CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas W. Elmendorf, Director

July 25, 2013

Honorable Chris Van Hollen
Ranking Member
Committee on the Budget
U.S. House of Representatives
Washington, DC 20515

Re: How Eliminating the Automatic Spending Reductions Specified by the Budget Control Act Would Affect the U.S. Economy in 2014

Dear Congressman:

This letter responds to your request for an analysis of how a cancellation of the automatic spending reductions specified by the Budget Control Act of 2011 (Public Law 112-25) would affect the U.S. economy. Pursuant to that act, federal spending in 2013 has been subject to across-the-board cuts, also referred to as sequestration. (Certain programs—including Social Security, for example—are exempt from those reductions.) For the 2014–2021 period, the act requires automatic reductions, through sequestration, of nonexempt mandatory spending and reductions in the caps on discretionary budget authority.

As you requested, the Congressional Budget Office (CBO) analyzed a proposal under which the automatic spending reductions in effect for 2013 would be canceled at the beginning of August and none of the reductions scheduled for 2014 would be implemented; for 2013, mandatory payments made after early August would be at the rates in effect prior to sequestration, and agencies would have an additional year to obligate the restored discretionary funding.[1] In total, by CBO's estimates, canceling the automatic spending reductions effective August 1 would increase outlays relative to those under current law by $14 billion in fiscal year 2013 and by $90 billion in fiscal year 2014.[2]

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[1] Most discretionary appropriations are provided for one fiscal year, so the authority to obligate any of those funds generally lapses on October 1 (the start of a new fiscal year). The proposal that CBO analyzed assumes that the authority to obligate the restored 2013 funding would be extended through all of fiscal year 2014.

[2] Outlays would increase by another $62 billion in subsequent years relative to what would be spent under current law. As is the case with most discretionary appropriations, not all of the additional funds that would be made available to agencies under the proposed policy would be spent. Also, if the proposal was enacted in September instead of early August, some outlays would

Those changes would increase the level of real (inflation-adjusted) gross domestic product (GDP) by 0.7 percent and increase the level of employment by 0.9 million in the third quarter of calendar year 2014 (the end of fiscal year 2014) relative to the levels projected under current law, CBO estimates.[3] Those figures represent CBO's central estimates, which correspond to the assumption that key parameters of economic behavior (in particular, the extent to which higher federal spending boosts aggregate demand in the short term) equal the midpoints of the ranges used by CBO.[4]

The full ranges CBO uses for those parameters suggest that, in the third quarter of calendar year 2014, real GDP could be between 0.2 percent and 1.2 percent higher, and employment 0.3 million to 1.6 million higher, under the proposal than under current law. Because those estimates indicate the effects of a *prospective* change in law, they do not encompass the full impact of the sequestration that has already occurred.

Although output would be greater and employment higher in the next few years if the spending reductions under current law were reversed, that policy would lead to greater federal debt, which would eventually reduce the nation's output and income below what would occur under current law.[5] Moreover, boosting debt above the amounts projected under current law would diminish policymakers' ability to use tax and spending policies to respond to unexpected future challenges and would increase the risk of a fiscal crisis (in which the government would lose the ability to borrow money at affordable interest rates).

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shift from late fiscal year 2013 into early fiscal year 2014, but that change would not significantly affect the estimated economic impact described in this letter.

[3] The estimated effects are given for the third quarter of calendar year 2014, rather than the fourth quarter, because the policy being analyzed addresses only fiscal years 2013 and 2014. The effects on output and employment in calendar year 2013 would be smaller than those in 2014.

[4] The approach that CBO has adopted to estimate the short-term economic impact of the proposal is similar to the method that the agency has used to assess the impact of the American Recovery and Reinvestment Act and the impact of various potential policies designed to increase output and employment. For a discussion of that approach, see Felix Reichling and Charles Whalen, *Assessing the Short-Term Effects on Output of Changes in Federal Fiscal Policies*, Congressional Budget Office Working Paper 2012-08 (May 2012), www.cbo.gov/publication/43278.

[5] For an analysis of the short- and long-run effects of different amounts of deficits and debt, see Congressional Budget Office, *Macroeconomic Effects of Alternative Budgetary Paths* (February 2013), www.cbo.gov/publication/43769.

I hope that you find this information useful. If you have any questions, please feel free to contact me or CBO staff. The primary staff contact for this analysis is Benjamin Page.

Sincerely,

Douglas W. Elmendorf

Douglas W. Elmendorf
Director

cc: Honorable Paul Ryan
Chairman