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**Understanding the Bipartisan Budget Act
December 11, 2013**

Yesterday, budget committee Chairmen Murray and Ryan announced an agreement to set discretionary funding levels for 2014 and 2015, replace a portion of sequestration for those years, and modestly reduce ten-year deficit levels. The "Bipartisan Budget Act" is likely to be voted on later this week, as is a short-term "Doc Fix" to avoid a steep cut in Medicare physician payments.

The Bipartisan Budget Act would provide \$45 billion of sequester relief in FY2014 and \$18 billion in FY2015, split evenly between defense and non-defense. This \$63 billion of costs would be offset with \$85 billion of cuts and user fees over ten years, including from extending the sequester's mandatory spending cuts through 2023, increasing airline fees, reforming civilian and military retirement programs, reducing various overpayments, increasing PBGC premiums, and making various other changes.

On net, CBO scored the package as reducing deficits by about \$23 billion through 2023 – though it would produce fewer savings after accounting for interest costs and changes to discretionary accruals. In the second decade, the legislation is likely to reduce deficits by approximately \$100 billion.

This package represents an improvement over the status quo since it replaces some of the mindless, upfront, across-the-board sequester cuts with better targeted savings that are both larger and produce additional deficit reduction over the long term. The bill would also set discretionary numbers for this year so appropriators can make the choices necessary to fund the government; this could help the political system to move away from governing by crisis.

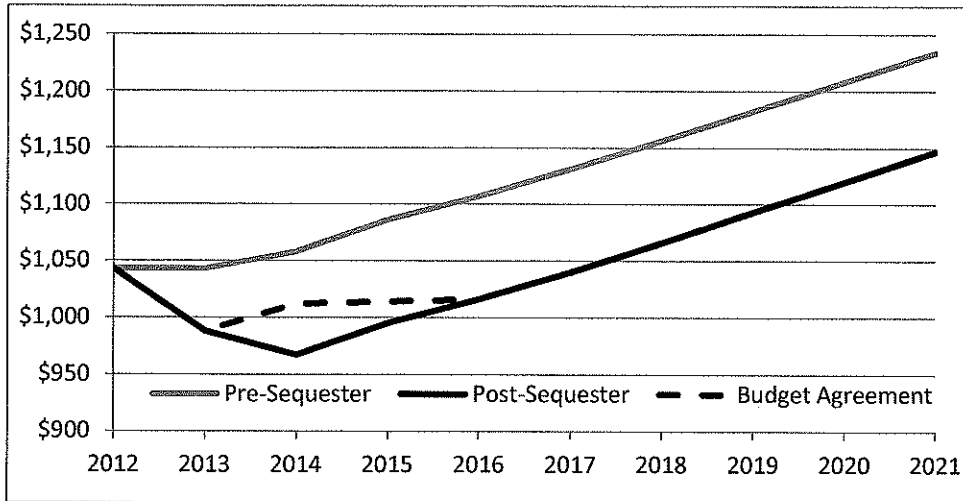
However, the legislation will not significantly improve the long-term fiscal situation, and would leave debt on an upward path. Though this bill could be a stepping stone for further reforms, much more will have to be done in order to put the budget on a sustainable path. Policymakers should build on this progress to pass real tax and entitlement reforms that put the debt on a downward path as a share of the economy.



Sequester Relief in the Bipartisan Budget Act

The Bipartisan Budget Act would reduce discretionary sequestration in half in FY2014, by \$45 billion. It would also reduce the FY2015 sequester by about one-fifth, or \$18 billion. The result would be budget caps that avoid a \$20 billion cut below the current continuing resolution and ease into sequester-level cuts by 2016. In total, the caps would allow discretionary spending to rise from \$986 billion today to \$1,012 billion in FY2014 (as opposed to falling to \$967 billion), \$1,014 billion in FY2015, and \$1,016 billion in FY2016.

Fig. 1: Discretionary Funding Levels (Budget Authority, Billions)



The sequester relief would be divided exactly equally between defense and non-defense spending. As a result, non-defense spending would increase from \$468 billion today to nearly \$492 billion, and then gradually grow to the original sequester levels of \$493 billion by 2016. Defense spending, meanwhile, would rise from \$518 billion today to just above \$520 billion, rather than falling to \$498 billion as under the sequester. Next year, defense spending would increase slightly to \$521 billion before reaching the sequester cap of \$523 billion in 2016.

The legislation would allow the Budget Committee chairs to deem spending levels for both FY2014 and FY2015 in order to allow appropriators to set spending at the new levels.

Mandatory Spending Offsets in the Bipartisan Budget Act

The sequester relief described above would increase discretionary outlays by about \$62 billion through 2023, which adds just over \$80 billion to the debt if interest is included. To offset this cost, the legislation includes roughly \$85 billion of spending cuts and non-tax receipts (i.e. user fees), which would save nearly \$100 billion including interest.



Among the offsets are the following:

Mandatory Sequester Extension. The agreement would extend sequestration of certain mandatory programs, which ends in 2021, through 2023. This would save about \$28 billion, about two-thirds coming from a 2 percent reduction in Medicare provider payments.

Federal Civilian Retirement Contributions. The agreement would increase pension contributions for new federal civilian workers from 3.1 percent of wages to 4.4 percent.

Military Retirement Reforms. The agreement would reduce annual cost-of-living-adjustments (COLAs) by 1 percentage point for retirees under age 62, with a one-time catch up when they reach that age. Importantly, the savings from this provision would allow lower discretionary accrual contributions from the Defense Department and therefore would allow for modestly increased net spending in this decade, while reducing it in future decades.

PBGC Premiums The agreement raises flat-rate and variable-rate premiums charged by the Pension Benefit Guaranty Corporation to guarantee private companies' pension benefits.

Fig. 2: Discretionary Funding Levels (Budget Authority, Billions)

	2014-2023 Savings
Defense sequester relief	\$31 billion
Non-defense discretionary sequester relief	\$31 billion
Subtotal, Gross Costs	\$62 billion
<i>Interest</i>	<i>\$20 billion</i>
Gross Costs, Including Interest	\$82 billion
Extend mandatory sequester through 2023	-\$28 billion
Increase airline user fees	-\$13 billion
Increase PBGC fees	-\$8 billion
Extend customs fees through 2023	-\$7 billion
Increase federal civilian retirement contributions	-\$6 billion
Reduce COLAs for working age military retirees	-\$6 billion [^]
Higher education savings	-\$5 billion
Natural resources savings	-\$4 billion
Reduce fraud and abuse	-\$3 billion
FEHB change	-\$3 billion
Reduce unobligated balances	-\$2 billion
Subtotal, Gross Savings	-\$85 billion
<i>Interest</i>	<i>-\$12 billion</i>
Gross Savings, Including Interest	-\$97 billion
Total, Net Savings	-\$14 billion

[^]This provision would add \$2 billion to the deficit over ten years if the reduced accrual payments are used to increase spending in other areas.



Airline Fees. The agreement would increase aviation security fees from \$2.50 for a direct flight and \$5 for an indirect flight to \$5.60 for all flights, while eliminating an assessment on airlines.

Fraud and Abuse. The agreement would reduce fraud and abuse throughout government by strengthening third party liability for Medicaid, reducing unemployment insurance over-collections, restricting access to the Death Master File, and making other changes.

Customs Fees. The agreement would extend current merchandise processing fees beyond their 2021 expiration date to 2023.

Natural Resources. The agreement would cancel a deepwater and natural gas research program, end the ability of the Strategic Petroleum Reserve to accept oil, limit interest payments from royalty overpayments, reform some mineral leases, and make other reforms.

Federal Employee Health Benefits. The agreement would allow federal workers in FEHB to enroll in a new "self plus one" enrollment tier to better align with other benefit plans.

Student Loans. The agreement would reduce the maximum fee that guaranty agencies are permitted to collect from borrowers who have defaulted on their student loans and are now repaying and would shift some payments to loan servicers from mandatory to discretionary funding.

Other Changes. The agreement would cancel unobligated balances in asset forfeiture funds, limit federal contractor salaries for compensation to \$487,000, and make other changes.

Fiscal Impact of the Bipartisan Budget Act

Over the next decade, the Bipartisan Budget Act is projected to reduce primary deficits by about \$23 billion and total deficits (with interest) by about \$14 billion. Accounting for the higher defense spending that is likely to occur as a result of the military retirement changes ([see our blog](#)), the legislation would reduce deficits by \$5 to \$10 billion.

Fig. 3: Savings and Costs in the Bipartisan Budget Act (Billions)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Ten-Year
Gross Costs	-\$26	-\$22	-\$9	-\$3	-\$2	-\$1	\$0	\$0	\$0	\$0	-\$62
Gross Savings	\$3	\$3	\$4	\$5	\$5	\$5	\$5	\$6	\$20	\$27	\$85
Sub-Total	-\$23	-\$18	-\$4	\$2	\$3	\$5	\$5	\$6	\$20	\$27	\$23
Net Interest	\$0	\$0	-\$1	-\$1	-\$1	-\$1	-\$1	-\$1	-\$1	\$0	-\$8
Net Impact	-\$23	-\$19	-\$5	\$1	\$2	\$3	\$4	\$4	\$20	\$27	\$14

Note: Numbers may not add to totals due to rounding. Positive numbers reflect deficit reduction.

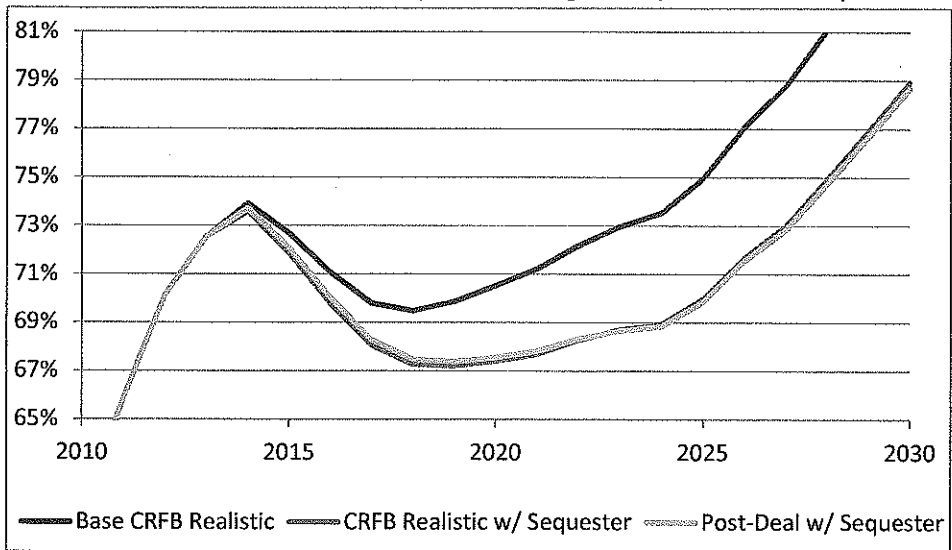


This deficit reduction reflects the net impact of \$63 billion in sequester relief – spent mostly by 2016 – and \$85 billion of mandatory spending cuts and higher non-tax receipts. Because the sequester relief is frontloaded, the legislation would increase the deficit in the near term and reduce it over the long term. This mix is likely to help support the economic recovery and promote faster long-term growth than would otherwise be the case.

Although CBO has not produced long-term estimates, we estimate the Bipartisan Budget Act would reduce the deficit in the second decade by roughly \$100 billion, including interest.

The agreement would unfortunately not change the current trajectory of the debt by a significant degree - debt as a percent of GDP would reach 78.7 percent by 2030 as opposed to 78.9 percent if the sequester were to remain in place. But the agreement would at least be a step in the right direction and result in substantially lower spending than if the sequester were waived.

Fig. 4: Debt Projections Under the Bipartisan Budget Act (Percent of GDP)



Conclusion

CRFB hopes that lawmakers will build on some of the bipartisan measures they were able to agree to in the conference committee to find solutions to our underlying fiscal challenges that still remain untouched. It will take true leadership to identify the necessary fixes to slow health care cost growth, rein in retirement costs, and reform an outdated tax code. This package is a step in the right direction, but far more must be done to put our budget on a sustainable fiscal path.