 billion in U.S. debt. This group includes commercial banks, savings banks and credit unions.

Figure 1. Structure of Federal Debt
$Billions, end of calendar year 2010



Insurance Companies and Oil Exporting Countries: These two debt-holders are tied both with $252.4 billion (for insurance companies, as of December 2011 and for the oil exporting countries, as of April 2012) in U.S. Treasury Securities.

Caribbean Banking Centers: This group includes Bahamas, Bermuda, Cayman Islands, Netherlands Antilles and Panama. As of April 2012, it holds $247 billion in U.S. Treasury Securities.

<u>Foreign Ownership of National Debt</u>

For a number of years, there has been growing concern over foreign ownership of our national debt. A growing proportion of the federal debt is held by foreign investors and governments. Foreign holdings of federal debt have increased for several reasons. First, global capital markets have become more international since the 1970s when regulatory controls on the capital flows were a common. In addition, many international investors have diversified their portfolios by including assets from many different countries. Second, some countries, especially in East Asia, have had very high savings rates that have financed significant accumulations of federal debt. By contrast, savings rates for the United States have been relatively low in recent decades, although savings rates have increased in the wake of the 2007 to 2008 financial crisis.

Third, trade and budget deficits that emerged in the 1980s implied that the flow of goods to the United States was in part financed by the flow of assets, public and private, to countries with trade surpluses.

The two largest foreign creditors are currently (as of this writing) Mainland China and Japan. There is also a large portion owned by a group identified as Oil Exporters which includes Ecuador, Venezuela, Indonesia, Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates, Algeria, Gabon, Libya and Nigeria. Please refer to **Figure 2** for a look at the current top 10 foreign holders of U.S. debt.

Figure 2: Top 10 Major Foreign Holders of Treasury Securities as of April 2012

China, Mainland	$1.145 trillion
Japan	$1.066 trillion
Oil Exporters*	$252.4 billion
Caribbean Banking Centers**	$247.0 billion
Brazil	$246.7 billion
Taiwan	$188.3 billion
United Kingdom	$154.2 billion
Switzerland	$151.1 billion
Russia	$146.8 billion
Belgium	$141.0 billion

Legitimate concern arises over countries, China in particular, that own our debt that may have national priorities or strategic objectives that run counter to those of the United States. Further concern arises over the possibility of these nations using their ownership of the debt as leverage against U.S. policy they might oppose. Others simply believe that foreign ownership of U.S. debt is a vote of confidence in the U.S. economy.

With the expansion of the global economy linking the economic growth of nations like never before, other analysts minimize the danger of countries, particularly China and Japan, divesting themselves away from U.S. treasuries. They say that if these countries began to sell of their treasuries, that U.S. interest rates would rise stifling U.S. economic growth. This would, however, be a danger to their economies just as much as it would be the United States. Increased interest rates and the stifling of economic growth in the United States could also damage Chin and Japan through decreased exports, for one. Further, with U.S. treasuries making up such a significant portion of China's currency reserves, the resulting reduction in value of their holdings should they begin to sell those treasuries would be damaging to the value of their own currency.

All of these perspectives have validity. Yet, regardless of whether foreign investment in the U.S. economy is viewed as a good or a bad thing, it is less of a critical issue than what the rapid increase in foreign investments highlights. That being, the United States has lived far beyond its means for far too long, accumulating larger and larger annual deficits that have placed our nation in the position of having to finance an enormous national debt. Annual federal spending must be brought into balance, reducing or eliminating annual deficits and a concerted effort will have to be made to pay down the national debt over the longer term.

Who Bears the Burden of the National Debt

Many economists believe that the burden of the national debt is largely shifted forward to future generations. The burden imposed by the national debt, however, does not arise from debt per se, but from budget deficits that gives rise to a national debt. If an economy is fully employed and the government increases its expenditures, for example, the resultant increase in total demand will cause interest rates to rise and this will reduce or "crowd out" interest-sensitive spending by the private sector.

This type of spending is likely to be for capital purposes (e.g. business spending for plant and equipment and household spending for housing and durable goods including automobiles). As a result, the private capital stock inherited by future generations is likely to be smaller and their real income or output will likely be lower. It is the reduction in future output that constitutes the burden of the national debt and it is a burden borne largely by future generations. It is a burden that cannot be decreased by borrowing abroad even though foreign borrowing could leave unchanged the size of the private capital stock.

THE STATUTORY DEBT LIMIT

The statutory debt limit (debt limit) is the maximum amount of money the government is allowed to borrow without receiving additional authority from Congress. Prior to 1917, Congress approved each issuance of debt. In 1917, to facilitate planning in World War I, the law established a dollar ceiling for federal borrowing which has been raised periodically over the years.

The debt limit applies to almost all federal debt – roughly 0.5 percent of total debt is excluded from debt limit coverage. The Treasury specifically defines "Total Public Debt Subject to Limit" as "the Total Public Debt Outstanding less Unamortized Discount on Treasury Bills and Zero-Coupon Treasury Bonds, old debt issued prior to 1917, and old currency called United States Notes, as well as Debt held by the Federal Financing Bank and Guaranteed Debt." In simpler terms, the debt limit applies to federal debt held by the public (again, that is debt held outside the federal government itself) and to federal debt held by the government's own accounts. Federal trust funds, like Social Security, Medicare, Transportation and Civil Service Retirement accounts, hold most of this internally held debt.

Standard methods of financing federal activities or meeting government obligations used by the Treasury Department can be hobbled when federal debt nears its legal limit. The government's income and outlays vary over the course of the year, producing monthly surpluses and deficits that affect the level of debt, whether or not the government has a surplus or deficit for the entire year. Even major government trust fund accounts that usually run annual surpluses can swing back and forth between deficits and surpluses on a month-to-month basis. The ability to borrow is actually central to Treasury cash management systems that handle fluctuations in federal revenues and outlays. When federal debt has neared the debt limit in the past, limiting Treasury's borrowing authority, financial management has become more complicated.

Why Have a Debt Limit?

The debt limit can hinder Treasury's ability to manage the federal government's finances. In extreme cases, when the federal debt is very near its statutory limit, Treasury must take unusual and extraordinary measures to meet federal obligations. While the debt limit has never caused the federal government to default on its obligations, it has at times caused great inconvenience and has added uncertainty to Treasury operations.

The debt limit also provides Congress with the strings to control the federal purse, allowing Congress to assert its constitutional prerogatives to control spending. The debt limit also imposes a form of fiscal accountability that compels Congress and the president to take visible action to allow further federal borrowing when the federal government spends more than it collects in revenues. On the other hand, some have advocated eliminating the debt limit arguing that other controls provided by the modern congressional budget process established in 1974 have superseded the debt limit and that the limit does little to alter spending and revenue policies that determine the size of the federal deficit.

Editor's Note: *For more information regarding the federal budget process, please refer to the Budget and Federal Spending chapter of the 2012 NRCC Issues Book.*

In recent years, quite a bit more attention has been paid to the statutory debt limit, the national debt, federal budget deficits and the government's overall fiscal situation.

DEBT AND DEBT LIMIT LEGISLATION: 112TH CONGRESS

On May 16, 2011, U.S. Treasury Secretary Timothy Geithner announced that the federal debt had reached its statutory limit and declared a debt issuance suspension period, unless Congress acted beforehand, which would allow certain extraordinary measures to extend Treasury's borrowing capacity until about Aug. 2, 2011. On July 1, 2011, the U.S. Treasury confirmed its view that its borrowing authority could be exhausted on that day. While many of the extraordinary measures have been used by previous Treasury secretaries, the funding provided by those measures may buy much less time than in previous debt limit episodes due to the size of recent and current federal deficits.

H.R. 1954, "Clean" Debt Limit Increase

On May 31, 2011, the House failed to pass H.R. 1954, a "Clean" Debt Limit Increase, by a vote of 97 to 318. H.R. 1954 would have increased the federal debt limit by $2.5 trillion from $14.294 trillion to $16.7 trillion without any corresponding spending cuts. This vote was expected to fail and was taken in order to show President Obama and Congressional Democrats that the House would not vote to increase the federal debt limit with significant concessions on spending and budgetary reforms. You can see how they voted here.

Below are selected vote hits on Democrats who voted for H.R. 1954:

- **Voted to increase the federal debt limit by $2.4 trillion without cutting spending**

    - Voted for the Rep. Camp (R-Mich.) motion to suspend the rules and pass the bill that would increase the statutory debt limit by $2.406 trillion to $16.7 trillion. (Motion Rejected 97-318; D: 97-82; R: 0-236)[5]

    - In a May 31, 2011, article, *Politico* reported, "The House overwhelmingly rejected a proposal Tuesday evening to raise the nation's borrowing limit without cutting spending, the latest act in what promises to be a summer-long political drama over the federal debt ceiling.

      "The GOP proposal, which would have raised the statutory borrowing cap to $16.7 trillion, did not get a single Republican vote and garnered just 97 Democrats in favor. Three-hundred-eighteen lawmakers voted 'no,' including 82 Democrats and all 236 Republicans in the chamber. Seven Democrats voted present."[6]

H.R. 2560, Cut, Cap and Balance Act

On July 19, 2011, the House passed H.R. 2560, the Cut, Cap and Balance Act, by a vote of 234-190. H.R. 2560 contained three components designed to rein in federal spending as a prerequisite for granting President Obama's request for an increase in the federal debt limit:

1) Cut $111 billion from FY 2012 spending levels by reducing non-security discretionary spending to pre-2008 levels, cutting non-veterans, non-Medicare, non-Social Security mandatory spending by $35 billion and matching defense spending to President Obama's requested levels

[5] H.R. 1954, CQ Vote #379, May 31, 2011
[6] Jake Sherman, "House Rejects Debt Increase," *Politico*, May, 31, 2011, http://www.politico.com/news/stories/0511/55982.html

2) Cap federal spending as a percentage of GDP gradually reducing the cap from 22.5 percent in FY 2012 to 19.9 percent in FY 2019

3) Require that both houses of Congress pass a balanced budget amendment (BBA) and send it to the states for ratification before an increase in the federal debt limit is granted

This legislation would have increased the statutory limit on federal debt from $14.294 trillion to $16.7 trillion once a proposal for a BBA requiring a balanced federal budget was transmitted to the states. You can see how they voted here.

Below are selected vote hits on Democrats who voted against H.R. 2560:

- **Voted against "Cut, Cap, and Balance," a bill to cut federal spending by $111 billion in FY 2012, gradually cap federal spending to under 20 percent of GDP by 2021 and require a balanced budget amendment to the U.S. Constitution be passed by both the House and the Senate in order to increase the debt limit of the federal government**

    - Voted against passage of a bill that would make an increase in the debt limit contingent upon the passage of a balanced-budget constitutional amendment. It also would set fiscal 2012 discretionary spending at $1.019 trillion and enforce statutory caps that limit spending as a percentage of gross domestic product (GDP) in fiscal 2012 through 2021. (Passed 234-190; D: 5-181; R: 229-9)[7]

    - In a July 22, 2011, article, *Politico* reported, "The GOP-controlled House passed Cut, Cap and Balance earlier this week on a mostly party-line 234-190 vote. The plan called for $111 billion in spending cuts in fiscal year 2012, gradually capping federal spending to just under 20 percent of Gross Domestic Product through 2021, and Congress to send states a constitutional amendment requiring a balanced budget in exchange for a $2.4 trillion hike to the debt ceiling."[8]

[7] H.R. 2560, CQ Vote #606, July 19, 2011
[8] Scott Wong, "Senate Rejects 'Cut, Cap, Balance,'" *Politico*, July 22, 2011, http://www.politico.com/news/stories/0711/59661_Page2.html

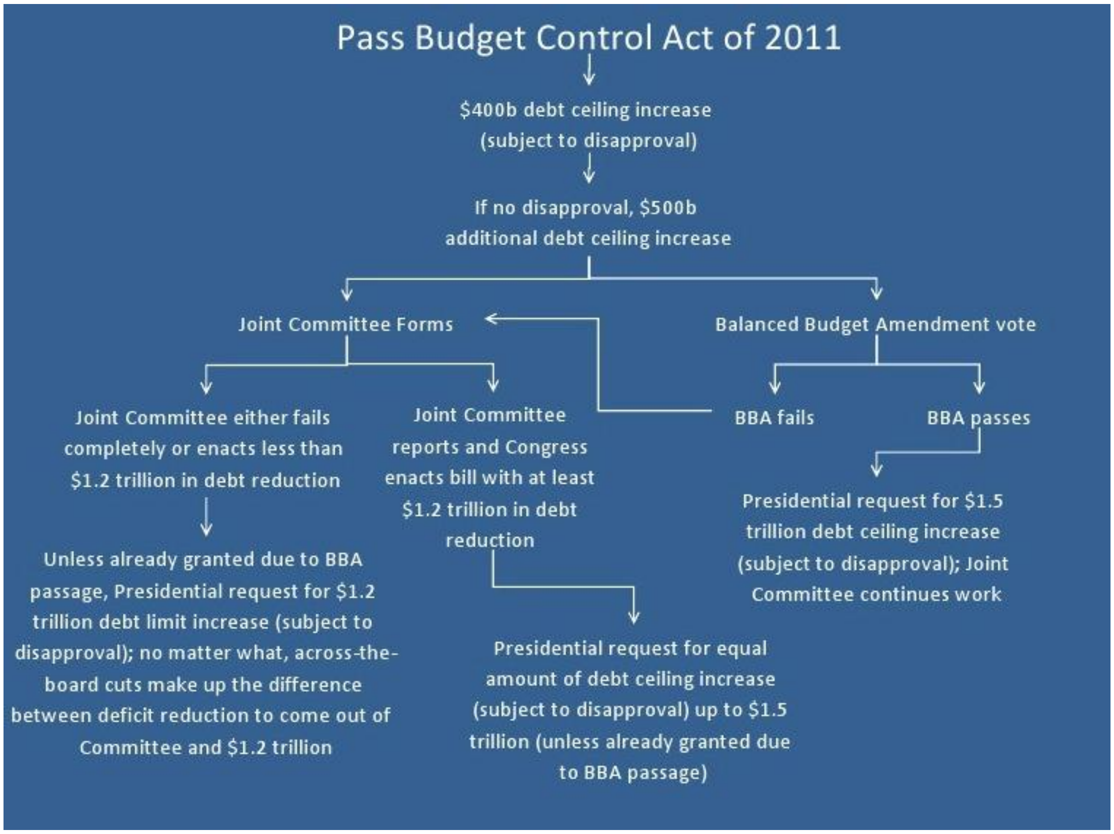
THE BUDGET CONTROL ACT OF 2011

On Aug. 2, 2011, following a months-long debt limit standoff, the House passed S. 365, the Budget Control Act of 2011 (BCA), on Aug. 1, 2011. You can see how they voted [here](). The Senate passed it on Aug. 2, 2011, and President Obama signed it into law (P.L. 112-25) on the same day. In the House vote, the final count showed 174 Republican yes votes, 66 Republican no votes and Democrats split evenly with 95 on each side.

In brief, the plan permitted continued government borrowing into 2013 and allowed the debt limit to be increased by up to $2.4 trillion in three tranches. It also required a vote be taken in both the House and Senate on a balanced budget amendment (BBA) to the U.S. Constitution and created a temporary joint select House-Senate committee, or the Joint Select Committee on Deficit Reduction (Joint Committee), to recommend budgetary changes to reduce the deficit. In addition to this, 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 FY 2012 to FY 2012 period.

There are two main groups of spending reductions in the BCA: 1) discretionary spending caps that came into effect in FY 2012; and 2) a $1.2 trillion automatic spending reduction process (sometimes referred to as the "trigger" since it would only be triggered if the Joint Committee failed to propose anything) that will come into effect on Jan. 2, 2013, unless new legislation is enacted to prevent it. The Congressional Budget Office (CBO) estimated that the BCA would reduce the deficit by at least $2.1 trillion through FY 2021.

The entire process associated with the BCA is procedurally complex, but it is outlined below. Additionally, here is a chart provided by *The Washington Post* that candidates may find helpful:



Debt Limit Increases

The plan provided for a debt limit increase between $2.1 trillion and $2.4 trillion in three tranches. Upon enactment of the bill, and when the President submitted certification that the national debt was within $100 billion of the statutory limit, the debt limit was automatically increased by $400 billion on Aug. 2, 2011. In addition to this initial increase, the BCA also authorized that the debt limit be increased by an additional $500 billion, subject to a disapproval resolution in Congress. If the disapproval resolution was not agreed to, or was vetoed by the President, the debt limit would increase by $500 billion for a total debt limit increase of $900 billion.

H. J. Res. 77: On Sept. 14, 2011, the House passed H. J. Res. 77 by a vote of 232 to 186 disapproving of the additional $500 billion debt limit increase. You can see how they voted here. Since the Senate was unable to pass the procedural legislation necessary to bring their disapproval resolution to the Senate Floor for a vote, the $500 billion increase occurred on Sept. 22, 2011.

Following this total debt limit increase of $900 billion, under the BCA if the President submitted another certification to Congress that the debt limit was again within $100 billion of breaching the limit, the debt limit would be increased again by $1.2 trillion, subject to another congressional resolution of disapproval.

H. J. Res. 98: On Jan. 12, 2012, President Obama submitted certification to Congress that the debt limit was again within $100 billion of breaching the limit and requested the $1.2 trillion increase allowed under the BCA. On Jan. 18, 2012, the House passed H. J. Res. 98 by a vote of 239 to 176. H. J. Res. 98 disapproved of and would have prevented the $1.2 trillion increase of the debt limit, if it had become law. Just as with H. J. Res. 77, H. J. Res. 98 did not move in the Senate and did not become law. Therefore, the debt limit was increased.

Discretionary Spending Caps

The BCA imposed discretionary spending caps – caps on the amount of money that can be spent through the annual appropriations process - for the next 10 years through FY 2021. The CBO estimates that these discretionary spending caps under the BCA will reduce federal spending by $917 billion from FY 2012 to FY 2021. These limits could be adjusted to accommodate several things: 1) changes in concepts and definitions; 2) appropriations designated as emergency requirements; 3) appropriations designated for Overseas Contingency Operations (OCO)/Global War on Terrorism (such as for military activities in Afghanistan); 4) appropriations for controlling health care fraud and abuse; and 6) appropriations designated as disaster relief. The last five in this list of six adjustments allowed under the BCA are effectively exempted from the caps.

Between FY 2012 and FY 2013, per the BCA, two separate caps exist on security and non-security spending. Security spending is defined by the BCA as discretionary appropriations associated with agency budgets for the Departments of Defense (DoD), 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). 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 (HHS), Education and Housing and Urban Development (HUD).

For FY 2014 through FY 2021, the limits cap spending in a single category (specified as the discretionary category), which includes all discretionary spending in all budget accounts.

Of the $917 billion these discretionary spending caps are expected to save, approximately $420 billion of it will be cut from the security spending category along over 10 years. Of this $420 billion to be cut from the security category, $350 billion of it will be cut from the budget category of defense with approximately $330 billion of that $350 billion specifically from the DoD.

Aside from the spending caps on security and non-security spending in FY 2012 and FY 2013, 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. The caps are enforced by across-the-board "sequestration", which would reduce the money in all discretionary accounts by a uniform percentage. Under the sequestration process, each nonexempt account is reduced by a uniform percentage, except that certain health and medical care accounts are limited to a two percent reduction no matter what. 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 FY 2014 (since the cap becomes one all-encompassing cap on discretionary spending as opposed to it being divided up into two separate categories). This authority is reserved for Congress to determine through the federal budget and appropriations processes. For example, the BCA set a discretionary spending limit of $1.047 trillion ($686 billion security and $361 billion for non-security) for FY 2013. But, the FY 2013 House Budget Resolution dropped that spending limit for FY 2013 down by approximately $19 billion to a new cap of $1.028 trillion. This simply means that the appropriators will stick to the $1.028 trillion amount for FY 2013 appropriations bills.

If, for some reason, the appropriations process does not result in spending levels that adhere to the cap amounts and they are breached, the BCA stipulates automatic cuts to non-exempt discretionary programs through a sequestration process. Here is a chart showing the statutory limits on discretionary spending for FY 2012 through FY 2021, per this provision of the BCA:

Fiscal Year	Discretionary Spending Limits (in billions of budget authority)
2012	$684 (security)
	$359 (non-security)
2013	$686 (security)
	$361 (non-security)
2014	$1,066
2015	$1,086
2016	$1,107
2017	$1,131
2018	$1,156
2019	$1,182
2020	$1,208
2021	$1,234

Discretionary spending limits are not unique. In current practice, the appropriators generally operate under caps set by Congress in a budget resolution or in another form. But those caps are enforced in the House and Senate, and the House and Senate can each waive them unilaterally. **The caps established by the BCA, in contrast, cannot be waived by a single chamber.**

Constitutional Balanced Budget Amendment

Between Oct. 1 and Dec. 31, the House and Senate would be required to vote, but not necessarily pass, a balanced budget amendment (BBA) to the Constitution. The contents of the amendment would be up to Congress. A debt limit increase is not contingent on passage of a balanced budget amendment, but the transmittal of a balanced budget amendment to the states would affect the potential size of the increase. Under the BCA, if a BBA had been sent to the states for ratification or if the legislation produced by the Joint Select Committee on Deficit Reduction (see below) was enacted and produced deficit reduction of $1.5 trillion or more, the amount of this debt limit increase could have been raised to $1.5 trillion.

H. J. Res. 2, BBA: On Nov. 18, 2011, the House failed to pass H. J. Res. 2 by a vote of 261 to 165. You can see how they voted here. H. J. Res. 2 would have added an amendment to the U.S. Constitution requiring that the U.S. government operated under a balanced budget each year. There were several different versions of a BBA considered for this vote, but the one that was brought up for a vote would have required a three-fifths vote in both the House and Senate to approve deficit spending (when total federal outlays are more than total federal revenues). In addition to requiring a balanced budget, H. J. Res. 2 would have also required a three-fifths vote to approve any increase of the debt limit in the future. H. J. Res. 2 would have also required a simple majority vote in both the House and Senate to approve raising taxes. Additionally, H. J. Res. 2 would have also allowed Congress to waive its requirements for any fiscal year in which a declaration of war is in effect or in any year in which the U.S. is engaged in a military conflict which poses an imminent threat or serious threat to national security, though Congress would need to actually declare such a situation in a joint resolution.

Below are selected vote hits on Democrats that voted aaginst H. J. Res. 2:

- **Voted against an amendment to the U.S. Constitution that would require the federal government to have a balanced budget**
    - Voted against the Rep. Smith (R-Texas) motion to suspend the rules and pass the joint resolution that would propose a constitutional amendment that would require a balanced budget starting in the first fiscal year beginning in calendar 2017 or the second fiscal year after ratification by three-fourths of the states, whichever is later. Under the proposal three-fifths of the entire House and Senate would be required to approve deficit spending or an increase in the public debt limit. A simple majority could waive the requirement in times of war or in the face of a serious military threat. (Rejected: 261-165; D: 25-161; R: 236-4)[9]

      Editor's Note: *A two-thirds majority of those present and voting is required to pass a bill under suspension of the rules and to pass a joint resolution proposing an amendment to the Constitution. In this case 284 members would have had to vote for the measure in order for it to pass.*

[9] H.J. Res. 2, CQ Vote # 858, Nov. 18, 2011

- **The amendment would allow Congress to waive the balanced budget requirement with a simple majority vote when a declaration of war is in effect**
    - In a Nov. 18, 2011, article, *Congressional Quarterly* wrote, "The House rejected a balanced-budget amendment to the Constitution on Friday afternoon, disappointing fiscal conservatives in the first House vote on the issue in 16 years.

      "The proposed constitutional amendment (H J Res 2) would require that total federal outlays in any given year not exceed the total amount of revenue taken in unless Congress votes with a three-fifths majority to allow it. It would allow Congress to waive the balanced-budget requirement with a simple majority vote in years when a declaration of war was in effect."[10]

- **The amendment would require a three-fifths majority in order to raise the debt limit**
    - In a Nov. 18, 2011, article, *Congressional Quarterly* wrote, "The House rejected a balanced-budget amendment to the Constitution on Friday afternoon, disappointing fiscal conservatives in the first House vote on the issue in 16 years.

      "The proposed constitutional amendment (H J Res 2) would require that total federal outlays in any given year not exceed the total amount of revenue taken in unless Congress votes with a three-fifths majority to allow it. It would allow Congress to waive the balanced-budget requirement with a simple majority vote in years when a declaration of war was in effect.

      "The proposed change to the Constitution also would institute a three-fifths majority requirement for raising the debt limit."[11]

- **The amendment would require the president to submit a balanced budget to Congress each year**
    - According to a Nov. 16, 2011 *Congressional Quarterly* House Action Report on H. J. Res. 2, the Balanced Budget Amendment, "This section summarizes the requirements on H J Res 2, the Balanced-Budget Amendment to the Constitution.

      "The constitutional amendment generally requires that the U.S. government operate under a balanced budget each year and not run any deficits.

      "Specifically, the amendment provides that total outlays for any fiscal year could not exceed total receipts for that year unless three-fifths of the whole number of each chamber of Congress votes to incur a budget deficit.

      "The president each year would be required to submit to Congress a budget proposal for the coming fiscal year that is balanced or would generate a surplus."[12]

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[10] Alexander Hart, "House Rejects Balanced-Budget Amendment," *Congressional Quarterly*, Nov. 18, 2011
[11] Alexander Hart, "House Rejects Balanced-Budget Amendment," *Congressional Quarterly*, Nov. 18, 2011
[12] CQ House Action Reports, "H.J.Res. 2," *Congressional Quarterly*, Nov. 16, 2011

Pell Grants and Loan Programs

The plan provided $17 billion for additional Pell grants through fiscal 2013. It barred the student loan program from providing financial incentives to students who repay their loans on time, which CBO says would reduce spending by $3.6 billion through fiscal 2021. The measure also eliminated interest-free grace periods and deferments for most graduate students, saving $18.1 billion over 10 years.

Joint Select Committee on Deficit Reduction

In addition to the deficit reduction achieved through the statutory caps on discretionary spending discussed above, the BCA also created a 12-member Joint Select Committee on Deficit Reduction (or "Super Committee," as it has been called by some) comprised of six members from each chamber of Congress, split evenly between the parties.

The members of the Committee were as follows:

Senate: Senators Patty Murray (D-Wash.) (co-chair), Max Baucus (D-Mont.), John Kerry (D-Mass.); Jon Kyl (R-Ariz.), Rob Portman (R-Ohio), Pat Toomey (R-Pa.)

House: Representatives Xavier Becerra (D-Calif.), Jim Clyburn (D-S.C.), Chris Van Hollen (D-Md.); Jen Hensarling (R-Texas) (co-chair), Fred Upton (R- Mich.), Dave Camp (R-Mich.)

The Committee was tasked with proposing legislation that would reduce the deficit by at least $1.5 trillion over 10 years, from FY 2012 to FY 2021. If legislation reducing the deficit by at least $1.2 trillion over 10 years was not enacted, an automatic spending reduction process (that includes sequestration) for cutting both discretionary and mandatory spending would be established. (**Note:** Mandatory spending refers to spending from budget authority that is provided by laws other than appropriations acts.) The Committee had a Nov. 23, 2011, deadline for voting on a proposal and the House and Senate both would have to vote on the plan – without the opportunity for amendment – by Dec. 23, 2011. There were no restrictions on the types of spending or revenue proposals that the Joint Committee could recommend and the proposal had to undergo a 48-hour vetting period by CBO before being presented to Congress.

On Nov. 21, 2011, the co-chairs of the Joint Committee announced that they were unable to reach an agreement before the deadline. Committee Republican co-chair Rep. Jeb Hensarling wrote an opinion piece for *The Wall Street Journal* conveying the Republican perspective as to why the Joint Committee failed to reach an agreement which you can read below:

THE WALL STREET JOURNAL.
WSJ.com
Nov. 22, 2011

Why the Super Committee Failed
By JEB HENSARLING

"All now know that the Joint Select Committee on Deficit Reduction has failed to reach an agreement. While there will still be $1.2 trillion of spending cuts as guaranteed under the

Budget Control Act, we regrettably missed a historic opportunity to lift the burden of debt and help spur economic growth and job creation. Americans deserve an explanation.

"President Obama summed up our debt crisis best when he told Republican members of the House in January 2010 that 'The major driver of our long-term liabilities . . . is Medicare and Medicaid and our health-care spending.' A few months later, however, Mr. Obama and his party's leaders in Congress added trillions of dollars in new health-care spending to the government's balance sheet.

"Democrats on the committee made it clear that the new spending called for in the president's health law was off the table. Still, committee Republicans offered to negotiate a plan on the other two health-care entitlements—Medicare and Medicaid—based upon the reforms included in the budget the House passed earlier this year.

"The Medicare reforms would make no changes for those in or near retirement. Beginning in 2022, beneficiaries would be guaranteed a choice of Medicare-approved private health coverage options and guaranteed a premium-support payment to help pay for the plan they choose.

"Democrats rejected this approach but assured us on numerous occasions they would offer a 'structural' or 'architectural' Medicare reform plan of their own. While I do not question their good faith effort to do so, they never did.

"Republicans on the committee also offered to negotiate a plan based on the bipartisan 'Protect Medicare Act' authored by Alice Rivlin, one of President Bill Clinton's budget directors, and Pete Domenici, a former Republican senator from New Mexico. Rivlin-Domenici offered financial support to seniors to purchase quality, affordable health coverage in Medicare-approved plans. These seniors would be able to choose from a list of Medicare-guaranteed coverage options, similar to the House budget's approach—except that Rivlin-Domenici would continue to include a traditional Medicare fee-for-service plan among the options.

"This approach was also rejected by committee Democrats.

"The Congressional Budget Office, the Medicare trustees, and the Government Accountability Office have each repeatedly said that our health-care entitlements are unsustainable. Committee Democrats offered modest adjustments to these programs, but they were far from sufficient to meet the challenge. And even their modest changes were made contingent upon a minimum of $1 trillion in higher taxes—a move sure to stifle job creation during the worst economy in recent memory.

"Even if Republicans agreed to every tax increase desired by the president, our national debt would continue to grow uncontrollably. Controlling spending is therefore a crucial challenge. The other is economic growth and job creation, which would produce the necessary revenue to fund our priorities.

"In the midst of persistent 9% unemployment, the committee could have enacted fundamental tax reform to simplify the tax code, help create jobs, and bring in over time the higher revenues that come with economic growth. Republicans put such a plan on the table—and even agreed to $250 billion in new revenue by eliminating or limiting most of the deductions, credits, loopholes and tax expenditures mainly enjoyed by higher-income Americans. We offered this to avoid the even larger tax increases already written into current law that will intensify the pain Americans are feeling during these difficult economic times.

"Republicans were willing to agree to additional tax revenue, but only in the context of fundamental pro-growth tax reform that would broaden the base, lower rates, and maintain current levels of progressivity. This is the approach to tax reform used by recent bipartisan deficit reduction efforts such as the Bowles-Simpson fiscal commission and the Rivlin-Domenici plan.

"The Democrats said no. They were unwilling to agree to anything less than $1 trillion in tax hikes—and unwilling to offer any structural reforms to put our health-care entitlements on a permanently sustainable basis.

"Unfortunately, the committee's challenge was made more difficult by President Obama. Since the committee was formed, he has demanded more stimulus spending and issued a veto threat against any proposed committee solution to the spending problem that was not coupled with a massive tax increase.

"Despite the president's disappointing lack of leadership, I believe my co-chair, Sen. Patty Murray, and every Democrat acted with honor and integrity and negotiated in good faith to the end. It was, of course, difficult to negotiate with six Democrats who, as Democratic committee member Jim Clyburn said on Nov. 13, 'never coalesced around a plan' themselves. But I believe this failure was not due to lack of effort or commitment.

"Ultimately, the committee did not succeed because we could not bridge the gap between two dramatically competing visions of the role government should play in a free society, the proper purpose and design of the social safety net, and the fundamentals of job creation and economic growth.

"A great opportunity has been missed, but America's fate will not be sealed by the failure of a temporary congressional committee. Spending cuts will begin anyway in 2013, but in a manner many of us, including our secretary of defense, believe could fundamentally harm our national security. I am committed to ensuring that full deficit reduction is realized, but Congress must work to achieve these savings in a more sensible manner that does not make us less safe.

"As Winston Churchill said, 'Americans can always be trusted to do the right thing, once all other possibilities have been exhausted.' Despite my disappointment with the committee's setback, I remain confident that we will yet again prove Churchill right."

So, since legislation was not enacted by Jan. 15, 2012, the automatic spending reduction process that includes sequestration has been triggered.

Automatic Spending Reduction Process Trigger

Editor's Note: *Again, it is important to note that the ultimate results of the automatic spending reduction process can only be approximated at this time for several reasons. Also, the automatic spending reduction process under the BCA is rather complicated and involves specific calculations and a working knowledge of budget terminology. Please keep this in mind when reading this section of this chapter and please contact the NRCC with any questions.*

The BCA set the amount of an automatic spending reduction process based on how much deficit reduction resulted from the work of the Joint Committee. Because no deficit reduction legislation was proposed, the total amount required from the automatic spending reduction process will be approximately $1.2 trillion. The automatic process for deficit reduction involves several steps and calculations. Very generally, the spending reductions are to be made equally from defense spending and from all other spending (referred to as "nondefense spending"). The reductions required in each of these categories are then divided proportionately between discretionary spending and mandatory spending. **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 spending caps already in effect.**

The spending reductions are achieved for mandatory spending through sequestration each year (FY 2013 to FY 2021). For discretionary spending, the reductions are achieved through sequestration the first year (FY 2013). For the other fiscal years (FY 2014 to FY 2021), the discretionary spending reductions are achieved through a downward adjustment of statutory limits on discretionary spending divided into two new categories that reflect defense and nondefense spending. Importantly, some programs, including both Social Security and Medicaid, are exempt from sequestration, and any sequestration of Medicare spending is capped at two percent (per the BCA). In addition to these three mandatory spending programs, significant other portions of mandatory spending are also exempt from sequestration – more on that later.

The precise implications of the automatic spending reduction process cannot be fully and precisely assessed at this time. The amounts of spending reductions required each year cannot yet be known, as they depend in part on spending estimates to be calculated in the future by the Office of Management and Budget (OMB). Furthermore, beginning in FY 2014, part of the spending reductions will be achieved through a downward adjustment of the statutory limits on discretionary spending, not by automatic across-the-board spending cuts. For discretionary spending, it will be Congress and the President who later determine the manner in which reductions are made to each account through the annual appropriations process each year.

The automatic spending reduction process entails four key steps:

- the statutory discretionary spending limits for FY 2013-FY 2021 are revised, by redefining the security and non-security categories and by extending such categories through FY 2021;

- the amount of spending reduction required for each year is calculated and divided equally between two categories: defense and nondefense;

- the annual amount of spending reductions required each year in each of these categories, defense and nondefense, is further divided proportionally between discretionary appropriations and mandatory spending (excluding certain programs and activities to be detailed later in this memo) within each category; and

- the spending reductions required in each year (FY 2013-FY 2021) are achieved through a combination of sequestration and the downward adjustment of the revised discretionary spending limits.

Revising Statutory Limits on Discretionary Spending: First, the previously set discretionary spending limits for FY 2013-FY 2021 are revised to: 1) redefine the security and non-security categories; and 2) set annual limits for each of these categories through FY 2021 (currently, from FY 2014-FY 2021, there is just one overall cap on discretionary spending). These revised categories basically divide the original discretionary spending limits between defense and **all** nondefense accounts. (At this point, the total amount of discretionary spending allowed under the limits is not yet reduced.) In contrast to the original discretionary limits, the security category is revised to include discretionary appropriations classified as budget Function 50 (National Defense) only (as opposed to DoD, DHS, VA, NNSA, international affairs programs and intelligence functions **all** being lumped together under the current discretionary caps for FY 2012 and FY 2013).

This newly created "defense" category would include, based on the definition of what budget Function 50 covers:

- military activities of DoD

- nuclear weapons-related activities of the Department of Energy (DoE) and the NNSA

- national security activities of several other agencies such as the Selective Service Agency and portions of the activities of the Coast Guard and the Federal Bureau of Investigation (FBI)

The programs in this function include: the pay and benefits of active, Guard and reserve military personnel; DoD operations including training, maintenance of equipment, and facilities; health care for military personnel and dependents; procurement of weapons; research and development; construction of military facilities, including housing; research on nuclear weapons; and the cleanup of nuclear weapons facilities.

The non-security category, now considered "nondefense," would be revised to include all other discretionary appropriations – the other discretionary appropriations not in budget Function 50 (National Defense) included in the original security category are essentially transferred to this revised non-security/nondefense category. There are 19 other budget function categories in addition to Function 50. For descriptions of each of these Budget Functions, click here.

By setting annual limits for the revised categories through FY 2021, the revised limits extend the "firewall" between different spending categories beyond the original two-year firewalls (for FY 2012 and FY 2013). Both changes to the discretionary spending limits presumably facilitate the equal split of the required spending reduction between defense and nondefense accounts over the nine years through FY 2021, as required in the next steps.

Calculating the Spending Reductions: Next, OMB is required to calculate the amount of deficit reduction required to be achieved in the newly revised defense and nondefense budget functions each year through this automatic process. The calculation involves five steps:

1) begin with $1.2 trillion (the budget goal);

2) subtract the amount of deficit reduction in the Joint Committee bill, if enacted (it was not, so this amount to be subtracted is zero;

3) subtract 18 percent attributable to debt service (CBO has estimated this amount to be $216 billion, but this amount could change)

4) divide by nine, to allocate the spending reductions equally across the nine fiscal years (FY 2013-FY 2021); and

5) divide by two, to allocate the spending reductions between defense and nondefense functions.

Again, this calculation provides the amount of spending reductions required from each of the two categories of defense and nondefense for each fiscal year covering FY 2013-FY 2021. The chart below shows hypothetical calculations done by the Congressional Research Service (CRS) if the automatic spending reduction process is triggered:

Description of Calculation	Hypothetical Illustration: If Joint Committee Bill is not Enacted & the Automatic Spending Reduction Process is Triggered
Budget Goal	$1.2 trillion
Subtract amount of deficit reduction in Joint Committee bill, if enacted	$1.2 trillion - $0 = $1.2 trillion
Multiply difference by 18%, to determine amount attributable to debt service	$1.2 trillion x 0.18 = $216 billion
Subtract the 18%, to account for debt service savings	$1.2 trillion - $216 billion = $984 billion
Divide by 9, to determine spending cuts for each year, FY 2013-FY2021	$984 billion / 9 = $109.3 billion
Divide by 2 to allocate between defense and nondefense spending	$109.3 billion / 2 = $54.7 billion

Implementing the Required Spending Reductions: Finally, the required spending reductions are achieved each year (FY 2013-FY 2021) through a combination of a sequestration process and the downward adjustment of the revised discretionary spending limits. Specifically, the reductions required are implemented in three parts:

1) for discretionary spending for FY 2013, a sequestration (across-the-board cut) of budgetary resources in that year (**this is what the House Republicans are attempting to replace in the coming week through a reconciliation process**);

2) for discretionary spending for FY 2014-FY 2021, a downward adjustment of the revised discretionary spending limits; and

3) for mandatory spending, a sequestration of budgetary resources in each year from FY 2013 through FY 2021.

As detailed above, the BCA requires OMB to calculate and the President to order a sequestration of nonexempt discretionary appropriations for FY 2013, and of nonexempt mandatory spending for FY 2013 and for each year through FY 2021. The sequestration for FY 2013 is to occur on Jan. 2, 2013, and the sequestrations for subsequent years are to occur on the date the sequestration preview report is issued (issued by the President). Generally, each nonexempt account is reduced by a uniform percentage necessary to achieve the reductions required. For example, if for FY 2013 hypothetically $54.2 billion in spending reductions are required in defense discretionary appropriations, and assuming the total amount of nonexempt defense discretionary appropriations is $546 billion, then each nonexempt account within the defense function would be reduced by 9.9 percent. For the nondefense category, the BCA requires that OMB increase the reductions required in discretionary appropriations and nonexempt non-Medicare spending by a uniform percentage to, in effect, offset the reductions not achieved in Medicare spending as a result of the two percent limit set by the BCA for cuts to Medicare spending.

Finally, on the date the sequestration preview report is issued (usually with the President's budget request), for each year covering FY 2014-FY 2021, OMB is required to adjust downward the revised statutory limits on discretionary spending for each category by the amount of spending reduction required within each category for that year, calculated in the manner described above. As a result, the spending reductions in discretionary appropriations for FY 2014-FY 2021 are achieved by further limiting the maximum amount that may be appropriated in each category for each year. **In contrast to the spending reductions achieved through sequestration for FY 2013, the lower limits for subsequent fiscal years will provide Congress and the President the opportunity to determine the manner in which the reductions are made to each account through the annual appropriations process each year. This is why the reductions in FY 2013 are of such great concern.**

The table below, courtesy of CRS and CBO, shows the expected cuts in dollars, the percentage reduction of each category and the defense and nondefense cap levels after the $1.2 trillion automatic spending reduction (based on current projections:

Table 3. $1.2 Trillion Automatic Spending Reduction by Major Category
(Budget Authority, FY2013 to 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	$55	$55	$55	$55	$55	$55	$55	$55	$55
Medicare (Mandatory)	$11	$11	$12	$13	$13	$14	$15	$16	$17
Other Non-Exempt Mandatory	$5	$5	$6	$6	$5	$5	$5	$5	$5
Discretionary	$39	$38	$37	$36	$36	$36	$34	$33	$33
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 Non-Exempt 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%
Projected Discretionary Cap Levels in Billions of Dollars Under $1.2 Trillion Reduction									
Defense	$491	$501	$511	$522	$535	$548	$561	$575	$589
Non-Defense	$462	$472	$483	$494	$505	$517	$532	$545	$557

What Is Exempt From and What is Subject to Sequestration: Any sequestration of mandatory budgetary resources, including this particular process under BCA, is subject to rules already in law that exempt Social security, Medicaid and certain other programs from any automatic cancellation of funding. In general, unless a program is specifically exempted by these rules, it is otherwise included in any sequestration under the BCA. **According to CBO, under current law, mandatory spending over the 2013-2021 period will total $24 trillion and roughly 70 percent of that spending would be exempt from sequestration.**

As has been previously stated, special rules govern sequestration and certain programs are exempt from it. For the most part, these provisions are found in Sections 255 and 256 of the Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA). Questions about the specific impact of sequestration on any particular program or policy area cannot be answered strictly from reading the relevant provisions of law. If sequestration occurs, all nonexempt "programs, projects and activities" must be reduced by a uniform percentage (unless provided otherwise under special rules). **It is important to understand that ultimately, the execution and impact of any automatic spending reduction triggered under provisions of the BCA will depend in large part on legal interpretations and actions taken by OMB.**

Section 255 of the BBEDCA contains a list of programs and activities that are exempt from sequestration. Most are mandatory, although a few are discretionary. **While the law provides a list of programs and types of spending that are exempt from sequestration, there is no definitive list of programs or types of spending that would absolutely be subject to sequestration. As stated above, the impact of sequestration on any given program will depend on the actions and interpretations of OMB.**

The following are selected programs identified in Section 255 as exempt from sequestration:

Editor's Note: *The full, very long list of programs and activities exempt from sequestration can be found at the very end of this section.*

- Social Security benefits (old-age, survivors and disability) and Tier 1 Railroad Retirement benefits
- All programs administered by the VA, and special benefits for certain World War II veterans

- Net interest (budget function 900)

- Payments to individuals in the form of refundable tax credits (this would include the Earned Income Tax Credit, the refundable portion of the Child Tax Credit and the Obamacare refundable tax credit for individuals and families with incomes between certain levels to help them purchase health insurance coverage)

- Unobligated balances, carried over from prior years, for nondefense programs

- At the President's discretion (subject to notification to Congress), military personnel accounts may be exempt entirely, or a lower sequestration percentage may apply

- A list of "other" budget accounts and activities:

  Editor's Note: *Please refer to the end of this memo for the complete list.*

  - Activities resulting from private donations, bequests, or voluntary contributions to the Government.

  - Activities financed by voluntary payments to the Government for goods or services to be provided for such payments.

  - Advances to the Unemployment Trust Fund and Other Funds (16–0327–0–1–600).

  - Payments to various retirement, health care and disability trust funds

  - Certain Tribal and Indian trust accounts

  - Medical Facilities Guaranty and Loan Fund

  - Specified federal retirement and disability accounts and activities

  - Prior legal obligations of the federal government in specified budget accounts (programs include the Federal Crop Insurance Corporation Fund)

- Low-income programs, including:

  - Academic Competitiveness/Smart Grant Program (91–0205–0–1–502).

  - Child Care Entitlement to States (75–1550–0–1–609).

  - Child Nutrition Programs (with the exception of special milk programs) (12–3539–0–1–605).

  - Children's Health Insurance Fund (75–0515–0–1–551).

  - Commodity Supplemental Food Program (12–3507–0–1–605).

- Family Support Programs (75–1501–0–1–609).
- Federal Pell Grants under section 401 Title IV of the Higher Education Act.
- Grants to States for Medicaid (75–0512–0–1–551).
- Payments for Foster Care and Permanency (75–1545–0–1–609).
- Supplemental Nutrition Assistance Program (SNAP, or Food Stamps) (12–3505–0–1–605).
- Supplemental Security Income (SSI) Program (28–0406–0–1–609).
- Temporary Assistance for Needy Families (75–1552–0–1–609).

- Medicare Part D premium and cost-sharing subsidies; Medicare Part D catastrophic subsidy payments; and Qualified Individual (QI) premiums

- Specified economic recovery programs including GSE Preferred Stock Purchase Agreements, the Office of Financial Stability and the SIGTARP

- The following "split-treatment" programs, to the extent that the programs' budgetary resources are subject to obligation limitations in appropriations bills:
  - Federal Aid-Highways
  - Highway Traffic Safety Grants
  - Operations and Research NHTSA and National Driver Register
  - Motor Carrier Safety Operations and Programs
  - Motor Carrier Safety Grants
  - Formula and Bus Grants
  - Grants-in-Aid for Airports

In addition to the exemptions in Section 255 of the BBEDCA, Section 256 of the law established special rules for sequestration of certain programs. **Once again, the effect of sequestration on any given program is subject to the interpretation of the law's provisions by OMB.**

The following is a list of programs included in Section 256:

- **Student loans under Title IV-B and IV-D of the Higher Education Act:** During a period of sequestration, origination fees on Federal Direct Loan (DL) program loans (both Subsidized and

Unsubsidized Stafford Loans, PLUS Loans and Consolidation Loans) must be increased by the uniform percentage specified in the sequestration order.

- **Medicare:** While BBEDCA ordinarily limits reduction of certain Medicare spending to four percent under a sequestration order, the BCA limits the size of this reduction to two percent. Under a sequestration triggered by the BCA, if the uniform percentage is less than two percent, it will be applied to all nonexempt accounts, including Medicare. If the percentage is higher than two percent, than a two percent reduction will be made in Medicare spending, and the uniform reduction percentage for the remaining programs will be recalculated and increased by the amount necessary to achieve the total level of reductions needed. Under sequestration, Medicare's benefit structure would generally remain unchanged (i.e. beneficiaries would not see a change in their Medicare coverage). Additionally, spending for certain Medicare programs are exempt from sequestration (please refer to the list at the end of this memo).

- **Health Centers, Indian Health and Veterans' Medical Care:** The BBEDCA limits the amount of funding that can be reduced from community and migrant health centers under a sequestration to two percent. This two percent limit applies to discretionary appropriations that the health center program receives – health centers are also receiving additional mandatory appropriations under the Democrats' government takeover of health care from FY 2011 through FY 2015. It is unclear if these mandatory funds would be affected by the two percent cap – this goes back to OMB's role in this process. Also, the BBEDCA states that sequestration may only reduce funding appropriated to the two Indian Health Service (HIS) accounts in HHS by two percent in any fiscal year. Under the BBEDCA, a maximum two percent reduction in budget authority is allowed for VA medical care for any fiscal year. There is apparently a discrepancy later in the law, as it was amended in 2010, that says that all programs administered by the VA are excluded from sequestration.

- Child Support Enforcement

- Federal Pay

- Federal Administrative Expenses

- Unemployment Compensation

- Commodity Credit Corporation

HOUSE REPUBLICAN PLAN TO REPLACE THE FIRST YEAR OF THE SEQUESTER

In the wake of the Joint Committee's failure to achieve its deficit-reduction goals, discretionary spending levels are scheduled to be reduced by $98 billion effective Jan. 2, 2013. After accounting for lowering the FY 2013 discretionary spending cap from $1.047 trillion (per the BCA) to $1.028 trillion (as provided for in the House-passed FY 2013 budget resolution), $78 billion actually reflects the remainder of the FY 2013 discretionary sequester amount. Thus, current law requires that there be across-the-board cuts imposed on Jan. 2, 2013. The sequester will result in a 10 percent reduction in DoD programs and an eight percent reduction in certain domestic programs, such as the National Institutes of Health (NIH) and border security.

Intended as a mechanism to force action on deficit reduction, there is bipartisan agreement that the sequester going into place would undercut key responsibilities of the federal government. Of particular concern is the impact sequestration, if allowed to occur, would have on our national security. The sequestration cuts would be on top of the savings in discretionary defense spending that have already been implemented.

The House Armed Services Committee (HASC) has analyzed the impact of the sequestration, and found that if left in place, sequestration would cut the military to its smallest size since before World War II – all while we are still a nation at war in Afghanistan, facing increased threats from Iran and North Korea, unrest in the Middle East and a rising China. Major consequences, according to HASC, include:

Editor's Note: *Again, please keep in mind that much is still left to be determined regarding the automatic spending reduction process and sequestration, per OMB's involvement in determining specifics and interpreting the law. These "consequences" are ones determined by HASC and found in a September 2011 report the Committee released entitled, "Assessment of Impacts of Budget Cuts."*

- 200,000 soldiers and Marines separated from service, bring our force well below our pre-9/11 levels;
- Ability to respond to contingencies in North Korea or Iran at jeopardy;
- The smallest ground force since 1940;
- A fleet of fewer than 230 ships, the smallest level since 1915;
- The smallest tactical fighter force in the history of the Air Force;
- Our nuclear triad that has kept the U.S. and 30 of our allies safe for decades will be in jeopardy;
- Reductions of 20 percent in defense civilian personnel; and
- Two BRAC rounds of base closings.

Additionally, Defense Secretary Leon Panetta said in a Nov. 14, 2011, letter to Senator John McCain (R-Ariz.), "If the maximum sequestration is triggered, the total cut will rise to about $1 trillion compared with the FY 2012 plan. The impacts of these cuts would be devastating for the Department…Facing such large reductions, we would have to reduce the size of the military sharply. Rough estimates suggest after ten years of these cuts, we would have the smallest ground force since 1940, the smallest number of ships since 1915, and the smallest Air Force in its history."

Also, according to an analysis by the House Appropriations Committee, the sequester could also have a significant impact on nondefense discretionary programs, including:

- Automatically reducing Head Start by $650 million, resulting in 75,000 fewer slots for children in the program;

- Automatically reducing the NIH by $2.4 billion, an amount equal to nearly half of total NIH spending on cancer this year; and

- A reduction of approximately 1,870 Border Patrol Agents (a reduction of nearly nine percent of the total number of agents).

The 1974 Budget Act provides Congress with a special procedure to give expedited consideration to bills enacting the spending, revenue and debt policies contained in the budget resolution. To trigger these expedited procedures, the budget resolution must include what are called reconciliation instructions calling on specific committees to achieve specified amounts of savings in programs within their jurisdictions. The committees choose which programs to address and which policies to adopt.

Reconciliation Instructions in the FY 2013 House Republican Budget Resolution

In an effort to reprioritize savings and achieve additional deficit reduction, included in the FY 2013 House Republican budget resolution (H. Con. Res. 112), a replacement for the first year of the discretionary sequester triggered under the BCA. To effectuate this change, the tool of reconciliation was employed, giving an aggregate instruction of $261 billion over 10 years in deficit reduction to six House Committees:

- Agriculture

- Energy and Commerce

- Financial Services

- Judiciary

- Oversight and Government Reform

- Ways and Means

Reconciliation-produced deficit reduction is intended to fully cover the deficit impact of the first year of the discretionary sequester under the BCA in less than five years. Because the reconciliation instructions are solely focused on mandatory spending, the House Republican proposal for replacement is intended to dwarf the sequester by multiple factors within 10 years and exponentially outside of the 10-year budget window.

Editor's Note: *For more information regarding the FY 2013 House Republican Budget Resolution, please refer to the Budget and Federal Spending chapter of the 2012 NRCC Issues Book.*

H.R. 5652, Sequester Replacement Reconciliation Act

Introduced on May 9, 2012, by House Budget Committee Chairman Paul Ryan (R-Wis.), H.R. 5652 would modify the BCA with the intent of canceling the sequestration of FY 2013 discretionary spending currently scheduled to occur (at the time of this writing) beginning Jan. 2, 2013. The House passed H.R. 5652 on May 10, 2012, by a vote of 218 to 199. You can see how they voted here. But, unfortunately, H.R. 5652 has proceeded no further in the Senate. As called for by the House-passed FY 2013 budget resolution, H.R. 5652 would replace the $98 billion sequester in discretionary spending (per the Budget Control Act) for FY 2013 with two things:

- a $19 billion reduction in the discretionary spending cap for FY 2013 so that the total to be cut would be lowered to $78 billion – this is in line with the House-passed FY 2013 budget resolution which lowered the cap set by the Budget Control Act from $1.047 trillion to $1.028 trillion; and

- reconciliation savings from mandatory programs recommended by six House committees.

It would also eliminate the separate cap on defense spending for FY 2013 to allow for higher spending levels. The reason for this focus on defense spending is that defense programs would bear the brunt of the cuts under sequestration. Under the sequestration process, the first $109 billion in automatic cuts is scheduled to occur in January 2013, with approximately $12 billion to be cut from mandatory programs and almost $98 billion from discretionary programs – including $55 billion from defense and $43 billion from non-defense programs. Lawmakers from both parties, and Defense Secretary (and former House Budget Committee chair and Office of Management and Budget director) Leon Panetta, have said they want to avoid such automatic, indiscriminate cuts and are particularly concerned about the possible impact of the almost $500 billion in cuts that would made to defense over ten years. These reductions would come on top of already-planned reductions of $490 billion over the same ten years (more on this later).

The following chart is courtesy of House Budget Committee Republicans:

	2012-2013	2012-2017	2012-2022
Scheduled 2013 Sequester ($78,480*)	-45,410	-77,799	-77,799
Agriculture	-8,200	-19,700	-33,200
Energy and Commerce	-3,750	-28,430	-96,760
Financial Services	-3,000	-16,700	-29,800
Judiciary	-100	-11,200	-39,700
Oversight & Govt. Reform	-2,200	-30,100	-78,900
Ways and Means	-1,200	-23,000	-53,000
Net Reconciliation Savings (minus overlap)	-18,350	-116,330	-261,460
Savings as a Percentage of Replaced Sequester	40%	150%	336%

*Remaining discretionary sequester necessary in 2013 after accounting for the savings of the $19 billion delta between the BCA's $1.047 trillion discretionary cap and the House FY 2013 budget resolution's $1.028 trillion top line. The discretionary sequester would reduce budget authority in FY 2013. The outlay and deficit reduction resulting from $78 billion of this sequester amounts to $45 billion in FY 2013 with the remaining savings occurring in subsequent years. Note that the House's reconciliation replaces the first year of the discretionary sequester and does not affect the first year of the mandatory sequester – added together, they amount to $110 billion.

The savings from the below reforms of mandatory programs would replace the discretionary sequester cuts in FY 2013 – they are broken down by program or program area.

Editor's Note: *The majority of the background and proposed reform information has been provided by each committee of jurisdiction, unless otherwise noted.*

Supplemental Nutrition Assistance Program (SNAP, or Food Stamps)

- **Restrict Categorical Eligibility under the SNAP Program:**

  Background: Under current law, an individual can automatically qualify for SNAP based on receipt of benefits through other low-income assistance programs like the Temporary Assistance for Needy Families (TANF) block grant, Supplemental Security Income (SSI), etc. The Obama Administration has actively encouraged states to implement a policy called "broad-based categorical eligibility," which means states are conveying SNAP eligibility based upon a household receiving a TANF-funded brochure or access to an "800" number hotline.

  As of January 2012, there are now 43 jurisdictions – 40 states, D.C., Guam and the Virgin Islands – implementing this policy. Of the 43 jurisdictions using broad-based categorical eligibility, 39 currently have no asset test and 27 have a gross income limit above 130 percent of the federal poverty guidelines.

  Committee: Agriculture

  Proposed Reform: This proposal would restrict categorical eligibility to only those households receiving cash assistance from SSI, TANF or a state-run General Assistance (GA) program. Receiving a TANF-funded brochure or a referral to an "800" number telephone hotline would no longer automatically make a household SNAP eligible.

  CBO Estimate: This proposal would save $11.7 billion over ten years.

- **Eliminate the SNAP "Heat and Eat" Loophole:**

  Background: Under current law, low-income households receiving any Low Income Home Energy Assistance Program (LIHEAP) payments also qualify for the SNAP Standard Utility Allowance (SUA) which automatically increase their SNAP benefits. Approximately 16 states and D.C. are abusing this interaction (often at the behest of advocacy groups) by sending $1 or $5 LIHEAP checks to low-income households so they may automatically take advantage of the SUA. In practice, if a participant receives $1 in LIHEAP, they can automatically deduct the SUA from their income, so their net income goes down and they receive more SNAP benefits. For example, this can trigger as much as $130 in additional SNAP benefits per month.

Committee: Agriculture

Proposed Reform: This proposal would change current law so that a LIHEAP payment no longer automatically triggers the SUA deduction, closing this loophole. This provision in no way prevents those households who are paying their utility bills out-of-pocket from receiving the SNAP SUA. Any household paying their utility bills can still receive this deduction.

CBO Estimate: This proposal would save $14.3 billion over ten years.

- **Eliminate the Indexing on SNAP Nutrition Education:**

Background: Under current law, states have the option of providing nutrition education to SNAP recipients as part of their program operations - such education is 100 percent funded by the federal government. Funding for the SNAP nutrition education program is capped at $375 million, but is indexed for inflation so that the amount spent increases each year.

Committee: Agriculture

Proposed Reform: This proposal would eliminate the automatic annual spending increase.

CBO Estimate: This proposal would save $546 million over ten years.

- **Terminating the SNAP Increase from the Stimulus:**

Background: The 2009 economic stimulus package included an across-the-board increase in SNAP benefits effective in April 2009. The stimulus effectively replaced the increase in SNAP benefits that occurs under the Food and Nutrition Act, which is normally based on annual food-price inflation indexing. The stimulus increase was to stay in place until food-price inflation "caught up" so that families did not see a decrease in their monthly SNAP benefit allotment. Therefore, the stimulus benefit increase was originally expected to terminate after FY 2018, when food-price inflation was estimated to "catch up" with the stimulus increase.

Last Congress, when the Democrat majority needed to pay for their other "priorities," including a teacher's union bailout and increasing school meal standards, the stimulus SNAP increase was used *twice* to offset other laws. They achieved their savings by moving up the stimulus termination date to Oct. 31, 2013.

Committee: Agriculture

Proposed Reform: This proposal would terminate the stimulus increase of SNAP benefits on July 1, 2012.

CBO Estimate: This proposal would save $5.9 billion over ten years.

- **Eliminate the 50/50 Cost Share for the SNAP Employment and Training (E&T) Program:**

  Background: Each fiscal year, the U.S. Department of Agriculture (USDA) provides federal formula grants to state agencies for states to operate a SNAP Employment and Training (E&T) program. In addition to this funding, states have the option of providing more funding towards their state E&T program, which USDA is required to match. According to the Government Accountability Office (GAO), there are 47 federal employment training programs and almost all federal employment and training programs overlap with at least one other program in that they provide similar services to similar populations.

  Committee: Agriculture

  Proposed Reform: This proposal would maintain the federal formula grants for employment training, but eliminate the 50/50 cost share, thus resulting in savings for federal taxpayers.

  CBO Estimate: This proposal would save $3.1 billion over ten years.

- **Eliminate State Performance Bonuses Under SNAP:**

  Background: States are responsible for administering the SNAP program and it is their duty to process applications in a timely manner, ensure households receive the accurate amount of SNAP benefits, and make certain the program is administered in the most effective and efficient manner. Under current law, states can receive a bonus for doing a good job. Annually, these bonuses total $48 million.

  Committee: Agriculture

  Proposed Reform: This proposal would eliminate the bonuses that are given to states for essentially doing their job.

  CBO Estimate: This proposal would save $480 million over ten years.

Refundable Child Tax Credit

- **Preventing Abuse in the Refundable Child Tax Credit:**

  Background: Current law provides for a child tax credit in the amount of $1,000 per child under the age of 17 ($500 per child beginning in 2013). This credit is partially refundable, meaning that taxpayers may, depending on their income and other tax obligations, receive a government check as a result of this credit. Such checks are considered spending for budget purposes. Under the rules in effect through 2012, the refundable portion of the child tax credit – sometimes referred to as the additional child tax credit (ACTC) – is capped at 15 percent of the taxpayer's earned income above $3,000.

  Also under current law, individuals who are ineligible to work in the United States – and are thus ineligible for a Social Security Number (SSN) – can obtain an Individual Taxpayer Identification Number (ITIN) for tax purposes. In 1996, Congress enacted legislation making those without SSNs ineligible to receive the Earned Income Tax Credit (EITC), a similar refundable tax credit. However, when the refundable portion of the child tax credit was subsequently enacted in 1997, Congress included no similar limitation, and the Treasury Department has taken the position that it lacks the statutory authority to limit the ACTC to those with an SSN. Thus, the refundable portion of the child tax credit currently remains available to individuals who are unable to obtain an SSN because they are ineligible to work in the U.S.

Committee: Ways and Means

Proposed Reform: This proposal would close this loophole and individuals (or at least one spouse in the case of a joint tax return) would be required to include their SSN on their tax return in order to claim the refundable portion of the child tax credit.

Joint Committee on Taxation (JCT) Estimate: The proposal would save $7.6 billion over ten years.

Obamacare

- **Fully Recapturing Exchange Subsidy Overpayments:**

  Background: Obamacare fails to adequately protect taxpayers from overpayments of health insurance Exchange subsidies, even in the case of fraud. Exchange subsidy eligibility is based on two-year old income tax return data. Because income can change, the government will conduct an annual review to determine if someone received more taxpayer-funded subsidies than he/she was entitled to.

  If an overpayment was made, the recipient is required to repay some or all of the overpayment, subject to certain limits described below. Originally, under the health care law, the maximum amount a subsidy recipient was required to repay was $250 for an individual or $400 for a family, even if he/she/they received thousands of dollars in subsidy overpayments. Since the health care law's enactment, **two laws have increased the maximum amount of improper Exchange subsidy payments the government can recoup,** but in some instances still fails to require full repayment.

  Committee: Ways and Means

  Proposed Reform: The proposal would require those who receive Exchange subsidies to which they are not entitled to repay the full amount of overpayments. Individuals and families would still be allowed to keep the subsidies they are entitled to receive under the law.

  JCT and CBO Estimate: This would reduce the deficit by $43.9 billion over ten years.

- **Eliminate the Prevention and Public Health Slush Fund:**

  Background: Obamacare created a new "Prevention and Public Health Fund" (PPHF) controlled by the Secretary of HHS designed to supplement spending on public health programs (all programs within the Public Health Service Act are eligible for funding). The law created an advanced appropriation of $16 billion for the first ten years of the program and a permanent $2 billion annual appropriation for the fund in perpetuity.

The PPHF has already been the focus of several votes in the House – to eliminate it entirely or reduce its funding.

Committee: Energy and Commerce

Proposed Reform: This proposal would repeal the fund.

CBO Estimate: This proposal would save approximately $11.9 billion over ten years.

- **Repeal Unlimited Obamacare State Exchange Grants:**

Background: Obamacare provided the Secretary of HHS a direct appropriation of "such sums as necessary" for grants to states to facilitate the purchase of qualified health plans in newly created exchanges. The Secretary can determine the amount of spending and spend the funds without further Congressional action – an unprecedented authority that gives an executive branch official an unlimited tap into the federal Treasury.

Committee: Energy and Commerce

Proposed Reform: This proposal would strike the unlimited direct appropriation and rescind any unobligated funds. **The House passed an identical proposal last year.**

CBO Estimate: This proposal would save approximately $14.5 billion over ten years.

- **Defund the Consumer Operated and Oriented Plan (CO-OP):**

Background: Obamacare created the Consumer Operated and Oriented Plan (CO-OP) program to provide government-subsidized loans to qualified non-profit health insurance plans. The law appropriated $6 billion for such loans. **H.R. 1473, the final continuing resolution for FY 2011, reduced this amount to $3.8 billion.**

OMB has warned of potential taxpayer losses and awards given to potentially unqualified entities have raised serious concerns about CO-OPs. In the proposed rule for CO-OPs, OMB estimated that up to "50 percent of all loans" will not be repaid – jeopardizing hundreds of millions of taxpayer dollars. Union entities, some of which appear to fail to meet basic statutory criteria for program eligibility, have been the primary recipients of awards under the CO-OP program.

Committee: Energy and Commerce

Proposed Reform: This proposal would rescind all unobligated funds made available to the CO-OP program in Obamacare.

CBO Estimate: This proposal would save approximately $872 million over ten years.

- **Rebase the Disproportionate Share Hospital (DSH) Allotments in FY 2022:**

  Background: Obamacare includes annual aggregate DSH reductions for FY 2014 through FY 2020, but allotments revert to levels prior to Obamacare in FY 2021. The reductions were included to reflect a projected increase in insured Americans and a declining need for uncompensated care funding. **The Middle Class Tax Relief and Job Creation Act of 2012, enacted on Feb. 22, 2012, included a rebasing of DSH payments for FY 2021.**

  Committee: Energy and Commerce

  Proposed Reform: This proposal would rebase the FY 2022 allotments to maintain the FY 2021 level of reductions. **This policy was also included in the President's Budget Proposal for FY 2013.**

  CBO Estimate: This proposal would save $4.2 billion over 10 years.

- **Repeal the Medicaid Maintenance of Effort (MOE) Requirement Imposed on States:**

  Background: Under current law, there is a Maintenance of Effort (MOE) requirement in place whereby a state is prohibited from having eligibility standards, methodologies, or procedures under its state Medicaid or Children's Health Insurance Program (CHIP) plans that are more restrictive than those in effect on March 23, 2010, the date of enactment of Obamacare. This MOE is a significant barrier for states trying to better manage their Medicaid and CHIP programs – especially for those states wanting to implement program integrity measures that would ensure proper eligibility verification. In 2011, for example, inadequate eligibility review cost the taxpayers approximately $15 billion in improper payments under the Medicaid program.

  Committee: Energy and Commerce

  Proposed Reform: This proposal would repeal the MOE on states for Medicaid and CHIP as mandated by Obamacare. The repeal of the MOE merely allows states the same operational flexibility they have exercised since the beginnings of the Medicaid and CHIP programs.

  CBO Estimate: This proposal would save approximately $600 million over ten years.

- **Repeal the Increased Federal Medicaid Funding Cap and Match Rate for Territories:**

  Background: Obamacare increased the federal Medicaid match rate for the territories from 50 percent to 55 percent beginning in FY 2011. Additionally, the law increased the cap on federal Medicaid spending directed to the territories by $6.3 billion over ten years.

  Committee: Energy and Commerce

  Proposed Reform: This proposal would reverse both the increased Medicaid federal match and cap for the territories as provided under Obamacare.

  CBO Estimate: This proposal would save $6.3 billion over ten years.

Dodd-Frank

- **Eliminate the Dodd-Frank Bailout Fund:**

  Background: The Dodd-Frank Act granted the FDIC "Orderly Liquidation Authority" that gives government bureaucrats the authority to use taxpayer dollars to bail out the creditors of "too big to fail" institutions and treat similarly situated creditors differently. The Democrats have claimed that they created this new resolution authority to prevent a replay of the 2008 bailouts of Bear Stearns, AIG, Fannie Mae, Freddie Mac, Citigroup, Bank of America, GM and Chrysler. But in reality, Dodd-Frank's Orderly Liquidation Authority mechanism just perpetuates the very taxpayer-funded bailout regime it claims it to abolish.

  Committee: Financial Services

  Proposed Reform: The proposal would end "too big to fail" by repealing this Dodd-Frank fund that paves the way for future bailouts.

  CBO Estimate: This proposal would save $22 billion over ten years for deficit reduction.

- **Eliminate automatic funding for the Consumer Financial Protection Bureau (CFPB):**

  Background: The centerpiece of the Dodd-Frank Act is the Consumer Financial Protection Bureau (CFPB), a large and powerful federal agency that is – by design – accountable to neither the executive branch nor Congress. Its Director has the unprecedented and sole authority to decide which financial products Americans can and cannot use. In addition, the Dodd-Frank Act authorizes the CFPB to fund itself by drawing money directly from the Federal Reserve to whatever extent the CFPB Director deems "necessary" up to $548 million in FY 2012, $598 million in FY 2013 and 12 percent of the Fed's operating expenses each fiscal year thereafter. Not Congress, not the President, not even the Fed which provides its funding can oversee how the CFPB Director spends these hundreds of millions of dollars.

  Committee: Financial Services

  Proposed Reform: This proposal would make the CFPB subject to the ordinary congressional appropriations process and authorize the appropriation of $200 million to the agency for FY 2012 and FY 2013.

  CBO Estimate: This proposal would achieve savings of $5.4 billion over ten years.

Housing Bailout(s)

- **Terminate ineffective housing bailout(s)**

  Background: The Obama Administration claimed HAMP, its signature foreclosure prevention initiative, would help up to four million struggling homeowners. Instead, HAMP has resulted in only 763,000 loans being permanently modified and has been the target of widespread and bipartisan criticism. Of the $30 billion in TARP funds set aside for HAMP, $2.54 billion has actually been disbursed. The Special Inspector General for TARP (SIGTARP), the Congressional Oversight Panel, the GAO and even *The New York Times* editorial page have all reported on the ineffectiveness of HAMP and highlighted how this program has hurt, rather than helped, many struggling homeowners.

Committee: Financial Services

Proposed Reform: This proposal would terminate HAMP. **On March 9, 2011, the House passed H.R. 839, the HAMP Termination Act, which would have done the same thing.**

CBO Estimate: This proposal would result in deficit reduction of $2.8 billion over ten years.

Flood Insurance Program

- **Reform the National Flood Insurance Program (NFIP):**

Background: The National Flood Insurance Act of 1968 established the National Flood Insurance Program (NFIP) to minimize the economic impact of floods and to provide flood insurance to individuals and businesses. Congress last enacted a long-term NFIP reauthorization and reform bill in 2004. H.R. 1309, the Flood Insurance Reform Act sponsored by Rep. Judy Biggert, includes a five –year reauthorization of the NFIP and will reform the program by encouraging broader participation, increasing financial accountability and eliminating unnecessary rate subsidies. The NFIP has historically failed to charge sufficient rates to cover its risk. HR. 1309 eliminates unnecessary rate subsidies by including a phase-in of full-risk, actuarial rates for new and certain existing areas designated as "Special Flood Hazard." **H.R. 1309 was passed by the Financial Services Committee by a 54-0 vote on May 12, 2011, and the House passed it 406-22 on July 12, 2011.**

Committee: Financial Services

Proposed Reform: This proposal would reform the NFIP in line with H.R. 1309.

CBO Estimate: This reform in accordance with H.R. 1309 would result in $4.9 billion in savings over ten years.

Federal Employees

- **Require federal employees to more equitably share in the cost of their retirement benefits:**

Background: Federal employees benefit from one of the most generous pension programs in the country. In addition to having both a defined contribution and defined benefit plan, federal employees pay a relatively modest amount towards their defined benefit retirement. While in the private sector the cost of retirement benefits are split relatively evenly between the employer and the employee, under the defined benefit portion of the Federal Employee Retirement System (FERS), federal employees received a lopsided 15-to-1 match for their pension. In other words, for every $1 that a federal employee contributes towards the cost of their defined benefit pension, the taxpayer is on the hook for $15.

Committee: Oversight and Government Reform

Proposed Reform: This proposal would increase pension contributions by five percent of salary over five years for current federal employees, by 8.5 percent of salary for current Members of Congress and current congressional employees by 7.5 percent. It also would revise the contribution rate for new federal employees and Members of Congress (those entering service after Dec. 31, 2012, who have less than five years of creditable service for retirement purposes). The employee contribution rate would by 5.8 percent for most federal employees and 6.3 percent for special occupational groups such as law enforcement (who receive a more generous defined benefit pension).

CBO Estimate: This proposal would save taxpayers approximately $80 billion.

- **Eliminate the early retirement Social Security equivalent benefit for federal employees:**

  Background: Under current law, federal employees receive a special benefit not available to those in the private sector. Federal employees who voluntarily early retire before age 62 receive a special benefit on top of their retirement until they reach age 62. Essentially, the current pension system pays workers more if they retire before reaching Social Security retirement age.

  Committee: Oversight and Government Reform

  Proposed Reform: This proposal would eliminate this special benefit for new hires. It would also permit individuals who are subject to mandatory early retirement (such as law enforcement and air traffic control officers) to continue to be eligible.

Social Services Block Grant (SSBG)

- **Repeal the Social Services Block Grant (SSBG):**

  Background: The Social Services Block Grant (SSBG) is a flexible source of federal funds that states use for a wide variety of social services. Begun in 1956 as a way to match state spending on services to help families leave welfare, the SSBG is now a 100 percent federal funding stream that can be used to provide almost any service to anyone regardless of their income. Many of the services funded by SSBG are duplicative of other federal programs including the Community Services Block Grant, Head Start, Foster Care and Adoption Assistance, Promoting Safe and Stable Families, etc.

  Committee: Ways and Means

  Proposed Reform: This proposal would eliminate the SSBG program.

  CBO Estimate: This would save taxpayers almost $17 billion over 10 years.

Medical Malpractice

➢ **Reform the medical liability system:**

Background: Many state supreme courts have judicially nullified reasonable litigation management provisions enacted by state legislatures, many of which sought to address the crisis in medical professional liability that reduces patients' access to health care and increases overall health care costs. Consequently, in such states, passage of federal legislation by Congress may be the only means of addressing the state's current crisis in medical professional liability, restoring patients' access to health care and controlling unnecessary costs.

Committee(s): Judiciary and Energy and Commerce

Proposed Reform(s): The Judiciary Committee proposed the HEALTH Act, modeled after California's decades-old and highly successful health care litigation reforms. Reforms that are included in the HEALTH Act include:

- A $250,000 cap on noneconomic damages
- Limits on the contingency fees lawyers can charge
- Provisions creating a "fair share" rule, by which damages are allocated fairly, in direct proportion to fault
- Reasonable guidelines – but not caps – on the award of punitive damages
- A safe harbor from punitive damages for products that meet applicable FDA safety requirements

CBO Estimate: The legal reforms in the HEALTH Act would reduce the federal budget deficit by an estimated $40 billion over the next 10 years. In addition, the Energy and Commerce Committee will also report medical liability reform to achieve savings of approximately $64 billion.

Medicaid

➢ **Reduce the Medicaid provider tax threshold to 5.5 percent:**

Background: States are able to use revenues from health care provider taxes to help finance the state share of Medicaid expenditures and receive federal matching funds even in instances where the taxes are largely rebated to the health care provider. Under current law, states are limited to a provider tax threshold of no higher than six percent of the net patient service revenues. The provider tax threshold was 5.5 percent up until Oct. 1, 2011.

Committee: Energy and Commerce

Proposed Reform: This proposal would reduce the provider tax threshold back to 5.5 percent beginning in FY 2013. **A significantly more restrictive policy was included in the President's Budget Proposal for FY 2013 which would have phased down the provider tax threshold to 3.5 percent.**

CBO Estimate: This proposal would save approximately $11.25 billion over 10 years.

- **Repeal bonus payments for states increasing their Medicaid enrollment:**

  Background: The Children's Health Insurance Reauthorization Act of 2009 (CHIPRA) authorized "bonus" payments to states that increase their Medicaid enrollment above a defined baseline from the prior year. This provision violates the standards for program integrity in the Medicaid program by providing bonus payments to states that implement oversimplified eligibility review procedures such as express lane eligibility and continuous eligibility periods. While on one hand, states have been prohibited from implementing more aggressive eligibility review procedures due to the Maintenance of Effort (MOE), states are receiving hundreds of millions to implement much less restrictive eligibility review methods through the CHIP bonus payment funding stream. The Centers for Medicare and Medicaid Services (CMS) has noted that in FY 2011, Medicaid cost the American taxpayers more than $15 billion in federal overpayments due to poor eligibility review.

  Committee: Energy and Commerce

  Proposed Reform: The proposal would repeal these bonus payments.

  CBO Estimate: This proposal would save taxpayers approximately $400 million over 10 years.

For more details of these proposed reforms, please refer to the following sources:

- Reconciliation Submissions by Committee, House Budget Committee - http://budget.house.gov/BudgetAnalysis/Reconciliation.htm

- Charge and Response – Replacing Dangerous Defense Cuts with Common Sense Spending Reductions, House Republican Conference - http://www.gop.gov/policy-news/12/05/07/charge-and-response-replacing-dangerous

- Reeling in Government Waste, Fraud and Abuse, House Republican Conference - http://www.gop.gov/policy-news/12/05/07/reeling-in-government-waste

- Responsibly Reprioritizing Sequester Savings, House Budget Committee - http://budget.house.gov/Reconciliation/

- Q&A on Reprioritizing Sequester Savings, House Budget Committee - http://budget.house.gov/Reconciliation/QASequesterSavings.htm

CBO Estimate of H.R. 5652: The Congressional Budget Office (CBO) estimated that enacting H.R. 5652 would yield net deficit reduction of $237.8 billion over the 2012-2022 period. This amount reflects changes in direct spending and revenues from reconciliation provisions that would yield gross estimated budgetary savings of $310.0 billion through 2022, partially offset by a cost of $72.2 billion through 2022 for its sequester replacement provisions. Assuming enactment by July 2, 2012, CBO and the Joint Committee on Taxation (JCT) estimate that H.R. 5652 would yield net deficit reduction of $242.8 billion over the 2012-

2022 period. This figure reflects gross reconciliation savings ($315.0 billion through 2022, partially offset by the cost of sequester replacement ($75.2 billion through 2022).

The estimated sequester replacement cost of roughly $72 billion over 10 years stem mostly from canceling the sequestration of existing balances for defense programs and advance appropriations for nondefense programs for 2013. However, that total could increase to as much as $97 billion if additional discretionary appropriations are enacted for 2013.

The full CBO report can be found here.

FULL LIST OF SECTION 255 EXEMPTIONS FROM SEQUESTRATION

- Social Security benefits (old-age, survivors and disability) and Tier 1 Railroad Retirement benefits

- All programs administered by the VA, and special benefits for certain World War II veterans

- Net interest (budget function 900)

- Payments to individuals in the form of refundable tax credits (this would include the Earned Income Tax Credit, the refundable portion of the Child Tax Credit and the Obamacare refundable tax credit for individuals and families with incomes between certain levels to help them purchase health insurance coverage)

- Unobligated balances, carried over from prior years, for nondefense programs

- At the President's discretion (subject to notification to Congress), military personnel accounts may be exempt entirely, or a lower sequestration percentage may apply

- A list of "other" budget accounts and activities:

    - Activities resulting from private donations, bequests, or voluntary contributions to the Government.

    - Activities financed by voluntary payments to the Government for goods or services to be provided for such payments.

    - Administration of Territories, Northern Mariana Islands Covenant grants (14–0412–0–1–808).

    - Advances to the Unemployment Trust Fund and Other Funds (16–0327–0–1–600).

    - Black Lung Disability Trust Fund Refinancing (16–0329–0–1–601).

    - Bonneville Power Administration Fund and borrowing authority established pursuant to section 13 of Public Law 93–454 (1974), as amended (89–4045–0–3–271).

    - Claims, Judgments, and Relief Acts (20–1895–0–1–808).

    - Compact of Free Association (14–0415–0–1–808).

    - Compensation of the President (11–0209–01–1–802).

    - Comptroller of the Currency, Assessment Funds (20–8413–0–8–373).

    - Continuing Fund, Southeastern Power Administration (89–5653–0–2–271).

    - Continuing Fund, Southwestern Power Administration (89–5649–0–2–271).

- Dual Benefits Payments Account (60–0111–0–1–601).
- Emergency Fund, Western Area Power Administration (89–5069–0–2–271).
- Exchange Stabilization Fund (20–4444–0–3–155).
- Farm Credit Administration Operating Expenses Fund (78–4131–0–3–351).
- Farm Credit System Insurance Corporation, Farm Credit Insurance Fund (78–4171–0–3–351).
- Federal Deposit Insurance Corporation, Deposit Insurance Fund (51–4596–0–4–373).
- Federal Deposit Insurance Corporation, FSLIC Resolution Fund (51–4065–0–3–373).
- Federal Deposit Insurance Corporation, Noninterest Bearing Transaction Account Guarantee (51–4458–0–3–373).
- Federal Deposit Insurance Corporation, Senior Unsecured Debt Guarantee (51–4457–0–3–373).
- Federal Home Loan Mortgage Corporation (Freddie Mac).
- Federal Housing Finance Agency, Administrative Expenses (95–5532–0–2–371).
- Federal National Mortgage Corporation (Fannie Mae).
- Federal Payment to the District of Columbia Judicial Retirement and Survivors Annuity Fund (20–1713–0–1–752).
- Federal Payment to the District of Columbia Pension Fund (20–1714–0–1–601).
- Federal Payments to the Railroad Retirement Accounts (60–0113–0–1–601).
- Federal Reserve Bank Reimbursement Fund (20–1884–0–1–803).
- Financial Agent Services (20–1802–0–1–803).
- Foreign Military Sales Trust Fund (11–8242–0–7–155).
- Hazardous Waste Management, Conservation Reserve Program (12–4336–0–3–999).
- Host Nation Support Fund for Relocation (97–8337–0–7–051).
- Internal Revenue Collections for Puerto Rico (20–5737–0–2–806).

- Intragovernmental funds, including those from which the outlays are derived primarily from resources paid in from other government accounts, except to the extent such funds are augmented by direct appropriations for the fiscal year during which an order is in effect.
- Medical Facilities Guarantee and Loan Fund (75–9931–0–3–551).
- National Credit Union Administration, Central Liquidity Facility (25–4470–0–3–373).
- National Credit Union Administration, Corporate Credit Union Share Guarantee Program (25–4476–0–3–376).
- National Credit Union Administration, Credit Union Homeowners Affordability Relief Program (25–4473–0–3-371).
- National Credit Union Administration, Credit Union Share Insurance Fund (25–4468–0–3–373).
- National Credit Union Administration, Credit Union System Investment Program (25–4474–0–3–376).
- National Credit Union Administration, Operating fund (25–4056–0–3–373).
- National Credit Union Administration, Share Insurance Fund Corporate Debt Guarantee Program (25–4469–0–3-376).
- National Credit Union Administration, U.S. Central Federal Credit Union Capital Program (25–4475–0–3–376).
- Office of Thrift Supervision (20–4108–0–3–373).
- Panama Canal Commission Compensation Fund (16–5155–0–2–602).
- Payment of Vietnam and USS Pueblo prisoner-of-war claims within the Salaries and Expenses, Foreign Claims Settlement account (15–0100–0–1–153).
- Payment to Civil Service Retirement and Disability Fund (24–0200–0–1–805).
- Payment to Department of Defense Medicare-Eligible Retiree Health Care Fund (97–0850–0–1–054).
- Payment to Judiciary Trust Funds (10–0941–0–1–752).
- Payment to Military Retirement Fund (97–0040–0–1–054).
- Payment to the Foreign Service Retirement and Disability Fund (19–0540–0–1–153).
- Payments to Copyright Owners (03–5175–0–2–376).

- Payments to Health Care Trust Funds (75–0580–0–1–571).
- Payment to Radiation Exposure Compensation Trust Fund (15–0333–0–1–054).
- Payments to Social Security Trust Funds (28–0404–0–1–651).
- Payments to the United States Territories, Fiscal Assistance (14–0418–0–1–806).
- Payments to trust funds from excise taxes or other receipts properly creditable to such trust funds.
- Payments to widows and heirs of deceased Members of Congress (00–0215–0–1–801).
- Postal Service Fund (18–4020–0–3–372).
- Radiation Exposure Compensation Trust Fund (15–8116–0–1–054).
- Reimbursement to Federal Reserve Banks (20–0562–0–1–803).
- Salaries of Article III judges.
- Soldiers and Airmen's Home, payment of claims (84–8930–0–7–705).
- Tennessee Valley Authority Fund, except nonpower programs and activities (64–4110–0–3–999).
- Tribal and Indian trust accounts within the Department of the Interior which fund prior legal obligations of the Government or which are established pursuant to Acts of Congress regarding Federal management of tribal real property or other fiduciary responsibilities, including but not limited to Tribal Special Fund (14–5265–0–2–452),
- Tribal Trust Fund (14–8030–0–7–452),
- White Earth Settlement (14–2204–0–1–452), and Indian Water Rights and Habitat Acquisition (14–5505–0–2–303).
- United Mine Workers of America 1992 Benefit Plan (95–8260–0–7–551).
- United Mine Workers of America 1993 Benefit Plan (95–8535–0–7–551).
- United Mine Workers of America Combined Benefit Fund (95–8295–0–7–551).
- United States Enrichment Corporation Fund (95–4054–0–3–271).
- Universal Service Fund (27–5183–0–2–376).
- Vaccine Injury Compensation (75–0320–0–1–551).

- Vaccine Injury Compensation Program Trust Fund (20–8175–0–7–551).

- Specified federal retirement and disability accounts and activities:
  - Black Lung Disability Trust Fund (20-8144-0-7-601).
  - Central Intelligence Agency Retirement and Disability System Fund (56-3400-0-1-054).
  - Civil Service Retirement and Disability Fund (24-8135-0-7-602).
  - Comptrollers general retirement system (05–0107–0–1–801).
  - Contributions to U.S. Park Police annuity benefits, Other Permanent Appropriations (14–9924–0–2–303).
  - Court of Appeals for Veterans Claims Retirement Fund (95–8290–0–7–705).
  - Department of Defense Medicare-Eligible Retiree Health Care Fund (97–5472–0–2–551).
  - District of Columbia Federal Pension Fund (20–5511–0–2–601).
  - District of Columbia Judicial Retirement and Survivors Annuity Fund (20–8212–0–7–602).
  - Energy Employees Occupational Illness Compensation Fund (16–1523–0–1–053).
  - Foreign National Employees Separation Pay (97–8165–0–7–051).
  - Foreign Service National Defined Contributions Retirement Fund (19–5497–0–2–602).
  - Foreign Service National Separation Liability Trust Fund (19–8340–0–7–602).
  - Foreign Service Retirement and Disability Fund (19–8186–0–7–602).
  - Government Payment for Annuitants, Employees Health Benefits (24–0206–0–1–551).
  - Government Payment for Annuitants, Employee Life Insurance (24–0500–0–1–602).
  - Judicial Officers' Retirement Fund (10–8122–0–7–602).
  - Judicial Survivors' Annuities Fund (10–8110–0–7–602).
  - Military Retirement Fund (97–8097–0–7–602).
  - National Railroad Retirement Investment Trust (60–8118–0–7–601).
  - National Oceanic and Atmospheric Administration retirement (13–1450–0–1–306).

- Pensions for former Presidents (47–0105–0–1–802).
- Postal Service Retiree Health Benefits Fund (24–5391–0–2–551).
- Public Safety Officer Benefits (15–0403–0–1–754).
- Rail Industry Pension Fund (60–8011–0–7–601).
- Retired Pay, Coast Guard (70–0602–0–1–403).
- Retirement Pay and Medical Benefits for Commissioned Officers, Public Health Service (75–0379–0–1–551).
- Special Benefits for Disabled Coal Miners (16–0169–0–1–601).
- Special Benefits, Federal Employees' Compensation Act (16–1521–0–1–600).
- Special Workers Compensation Expenses (16–9971–0–7–601).
- Tax Court Judges Survivors Annuity Fund (23–8115–0–7–602).
- United States Court of Federal Claims Judges' Retirement Fund (10–8124–0–7–602).
- United States Secret Service, DC Annuity (70–0400–0–1–751).
- Voluntary Separation Incentive Fund (97–8335–0–7–051).

➢ Prior legal obligations of the federal government in specified budget accounts:

- Biomass Energy Development (20–0114–0–1–271).
- Check Forgery Insurance Fund (20–4109–0–3–803).
- Credit liquidating accounts.
- Credit reestimates.
- Employees Life Insurance Fund (24–8424–0–8–602).
- Federal Aviation Insurance Revolving Fund (69–4120– 0–3–402).
- Federal Crop Insurance Corporation Fund (12–4085–0–3–351).
- Federal Emergency Management Agency, National Flood Insurance Fund (58–4236–0–3–453).
- Geothermal resources development fund (89–0206–0–1–271).

- Low-Rent Public Housing—Loans and Other Expenses (86–4098–0–3–604).
- Maritime Administration, War Risk Insurance Revolving Fund (69–4302–0–3–403).
- Natural Resource Damage Assessment Fund (14–1618–0–1–302).
- Overseas Private Investment Corporation, Noncredit Account (71–4184–0–3–151).
- Pension Benefit Guaranty Corporation Fund (16–4204–0–3–601).
- San Joaquin Restoration Fund (14–5537–0–2–301).
- Servicemembers' Group Life Insurance Fund (36–4009–0–3–701).
- Terrorism Insurance Program (20–0123–0–1–376).

➢ Low-income programs:

- Academic Competitiveness/Smart Grant Program (91–0205–0–1–502).
- Child Care Entitlement to States (75–1550–0–1–609).
- Child Enrollment Contingency Fund (75–5551–0–2–551).
- Child Nutrition Programs (with the exception of special milk programs) (12–3539–0–1–605).
- Children's Health Insurance Fund (75–0515–0–1–551).
- Commodity Supplemental Food Program (12–3507–0–1–605).
- Contingency Fund (75–1522–0–1–609).
- Family Support Programs (75–1501–0–1–609).
- Federal Pell Grants under section 401 Title IV of the Higher Education Act.
- Grants to States for Medicaid (75–0512–0–1–551).
- Payments for Foster Care and Permanency (75–1545–0–1–609).
- Supplemental Nutrition Assistance Program (12–3505–0–1–605).
- Supplemental Security Income Program (28–0406–0–1–609).
- Temporary Assistance for Needy Families (75–1552–0–1–609).

- Medicare Part D premium and cost-sharing subsidies; Medicare Part D catastrophic subsidy payments; and Qualified Individual (QI) premiums

- Economic Recovery Programs:

    - GSE Preferred Stock Purchase Agreements (20-0125-0-1-371).

    - Office of Financial Stability (20-0128-0-1-376).

    - Special Inspector General for the Troubled Asset Relief Program (SIGTARP) (20-0133-0-1-376).

- "Split Treatment" Programs:

    - Federal Aid-Highways

    - Highway Traffic Safety Grants

    - Operations and Research NHTSA and National Driver Register

    - Motor Carrier Safety Operations and Programs

    - Motor Carrier Safety Grants

    - Formula and Bus Grants

    - Grants-in-Aid for Airports

DEFICIT, DEBT AND DEBT LIMIT TALKING POINTS

- At a staggering $15 trillion, the debt is crippling economic recovery and job growth and Democrats' addiction to spending is only making a bad economy worse.

- During President Obama's tenure, total federal debt has now surpassed the size of the entire U.S. economy creating an environment of uncertainty that is keeping small business owners from hiring new employees and spurring the economy.

- To jump-start U.S. economic growth and job creation, we need tangible action and reform to rein in the growth of government spending and enhancing oversight and transparency.

ADDITIONAL INFORMATION AND RESOURCES

- Congressional Budget Office (CBO)
- Debt to the Penny and Who Holds It, U.S. Treasury - http://www.treasurydirect.gov/NP/BPDLogin?application=np
- House Budget Committee – http://budget.house.gov/
- Office of Management and Budget (OMB)
- Treasury Department – http://www.treasury.gov/