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SPECIAL REPORT:

Overview of the Budget Control Act of 2011

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Washington Strategic Consulting
1825 Eye Street, NW, Suite #600
Washington, DC 20006
www.wscdc.com
www.wscblog.com

Introduction

After a 6-month drama, during which time the nation was brought to the brink of potentially facing its first ever default, President Obama and Congress finally resolved their differences and, at the last possible moment, enacted legislation to permit the statutory debt ceiling to be raised. The President signed into law on Tuesday the Budget Control Act of 2011 (BCA), which passed the House on Monday by a vote of 269-161 and passed the Senate on Tuesday by a vote of 74-26.

Most of the drama was in the House, where Tea Party-backed conservatives repeatedly threatened permit the country to default if they did not receive in return an agreement to significantly cut federal spending. Ultimately, the vote proved anticlimactic as two-thirds of the House Republican Conference supported the BCA, including many Tea Party-backed members; the House Democratic Caucus split in two, with exactly half of their members supporting the measure (largely out of loyalty to President Obama) and half opposing. House Democratic Rep. Emmanuel Cleaver of Kansas City, Missouri summed up the view of most House Democrats when he called the BCA a "Satan sandwich" for its deep cuts to discretionary programs, which include several safety net programs for the poor and indigent.

The Senate vote was a fait accompli. The measure was opposed by the most conservative Republicans and progressive Democrats, but the outcome was never in doubt, especially since the BCA was negotiated largely by Senate Minority Leader Mitch McConnell (R-KY) and Vice President Joe Biden, with input from Senate Majority Leader Harry Reid (D-NV).

At its crux, the BCA permits the debt ceiling to be raised by $2.4 trillion in two tranches (which the Treasury Department estimates will keep the government operational through the November 2012 presidential election and into early 2013) in return for capping discretionary spending and establishing a framework for making changes to entitlement programs and, potentially, the tax code. Specifically, the BCA makes the following changes to federal law:

(1) Implements statutory budget caps on discretionary spending for FY 2012 – FY 2021, which the Congressional Budget Office (CBO) estimates will save about $917 billion;
(2) Requires the House and the Senate to vote on a balanced budget amendment to the U.S. Constitution later this year;
(3) Establishes a new temporary process for approving increases to the national debt ceiling;
(4) Establishes a "supercommittee" in Congress to identify up to an additional $1.5 trillion in deficit reduction over the next 10 years; and
(5) Implements changes to the Pell Grant and federal student loan programs that will negatively impact graduate students.

Budget Caps

The BCA establishes budget caps under which overall discretionary spending is essentially level-funded at FY 2011 levels in FY 2012 and FY 2013, and subsequently is permitted to rise by about 2% annually from FY 2014 – FY 2021. Discretionary spending refers to those federal programs that are subject to Congress's annual appropriations process; examples include health professions training programs, the CDC, and the NIH. Entitlement programs such as Social Security, Medicare, and Medicaid are not subject to these budget caps.

Separate discretionary budget caps are established for security and non-security spending in FY 2012 and FY 2013, with both security and non-security programs capped at comparable spending rates; each is scheduled to be cut by less than 1% in FY 2012 and to be increased by less than 1% in FY 2013. Security spending is defined in the law as funding for the Department of Defense, the Department of Homeland Security, the Department of Veteran's Affairs, nuclear programs, intelligence programs, and programs within the State Department and foreign operations. All other programs, including those within the Department of Health and Human Services and the Department of Education, are classified as non-security spending.

The law does not include this security / non-security "firewall" for FY 2014 – FY 2021; rather, the legislation provides only an overall discretionary cap. Consequently, it is plausible that security spending could receive the majority (or all) of the 2% annual increases scheduled for discretionary spending in FY 2014 – FY 2021, leaving non-security programs to be level funded or worse during these years.

Importantly, the law also puts into place a "sequestration" procedure under which across-the-board cuts are required if Congress breaches the discretionary spending caps. All discretionary programs would be hit by a sequestration, except for military personnel accounts. Congress may spend above the caps if it classifies such funding as an emergency, but the law defines the term "emergency" very narrowly and limits the amount of emergency funding that may be spent on natural disasters to the historical average of such funding.

Balanced Budget Amendment

The BCA requires the House and the Senate to vote on a balanced budget amendment to the U.S. Constitution during the first quarter of FY 2012 (i.e., October 1, 2011 – December 31, 2011). Conservative Republicans had pushed for a requirement that any debt ceiling increase be contingent upon a balanced budget amendment passing Congress, but they were overruled, in large part for practical reasons – passing a constitutional amendment is very difficult. An amendment to the Constitution must receive a two-thirds supermajority in both the House and the Senate in order to be sent to the States for ratification; the amendment then is ratified only after ¾ of the States approve the amendment.

The BCA establishes expedited procedures for bringing up, debating, and voting on the balanced budget amendment. This is to ensure that it cannot be filibustered in the Senate.

New Temporary Debt Ceiling Approval Process

The BCA establishes a new, temporary, and highly complex procedure under which the nation's statutory debt limit can be raised by up to $2.4 trillion in two tranches. The process is designed to permit the debt ceiling to be raised even if Congress votes to disapprove of such an increase.

In essence, under this plan, Republicans can oppose raising the debt ceiling without putting the nation at threat of default.

As established by the BCA, the first tranche raises the debt ceiling by $900 billion in two steps. In step one, the ceiling automatically increases by $400 billion once the President certifies to Congress that the nation is within $100 billion of breaching the existing debt limit; this has already occurred. In step two, the ceiling is further raised by another $500 billion if a joint resolution of disapproval is not enacted, meaning that it either does not pass Congress or it is vetoed by the president and Congress fails to override the veto. Under the BCA, Congress must vote on a joint resolution of disapproval on the first tranche of debt by September 14 at the latest.

If the joint resolution of disapproval is not enacted (i.e., it is defeated outright or vetoed and not overridden) the limit can increase by the additional $500 billion. If the joint resolution of disapproval is enacted (e.g., by Congress overriding a veto), the debt limit may not be raised and a sequestration of $400 billion must occur to be split evenly between defense and non-defense programs.

It is highly likely that the joint resolution of disapproval will not be enacted, though this probably will require President Obama to veto the measure. Since overriding a presidential veto requires a two-thirds supermajority in both the House and the Senate, it is expected that a veto could not be overridden and the debt limit will be increased even in the face of Republican opposition to increasing the debt limit.

The second tranche raises the debt ceiling by $1.2 trillion – $1.5 trillion, again contingent upon the President certifying that the nation is within $100 billion of breaching the debt limit and Congress defeating, or failing to override a presidential veto of a joint resolution of disapproval from Congress. Under the BCA, Congress must vote on the joint resolution of disapproval for the second tranche of debt within 15 days of the president submitting the certification to Congress that an increase is necessary. This probably will occur in February 2012.

The actual size of the debt limit increase in the second tranche is variable and dependent upon several factors outlined in the BCA:

- If a balanced budget amendment to the U.S. Constitution has passed Congress and been sent to the States for consideration, the debt ceiling can be raised by the full $1.5 trillion;
- If a balanced budget amendment does not pass Congress and the debt reduction legislation created by the congressional "supercommittee" is enacted into law and calls for deficit reduction of greater than $1.2 trillion, then the debt limit can be increased by the amount saved by the supercommittee legislation, but it cannot be raised by more than $1.5 trillion;
- If a balanced budget amendment does not pass Congress and the congressional supercommitee does not save at least $1.2 trillion in its legislation, or the legislation fails to be enacted, then the debt ceiling can be raised by only $1.2 trillion and a sequestration of up to $1.2 trillion must occur, with funding eliminated equally from defense and non-defense accounts over the period FY 2013 – FY 2021. The specific amount of the sequestration must equal the difference between $1.2 trillion and the amount of savings realized by the

legislative plan developed by the supercommittee. (If deficit reduction legislation from the supercommittee is not enacted, the sequestration must equal $1.2 trillion.)

Under the sequestration that would occur if the congressional supercommittee fails to save at least $1.2 trillion or its reported legislation fails to be enacted, certain programs would be exempted from the across the board cuts, including Social Security, Medicaid, CHIP, veteran's programs, and various programs for the poor. Medicare, however, is not exempted and could be cut by up to 2%, with all of the cuts mandated to come from reductions in reimbursements to health care providers.

Congressional "Supercommittee"

As stated above, the BCA establishes a congressional "supercommittee", formally named the Joint Select Committee on Deficit Reduction, to identify up to $1.5 trillion in savings from FY 2012 – FY 2021. Savings can come from any part of the government, but it is expected that the focus of the supercommittee will be mandatory spending programs (e.g., Social Security, Medicare, Medicaid, etc.) and tax reform.

The supercommittee will have 12 members, three each appointed by Senate Majority Leader Harry Reid, Senate Minority Leader Mitch McConnell, Speaker of the House John Boehner, and House Minority Leader Nancy Pelosi. Sen. Reid and Speaker Boehner get to select the two Committee Co-Chairs. Supercommittee members must be named within 14 days of enactment of the BCA, or August 16.

The Committee must develop a plan that receives the votes of at least seven committee members, meaning that any outcome must be bipartisan in nature. This will be difficult since Democrats already are demanding that any plan include increased revenues while Republicans are countering that any tax increases are a nonstarter. The solution may lie in how committee members, congressional leadership, and outside watchdog groups define the terms "revenue" and "taxes". Presumably, there may be bipartisan support for a comprehensive reform of the personal and corporate income tax codes that would eliminate loopholes and inefficiencies, broaden the base, and lower rates; so long as such a reform would be scored as increasing revenues by facilitating economic growth, Republicans could claim that they are not increasing taxes while Democrats can claim that they are increasing revenue. This will be a very difficult needle to thread.

The process for developing the legislative plan is expedited. The standing committees of the House and the Senate must submit their formal recommendations to the supercommittee by October 14. The supercommittee must then develop and vote on a plan by November 23 and, assuming the plan passes, report it to President Obama, Vice President Biden, Speaker Boehner, Sen. Reid, Sen. McConnell, and Rep. Pelosi by December 2. The plan then will be referred to the standing committees of the House and Senate for review; the committees must report the bill by December 9. Both the House and the Senate must vote on the plan by December 23 under expedited rules that prohibit delaying tactics such as the filibuster.

Pell Grants and Student Loan Programs

The BCA makes changes to the Pell Grant program and the William D. Ford Federal Direct Loan Program. First, the BCA adds $17 billion to the Pell Grant program in order to make it financially whole for the next two years. The Pell Grant program, which provides need-based grants to undergraduate college students, faces a significant deficit due to increased need resulting from the struggling economy. This influx of funds from the BCA should keep the program whole through the 2012 – 2013 school year.

In order to offset and pay for this $17 billion infusion, though, the BCA implements two changes to the Ford Direct Loan Program, which provides loans to undergraduate, graduate, and professional students. First, beginning on July 1, 2012, graduate and professional students are prohibited from receiving subsidized loans, meaning that they will accrue interest during their deferral period. Under the Direct Loan program, students do not have to repay their loan while they are in school and for six months after they complete their studies. Students receiving subsidized loans do not accrue interest during this deferral period while students with unsubsidized loans do accrue interest. Consequently, a subsidized loan is less expensive to the student than an unsubsidized loan. A student qualifies for a subsidized loan based on financial need. Under the change implemented by the BCA, graduate and professional students must receive unsubsidized loans regardless of their financial situation. Students in teaching certification of credentialing programs that are required by the State in which they reside are exempt from this new prohibition.

The BCA's second change to the Direct Loan Program prohibits the Department of Education (beginning on July 1, 2012) from offering and providing loan repayment incentives for on-time payment. Previously, students could receive incentives if they made at least 12 consecutive on-time payments.

Outlook

The full impact of the BCA is unclear at this time. Certainly the law's impact on specific programs and individuals is knowable (e.g., discretionary spending will increase much more slowly over the next ten years than compared to its historical rate of growth, and graduate and professional students receiving loans through the Ford Direct Loan Program will face increased debt upon completion of their programs), but many of the issues at hand will not be resolved until later this year when the supercommittee completes its work.

Much of the BCA is nothing but political theater; for example, the required votes on the balanced budget amendment and the joint resolutions of disapproval for the debt limit increases are largely symbolic and unlikely to have a major impact on public policy. The supercommittee, however, holds in its hands the future of government spending priorities and its actions will determine the legacy of the BCA.

If the supercommittee fails to agree to a plan or fails to meet its deficit reduction targets, discretionary programs, including the Defense Department, will face dramatic cuts. Medicare providers also are in the crosshairs and could see their bottom lines impacted significantly.

If the supercommittee does meet its targets and legislation is passed, entitlement programs such as Social Security, Medicare, and Medicaid are likely to see important changes to their underlying structures that will impact all Americans. And if tax reform is a part of any plan, the supercommittee's impact will be even greater.

The next five months promises to be increasingly dramatic as all sides and stakeholders rush to protect their pet programs and mitigate any impact of the supercommittee's plan. The 12 lawmakers appointed to the supercommittee will be imbued with tremendous power and assume a terrific burden as they grapple with plans that could alter the trajectory of this nation's social contract.

Contact Information

Washington Strategic Consulting (WSC) is prepared to provide a more detailed, in-person analysis of the impact of sequestration upon request. Please do not hesitate to contact Spencer Perlman (sperlman@wscdc.com) at (202) 207-3655 if you have any questions about the contents of this memorandum or the sequestration process in general.