



Summary of Analysis: Sequestration and Its Impact on Defense Communities

How It Started: The Budget Control Act of 2011

The Budget Control Act:

- allowed the President to raise the debt limit by \$2.1 trillion (in steps), which is currently estimated to be sufficient through early 2013; this debt limit increase is not contingent on any further action;
- established binding limits or “caps” on annual appropriations bills (which cover “discretionary” — or non-entitlement — programs such as defense, education, national parks, the FBI, the EPA, low-income housing assistance, medical research, and many others); the caps reduce projected funding for these programs by more than \$1 trillion through 2021, relative to the funding levels in CBO’s August 2010 baseline;
- required the House and Senate to vote in the fall of 2011 on an amendment to the Constitution to mandate a balanced budget every year; the House defeated the amendment on November 18 and the Senate defeated it on December 14 (a two-thirds vote is needed to amend the Constitution);
- established a Joint Select Committee on Deficit Reduction (the “Supercommittee”) to produce legislation to reduce projected deficits by at least an additional \$1.2 trillion through 2021 (beyond the savings generated by the discretionary caps); on November 21, 2011, the Committee’s co-chairs announced they could not reach agreement;
- established a fall-back mechanism to ensure that \$1.2 trillion in deficit reduction would be achieved if the Supercommittee failed (and to provide an incentive for members of the Supercommittee to reach agreement), providing for:
 - automatic, across-the-board budget cuts in many programs in 2013; and
 - reductions in each year from 2014 through 2021 in the annual caps on discretionary appropriations as well as automatic cuts in selected entitlement programs.

“How the Across-the-Board Cuts in the Budget Control Act Will Work” by Richard Kogan, Center for Budget and Policy Priorities, Revised April 27, 2012, <http://www.cbpp.org/cms/?fa=view&id=3635>

The BCA sets budget caps for the discretionary part of the federal budget and includes an enforcement mechanism, known as sequestration, designed to cut spending automatically if it exceeds the budget caps. The BCA also created the Joint Select Committee on Deficit Reduction, commonly known as the Super Committee, and charged it with finding an additional \$1.2 trillion in deficit reduction over the coming decade.

“Analysis of the FY 2013 Defense Budget & Sequestration” by Todd Harrison, Center for Strategic and Budgetary Assessments, Aug. 24, 2012, <http://www.csbaonline.org/publications/2012/08/analysis-of-the-fy2013-defense-budget-and-sequestration/>

What Happened Next: The Super Committee’s Failure

The Super Committee flopped.

“Sliding Past Sequestration,” Taxpayers for Common Sense, October 2012, http://www.taxpayer.net/user_uploads/file/FederalBudget/2012/TCS_Budget_Cuts_SlidingPastSequestration_October1a.pdf

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Because the Super Committee did not reach any agreement on additional deficit reduction, the law requires that the budget caps be lowered to achieve the \$1.2 trillion in deficit reduction through spending cuts. Half of these cuts apply to the ... budget... for national defense and the other half applies to non-defense accounts.

“Analysis of the FY 2013 Defense Budget & Sequestration” by Todd Harrison, Center for Strategic and Budgetary Assessments, Aug. 24, 2012, <http://www.csbaonline.org/publications/2012/08/analysis-of-the-fy2013-defense-budget-and-sequestration/>

The Cuts

[Sequestration] means huge cuts to the Pentagon budget. In 2013 alone, sequestration would slash defense spending up to 18%. Over 10 years, the military would take a \$1 trillion hit.

“A Warning Shot for Obama on Defense and Budget Cuts” by James Jay Carafano, Ph.D., The Heritage Foundation, Oct. 10, 2011, <http://www.heritage.org/research/commentary/2011/10/a-warning-shot-for-obama-on-defense-and-budget-cuts>

While the Department of Defense would be able to shift funds to ensure war fighting and critical military readiness capabilities were not degraded, sequestration would result in a reduction in readiness of many non-deployed units, delays in investments in new equipment and facilities, cutbacks in equipment repairs, declines in military research and development efforts, and reductions in base services for military families.

"OMB Report Pursuant to the Sequestration Transparency Act of 2012," Office of Management and Budget, Sept. 14, 2012, http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf

The Obama Administration's recent report on how it would slash nearly \$500 billion more from national defense over the next decade leaves lawmakers, the military, the defense industry, and the American public largely in the dark about the consequences of these massive spending cuts.

"Flawed sequester report reinforces need to quickly reverse damaging defense cuts" by Thomas Donnelly, Gary J. Schmitt and Mackenzie Eaglen, American Enterprise Institute, Sept. 20, 2012, <http://www.aei.org/press/foreign-and-defense-policy/defense/flawed-sequester-report-reinforces-need-to-quickly-reverse-damaging-defense-cuts-release/>

Impact on Personnel and Workforce

The magnitude of economic impacts resulting from BCA over the combined FY 2012-FY 2013 period have been shown to be large and their impact on the U.S. economy to be significant:

- Combined DOD and non-DOD agency spending reductions totaling \$115.7 billion in FY 2013 would reduce the 2013 U.S. GDP by \$215.0 billion.
- These spending reductions would result in the loss of 746,222 direct jobs including cutbacks in the federal workforce totaling 277,263 and decreases in the federal contractor workforce totaling 468,959 jobs, thus affecting all sectors of the national economy.
- The loss of these 746,222 direct jobs and 432,978 jobs of suppliers and vendors (indirect jobs) dependent on the prime contractors would reduce total labor income in the U.S. by \$109.4 billion.
- The loss of this labor income and the resultant impacts of reduced consumer spending in the economy would generate an additional loss of 958,508 jobs dependent on the

spending and re-spending of payroll dollars associated with the direct and indirect jobs lost as a result of BCA.

- This loss of \$215.0 billion in GDP and 2.14 million jobs in 2013 would erase two-thirds of the GDP gains projected for the year and raise the national unemployment rate by 1.5 percentage points by the end of 2013.

“The Economic Impact of the Budget Control Act of 2011 on DOD & Non-DOD Agencies,” Academic Report commissioned by the Aerospace Industries Association, by Stephen Fuller, July 12, 2012, http://www.aia-aerospace.org/assets/Fuller_II_Final_Report.pdf

President Obama has said he will exempt military personnel from the effects of sequestration. Veterans benefits also are protected.

“Report confirms feds would feel the effects of sequestration” by Charles Clark and Kellie Lunney, Government Executive, Sept. 14, 2012, <http://www.govexec.com/management/2012/09/report-confirms-feds-would-feel-sequestration/58130/>

Civilian personnel in the Defense Department will be “seriously affected” if a budget sequester takes effect next year, the Pentagon’s top budget official said Tuesday.

There will be a “high probability” of both a hiring freeze and furloughs of current employees should Congress allow the sequestration process to go forward, said Robert Hale, undersecretary of Defense and chief financial officer. Hale spoke at a *Government Executive* event in Arlington, Va.

[...]

Benefits could be affected as well, Hale said. For example, under a sequester, the Pentagon wouldn’t have enough money to pay all of its bills under TRICARE, Defense’s health care system. And Defense would have to cut back on family housing maintenance.

“Defense budget chief: Sequester would have serious impact on civilians” by Tom Shoop, Government Executive, Sept. 26, 2012, http://www.govexec.com/defense/2012/09/defense-budget-chief-sequester-would-have-serious-impact-civilians/58330/?oref=qovexec_today_nl

But what about the cost of implementing this massive and perhaps intermittent schedule of furloughs?

Further, each employee that is furloughed has certain rights under federal law to appeal the furlough and the cost of reviewing the appeal could be substantial. Obviously, the more costs associated with furloughs, the more weeks of furlough that will be required to meet the sequestration mandate.

"How Sequestration Would Work" by Scott Lilly, Center for American Progress, June 18, 2012, <http://www.americanprogress.org/issues/budget/report/2012/06/18/11751/how-sequestration-would-work/>

Impact on Procurement

By exempting military personnel, the burden of the sequester would fall disproportionately on military operations, training and maintenance, along with weapons modernization accounts. Keeping force levels steady, while cutting funds for readiness, research, and procurement, is a recipe for creating the "hollow force" that the chiefs of the four military services have repeatedly said they are determined to avoid.

"Flawed sequester report reinforces need to quickly reverse damaging defense cuts" by Thomas Donnelly, Gary J. Schmitt and Mackenzie Eaglen, American Enterprise Institute, Sept. 20, 2012, <http://www.aei.org/press/foreign-and-defense-policy/defense/flawed-sequester-report-reinforces-need-to-quickly-reverse-damaging-defense-cuts-release/>

Many companies would face a steady decline in new opportunities, rather than a precipitous drop.

The Pentagon may find it more difficult to apply across-the-board cuts to all programs rather than make larger reductions to fewer programs. It may be prudent for the Pentagon to delay signing contracts that would require spending funds that may be sequestered.

"Analysis of Bloomberg Government Study Sequestration Planning: Scenarios and Options for Defense Contractors" by Kevin Brancato and Robert Levinson, Bloomberg Government Blog, July 3, 2012, <http://about.bqov.com/2012/07/03/planning-for-sequestration/>

Panetta to ADC: Cuts Will Be a 'Disaster'

“But we’ve also got to be honest and open with each other about the nature of the fiscal challenge that confronts this country. There is a strategic and fiscal imperative that is driving the Department, as I said, towards a smaller, and leaner, and more agile force. That’s a reality, whether it’s coming out of Iraq and Afghanistan and reducing the force there, whether it’s the fiscal constraints that we’re going to be facing, there is no question – we are going to have to be smaller and leaner. Our budget made tough decisions to cut the size of the force – it has not been easy. But it would be irresponsible of us not to reduce the budget and do our role in confronting the fiscal challenge facing this country. Frankly, all of us have to work together at a time of a crisis in this country to confront that. And I know Congress is locked in partisan gridlock. They can’t figure out what the hell they’re going to do to try to deal with this issue. But let me tell you something – at some point they are going to have to find the strength and the will and the courage to do the right thing.

[...]

I have made clear – and I will continue to do so – that if sequestration is allowed to go into effect it’ll be a disaster for national defense, and it would be a disaster, frankly, for defense communities as well. And, frankly, it’s not only true about the DoD budget, it’s also true relating to the domestic discretionary cuts that will deprive communities of the federal support they need in areas like education. It is a mindless, indiscriminate formula that was never designed to be implemented. It was designed to trigger such untold damage that it would force people to do the right thing. I’m asking all of you to bring as much pressure as you can to make sure that Congress does not allow this to happen and that they do the right thing.

Secretary of Defense Leon E. Panetta, Remarks Delivered to the Association of Defense Communities Annual Conference, Monterey, Calif., Aug. 6, 2012, <http://www.defense.gov/speeches/speech.aspx?speechid=1716>

Is It Really So Bad?

If automatic reductions in defense spending go into effect, the fiscal year 2013 base (or non-war) budget will be reduced by \$55 billion to \$500 billion and remain at that level in real terms for the next decade. This will result in a total reduction of \$500 billion over a decade from projected levels of defense spending.

But it also means the Pentagon will still be spending more in 2013 after sequestration than it did in 2006, at the height of the Iraq war, and more than we spent on average at the end of the Cold War and during the first Gulf war.

Moreover, the United States will still account for 40% of the world's military expenditures -- 70% if you combine that with what our allies spend.

These cuts come after 13 straight years of defense increases, which brought defense spending to levels not seen since World War II.

[...]

The most serious security problem facing the nation is our federal debt. Reducing defense won't solve that problem. But since defense accounts for 20% of federal expenditures and 50% of all discretionary spending, it can and should... be reduced to 2006 levels, sequester or no sequester.

The American people support it. And if the Pentagon's leaders can't do it, they don't deserve to be there.

"Defense cuts won't hurt that much" by Lawrence Korb, CNN Money, Aug. 2, 2012,
<http://money.cnn.com/2012/08/02/news/economy/defense-cuts-commentary/>

What Happens Next

Devastating economic consequences of not addressing the fiscal cliff before [January]...:

- Absent legislative action, large spending cuts and large tax increases will hit the economy at the same time, causing a total fiscal contraction of \$500 billion, or about 3.2 percent of GDP.
- Washington's failure to address the pending fiscal cliff is already having an impact, cutting 0.6 percentage points from GDP growth for 2012.
- The worst could be ahead. If the fiscal contraction happens, the economy will almost certainly experience a recession in 2013 and significantly slower growth through 2014.
- From 2012 to 2015, the economy will lose 12.8 percent of the average annual real GDP it could have attained with moderate growth, sapping critical resources from all economic sectors.
- Job losses will be dramatic. By 2014, the fiscal contraction will result in almost 6 million jobs lost, and the unemployment rate could reach more than 11 percent.
- Households will take a big hit. Real personal disposable income will drop almost 10 percent by 2015.
- Manufacturers of consumer goods and defense contractors likely will see large and durable contractions in their industries.
- It will take most of the decade for economic activity and employment levels to recover from the fiscal shock. Another recession could deal a substantial blow to long-term economic potential, permanently reducing living standards in the United States

"Fiscal Shock: America's Economic Crisis," National Association of Manufacturers, Oct. 26, 2012, <http://www.nam.org/~media/45A37479471D4EB1AA3804DE86AECD1A.ashx>

Some defense analysts see the industry's fiscal-cliff hand weakened by measures taken before the election, when several defense firms threatened to send mass layoff notices to their employees over the threat of the across-the-board cuts. Industry studies forecast losses of more than 1 million jobs if sequestration took effect, and Republicans made those issues a key part of their campaigns in military-heavy states like Virginia.

[...]

Congressional aides argue industry officials and defense-minded lawmakers have been successful in convincing rank-and-file lawmakers that cuts to the Pentagon will not solve the deficit issues.

"I think everyone going into those negotiations understands there's just not a lot of savings left that's easily derived from the Pentagon," said one GOP congressional aide.

"People in the room know you could cut the whole department [of Defense], and you're still sitting around table trying to figure out the deficit," the aide said. "They know the solution doesn't flow through the Pentagon."

"Tax fight freezes defense industry out of negotiations over 'fiscal cliff'" by Jeremy Herb, The Hill, Nov. 20, 2012, <http://thehill.com/blogs/defcon-hill/budget-appropriations/268799-tax-fight-freezes-defense-industry-out-of-negotiations-on-fiscal-cliff>

"We're developing a [fiscal] 2014 budget that to some extent ... is not based on what Congress has done, because they haven't done it," the secretary said. "We don't know what the 2013 budget is going to be." The department is operating on a continuing resolution through March 2013 in lieu of a budget for the whole fiscal year, which began Oct. 1.

Panetta said Pentagon officials don't know what they can spend for fiscal 2013, let alone fiscal 2014.

"This is a strategic issue: it's 'What kind of stability am I going to have in terms of defense spending for the future?'" he said.

Noting that the department still is cutting almost \$500 billion from the defense budget over the next decade, Panetta said that to do so smartly requires some certainty.

"Panetta: Congress 'On The Clock' to Avert Sequestration" by Jim Garamone, American Forces Press Service, Oct. 25, 2012, <http://www.defense.gov//News/NewsArticle.aspx?ID=118344>

Voters are very concerned about the impact of the fiscal cliff. Today, 53% have heard a "great deal" or "some" about the impending budget challenge known as the fiscal cliff. Among those familiar with the fiscal cliff issue, 60% are at least very concerned, with one-quarter of likely voters (25%) saying they are extremely concerned.... Concern is high across party, with 73% of Republicans, 60% of independents, and 59% of Democrats saying they are concerned.... Voters strongly disapprove of the job that Congress has done in addressing the fiscal cliff, a belief that extends across party lines. Eighty-one percent (81%) of likely voters overall disapprove, with more than half (56%) saying they "strongly disapprove." ... Greater partisan differences exist on voters' opinions of the campaigns' involvement than that of Congress. Voters believe that partisan gridlock and special interests are primary causes of the crisis, and expect a bipartisan solution.... Nearly all likely voters agree (94% total agree) that both parties' inability to work together will lead to avoidable problems. They also believe that the fiscal cliff can only be solved with bipartisan cooperation (88% total agree).

"The Fiscal Cliff" Polling Memorandum, Center Forward, Oct. 15, 2012, <http://www.center-forward.org/2012/10/15/the-fiscal-cliff/>

Even if Congress is able to hammer out a debt deal that avoids sequestration in January, the resulting agreement will likely result in billions of dollars in additional cuts to the Defense Department — perhaps as much as \$25 billion — likely forcing the military to alter its roles and missions.

Internally, some of the nation's largest defense companies are also planning for a possible \$25 billion cut annually from current spending levels. That \$25 billion is half of what DoD is expected to absorb annually under sequestration....

"If they come up with a deal to avert sequestration, I think the defense portion of that deal will be cuts [at] about half the level that sequestration would require," said Todd Harrison, an analyst with the Center for Strategic and Budgetary Assessments.

But the cuts, under a debt deal, would likely be distributed differently from how they would be under sequestration.

“Instead of an even \$25 billion across every year for the next 10 years, it could be more back-loaded and it certainly would give DoD the flexibility to target those cuts, to allocate them in a thoughtful, strategic manner,” Harrison said.

“Sequestration or not, firms, DoD will take a hit” by Marcus Weisgerber, Federal Times, Nov. 18, 2012, <http://www.federaltimes.com/article/20121118/DEPARTMENTS01/311180002/Sequestration-not-firms-DoD-will-take-hit?odyssey=tab/topnews/text/FRONTPAGE>