Center for a New American Security
Fifth Anniversary

NOVEMBER 2012

Countdown to Sequestration
Why American Leaders Could Jump Off the Fiscal Cliff

POLICY BRIEF

By David W. Barno, Nora Bensahel, Joel Smith and Jacob Stokes

There is a strong possibility that sequestration will take effect on January 2, 2013. While in principle Congress and the president both would like to avoid sequestration, hardball politics in Washington could well dictate a different result. In fact, the president and some members of both parties in Congress could realize political benefits if the nation were to go off the fiscal cliff. They could also agree to a temporary deal that delays sequestration cuts and tax increases for several months to provide more time for the newly-elected Congress to craft a comprehensive agreement on taxes and spending (a "grand bargain"). But the prospects for a delay depend more on political calculations than on the extent of bipartisan support for avoiding the consequences of going off the cliff. In any scenario, the fate of sequestration depends on prospects for a broader resolution of the fiscal cliff, where the total dollars at stake are more than nine times larger than the defense sequestration cuts.

The elections did not change the balance of power in Washington. The president was reelected and Congressional leadership remains the same, and they are unlikely to break the deadlock of the last two years in just a few short weeks. The chances for a comprehensive grand bargain in the lame duck session are almost nil. And if Congress and the president judge that the consequences of the fiscal cliff – including the defense sequestration cuts – could be managed with only short-term negative consequences and then quickly reversed, chances for going off the cliff increase dramatically.

Sequestration and the Fiscal Cliff

Sequestration is only one of the key issues Congress faces during the upcoming lame duck session. Whether sequestration is implemented depends on several far more politically divisive fiscal changes – collectively known as the "fiscal cliff" – that will automatically take effect on January 2 unless Congress passes new legislation that President Barack Obama signs by the end of the year. Otherwise, the sequestration mechanism contained in the August 2011 Budget Control Act will trigger automatic spending cuts on January 2 that will reduce planned defense spending by $500 billion over the next 10 years (and will cut domestic discretionary spending by a similar amount).[1]

Furthermore, Congressional leaders will make these choices under the pressure of an impending fight over the debt ceiling, since Treasury Department officials estimate that the nation will reach the current debt limit early in 2013.[2] This looming deadline threatens a reprise of the 2011 debt ceiling battle which resulted in the downgrading of the U.S. credit rating and the enactment of the Budget Control Act. Therefore, the likelihood of sequestration taking effect cannot be accurately considered without taking into account the broader fiscal, economic and legislative contexts in which this decision will be made.

The upcoming fiscal cliff stems from budgetary policies that have kept extra dollars flowing through the broader economy during the nation's worst recession since the 1930s. Unless Congress acts to extend these policies, broad tax increases and spending cuts will automatically go into effect on January 2, including:

- Expiration of the Bush-era tax cuts;
- Expiration of the Alternative Minimum Tax patch;
- Expiration of the temporary payroll tax reduction;
- Automatic spending cuts to defense and domestic programs mandated by the Budget Control Act (sequestration);
- The lapse of extended unemployment benefits; and
- Reductions in payments to physicians under Medicare.

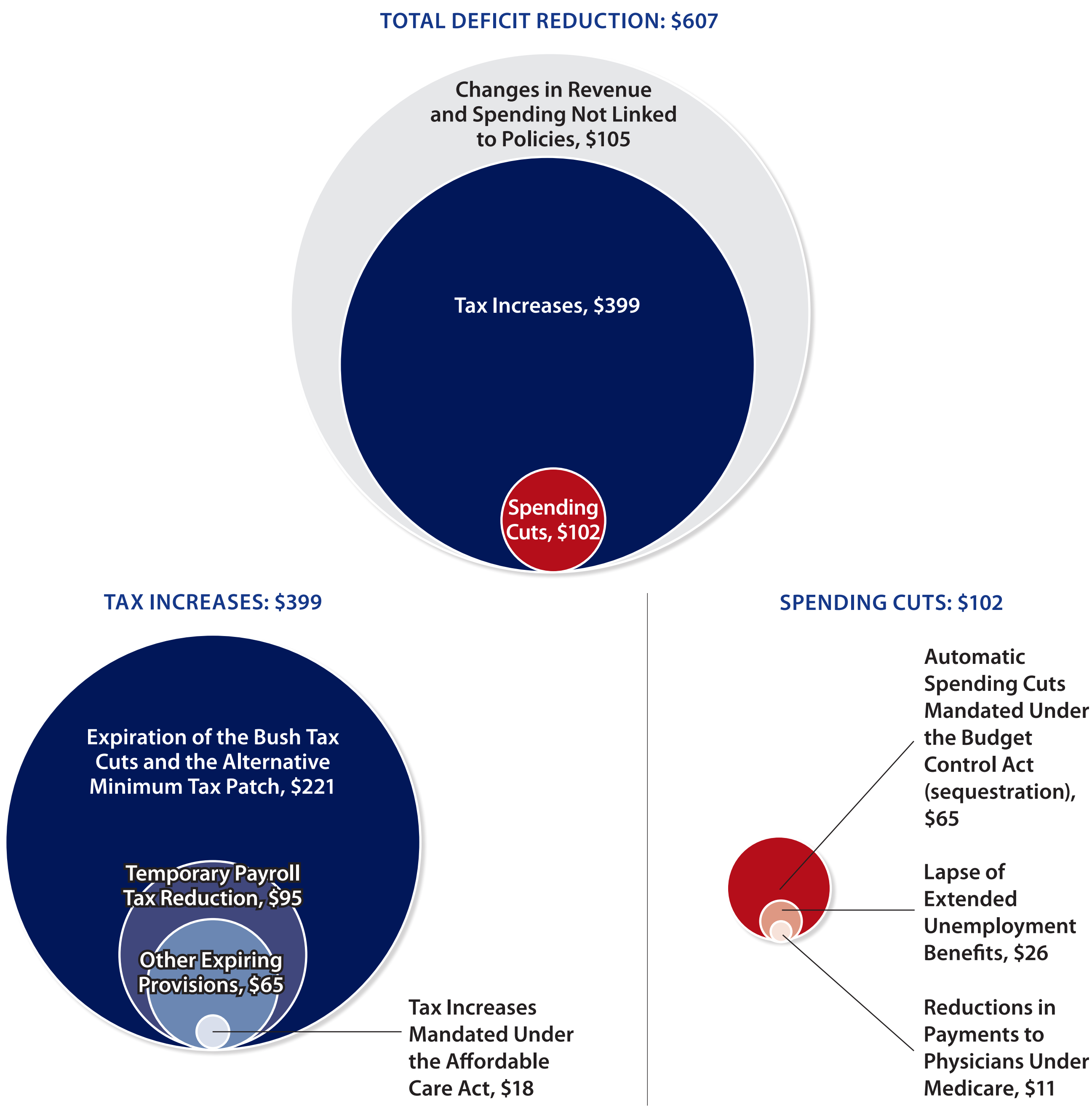
If Congress fails to reach agreement and allows these laws to take effect as scheduled, the economic impact on the United States could be considerable. The combined effects of deep government spending cuts, mainly through sequestration, alongside substantial tax increases for most Americans, would send a shock into the nascent U.S. economic recovery. The Tax Policy Center estimates that taxes on the average middle-income household would increase by nearly $2,000.[3]

Going off the fiscal cliff could also throw the U.S. economy back into recession. Increased taxes and reduced spending on government programs would remove more than $600 billion from the economy in 2013, dramatically reducing the deficit (see Figure 1). The Congressional Budget Office projects that going off the fiscal cliff would shrink the U.S. gross domestic product by 0.5 percent (instead of growing by 1.7 percent) and unemployment would reach 9.1 percent (instead of 8 percent.)[4] On the international stage, the International Monetary Fund has warned that persistent debt crises – including in the United States – are slowing global growth and beginning to drag down growth in emerging economies.[5] Those warnings assume,

About This Policy Brief

We began analyzing the implications of the nation's ongoing battles over defense budgeting and strategy in October 2011 with our report *Hard Choices: Responsible Defense in an Age of Austerity*. This policy brief continues CNAS' work on how federal budget issues affect U.S. national defense. While our focus has always been, and continues to be, national security policy rather than domestic politics, the most important defense issue today is the prospect of sequestration – the large automatic cuts that are scheduled to take place at the end of the year. As we argue in this brief, the fate of sequestration will be inextricably linked to the fate of the larger end-of-the-year tax and spending changes known as the "fiscal cliff." We therefore examine the political dynamics surrounding these other issues in order to assess the likelihood that sequestration cuts will be averted. This analysis will help inform expectations for future defense budgets and their implications for strategic planning.

FIGURE 1: THE FISCAL CLIFF – BUDGET DEFICIT REDUCTIONS UNDER CURRENT LAW BETWEEN FISCAL YEAR 2012 AND 2013 (IN BILLIONS)



Note: The figure for total deficit reduction does not include the effects of economic feedback, which according to the Congressional Budget Office could increase the deficit by $47 billion in Fiscal Year 2013.

Source: Congressional Budget Office

however, that Congress does not rapidly reverse any of these laws during 2013. Congress could limit some of the economic damage by passing legislation at any point that applies retroactively to the beginning of the year. The longer the original laws stay on the books, however, the greater the economic consequences.

Although the sequestration cuts would pose significant problems for the Department of Defense (DOD), the fiscal cliff changes pose even more problems for the country as whole. The total dollar effect of the fiscal cliff for Fiscal Year (FY) 2013 is four and a half times larger than the sequester cuts, and more than nine times larger than the defense portion of the sequester. In other words, lawmakers' concerns about the powerful economic setback associated with the fiscal cliff could quickly overwhelm more narrow concerns about deeper defense cuts – even though military and civilian leaders in DOD, the defense industry and some members of Congress strongly oppose further defense cuts.

The remainder of this policy brief outlines three possible scenarios for addressing the fiscal cliff changes during the lame duck session.

SCENARIO 1: CONGRESS AND THE PRESIDENT AGREE TO A GRAND BARGAIN

While some conditions seem to favor a comprehensive deal, the likely continuation of the 112th Congress's record of political gridlock – it has passed the fewest laws since World War II[6] – as well as the extremely short period of time in which to forge a large, complicated piece of legislation almost certainly means Congress and the president will not strike a grand bargain that includes reversing sequestration during the lame duck session of Congress.

At first glance, the prospects for such a deal seem higher than at any point during the past two years. President Obama's bargaining power has increased, now that he will serve a second term. Democrats want to prevent large cuts to domestic discretionary spending, and they have an incentive to cut a big deal before the next time the nation hits the debt ceiling, which is likely early in the new year.[7] During the last debt ceiling crisis, in August 2011, many Congressional Republicans allied with the Tea Party effectively withheld their support for raising the debt ceiling until they received concessions on deficit reduction (which included the sequestration mechanism as a penalty for not making further progress). Democrats will likely insist that any big deal in the lame duck session includes provisions on raising the current debt ceiling in order to prevent another budget crisis within a few months. Both parties also have an incentive to prevent the damage to the economy discussed above.

The total dollar effect of the fiscal cliff for Fiscal Year 2013 is four and a half times larger than the sequester cuts, and more than nine times larger than the defense portion of the sequester.

Republicans face substantial pain as well. While the economic effects of going off the fiscal cliff would likely shock the economy and generate widespread public outrage with both the president and Congress, Republicans would also have to contend with higher taxes, especially on high-income households, and significant cuts to defense spending – both outcomes Republicans oppose. Indeed, a group of Republican senators have already begun calling on their party colleagues to compromise on taxes in order to stop defense sequestration cuts.[8]

While conditions for deal-making might appear to be as advantageous as any time during the 112th

Congress, it remains highly unlikely that Congress will be able to leave behind its history of gridlock and hammer out a grand bargain – especially not in the short lame duck session. A sudden end to the partisan gridlock that has characterized the previous two years seems unlikely if not naïve. Aside from simple partisan sniping, a fundamental reality remains: Most Republicans do not support any tax increases and most Democrats do not support significant cuts to government services.

Even if Congress could enter into serious negotiations with a high likelihood of compromise, the logistics of passing a grand bargain are daunting. The lame duck session consists of the time between Election Day and the end of the year, roughly seven weeks. Some amount of time will be taken up preparing for the 113th Congress, and many departing members will focus on making arrangements for their post-Congress lives rather than putting their energies into legislating. In that context, Congress would have to draft legislation; debate and pass it in committees; debate and pass it in both chambers; reach a compromise agreement between the two chambers; redraft the compromise; and then pass the conference report.[9] Then the president would have to sign that bill into law before the end of the year. Barring an unforeseen change, the cumulative effect of partisan gridlock and a lack of time should squelch expectations for a grand bargain in the lame duck session.

SCENARIO 2: CONGRESS AND THE PRESIDENT AGREE TO DELAY SOME OR ALL OF THE FISCAL CLIFF CHANGES, POSSIBLY INCLUDING THE SEQUESTER

If Congress and the president fail to strike a comprehensive deal, they will face substantial pressure to delay some or all of the fiscal cliff provisions, including sequestration, before they take effect on January 2. A delay would produce many of the same short-term positive effects for the economy as a grand bargain. It would also defer deep cuts to defense and domestic programs.

The bargaining over a delay could resemble the politics of trying to reach a grand bargain. But the lack of comity between the two parties on the Hill suggests that even a scaled-down agreement would face a difficult and contentious path at best. Any deal to delay some or all of the fiscal cliff changes would probably occur only at the last minute, after other negotiations have failed, and in a "clean" bill stripped of any other legislative measures to better ensure speedy passage.

The effects of a delay would differ from those of a grand bargain in one significant regard. Financial markets may react poorly if the deficit reduction measures enacted in the Budget Control Act are delayed without having reached a bigger deal, because it would send a signal that Washington lacks the political will to solve the country's fiscal problems.[10] Credit agencies might also react by downgrading their ratings of U.S. debt. Standard and Poor's downgraded its ratings of U.S. debt after the legislative fight over raising the debt ceiling in 2011. Both Fitch Ratings and Moody's Investor Services have warned of a credit downgrade if Congress and the president do not reach an agreement that prevents the country from going off the fiscal cliff, increases the U.S. debt ceiling and creates a plan for reducing the budget deficit and stabilizing the federal debt.[11] As former Senators Sam Nunn and Pete Domenici wrote in October, "Absent more constructive action, simply postponing when we go over the cliff could hurt business confidence, worry investors and lead to another disruptive debate over raising the debt ceiling."[12]

Moreover, a delay can only occur if both chambers of Congress pass a bill that the president is willing to sign. Democrats have two powerful sources of leverage in the lame duck session, giving them significant negotiating power: a Democratic-controlled Senate and a presidential veto. Since they still control the Senate, no legislation can be passed without their support. This means that any bill to delay sequestration would inevitably have to garner bipartisan support – and implicitly have the president's backing – to gain enough votes to pass. There is a very good chance that this will not happen given the divisiveness of the issues involved.

Republicans have strong incentives to press for a delay, since that would avoid both substantial tax increases and cuts to defense spending in the short term. In early 2013, Republicans will also gain new leverage as the nation once again reaches its debt ceiling, which will require Congress to authorize additional government borrowing. This is an immensely powerful bargaining chip, as demonstrated in the summer of 2011.[13] Some Republicans may use those hardball tactics again in 2013, possibly in the midst of negotiations to reach a larger bargain on spending and revenues.

Conversely, the president and many Congressional Democrats would lose significant bargaining power by agreeing to a delay. Their bargaining position in the coming weeks is strong in the face of the looming fiscal cliff, and before the debt ceiling limit becomes a crisis. Unless Democrats concluded that the public would blame them – and them alone – for going off the fiscal cliff, there is little incentive for them to postpone the day of reckoning. Under these conditions, the president and Congressional Democrats would only be likely to support a bill that enacts an across-the-board delay to tax increases and spending cuts rather than just delaying cuts to defense programs. They also would likely require that such a deal address raising the debt ceiling to remove this trump card from the hands of Congressional Republicans in 2013.

SCENARIO 3: CONGRESS AND THE PRESIDENT FAIL TO REACH ANY AGREEMENT, AND THE NATION GOES OFF THE FISCAL CLIFF

Continued gridlock during the lame duck session remains a high probability. Budget talks during the remainder of the year will likely involve a significant amount of brinksmanship among negotiators trying to maximize their own gains. Given that reality – as well as the poor record of the 112th Congress – brinksmanship aimed at achieving gains might well end in failure, preventing a deal and driving the nation off the fiscal cliff.

As noted above, the tight legislative calendar in the lame duck session and the large number of weighty issues on the agenda make it likely that negotiations on any sizable deal would continue until the last possible moment. If talks break down at that point, the time left to agree to a delay would be very short. Efforts to broker an agreement to delay sequestration would probably have to occur at the same time as efforts to agree on a grand bargain. But lawmakers looking for a deal would likely shun simultaneous efforts, since such efforts would remove the urgency of reaching a bargain.

Although President Obama has opposed sequestration as a way to reduce the deficit, it remains unclear whether he would support legislation to undo it without an agreement on new sources of revenue. In a recent report to Congress, the Obama administration wrote, "Sequestration is a blunt and indiscriminate instrument. It is not the responsible way for our Nation to achieve deficit reduction."[14] But the strength of the president's resolve to avoid sequestration under *any* conditions is uncertain. In August, he told a Virginia newspaper, "If the choice is between sequester going through or tax cuts continuing for millionaires and billionaires, I think it's pretty clear what the American people would choose."[15] But he also clearly stated during the final presidential debate that sequestration "will not happen,"[16] although his spokesmen walked back that language the following day.[17] Republican leaders, on the other hand, have demonstrated their equally strong and opposing view against raising taxes throughout the 112th Congress.

Legislators from both parties might see some advantages in letting the nation go off the fiscal cliff and allowing the sequester cuts to take effect. According to press reports, some Republicans have promised to pressure their leadership and slow down the legislative process to ensure that there is no deal to delay the cuts.[18] For Republican deficit hawks, ensuring that Congress reduces government spending, whatever the consequences, is the highest priority. Grover Norquist, the influential head of Americans for Tax Reform, recently stated that, "Sequestration is not the worst thing," and Rep. Jim Jordan (R-Ohio), who chairs the conservative Republican Study Committee, said, "The only thing worse than cutting national defense is not having any scheduled cuts at all take place."[19]

For the president and Congressional Democrats, going off the fiscal cliff would improve their bargaining position with Republicans. This result indirectly accomplishes many Democratic objectives: it raises taxes on higher incomes, increases government revenues, decreases the deficit and further reduces defense spending. Having so far accomplished few of these goals with the 112th Congress, President Obama might find going off the fiscal cliff a legitimate option if he concludes that no better deal with Republican lawmakers could be achieved in the coming weeks – especially if he believes he could quickly mitigate the fiscal cliff's worst economic effects (as discussed below).

In a perverse twist of logic, both parties might benefit from the new tax and spending baselines created by going off the fiscal cliff. Allowing the Bush-era tax cuts to expire would automatically raise taxes on the majority of Americans to pre-2001 levels, which would reduce the deficit by $3.7 trillion over the next decade.[20] With sequestration in force, spending would be cut by about $1 trillion over 10 years, carved equally out of defense and non-defense discretionary accounts. Both tax increases and spending cuts would occur automatically, without a single lawmaker needing to vote to support such dramatic changes.

Lawmakers from both parties might therefore see going off the cliff as a way of reaching a broader consensus in 2013 about balancing the nation's revenues and expenditures.

Ironically, these new baselines might break the partisan deadlock over taxes and spending and enable Congress to reach a grand bargain in early 2013. Republican lawmakers could then vote in favor of a tax "cut." And as revenues increase, more Democratic lawmakers may be willing to vote to "increase" spending on defense programs by reversing sequestration, at least in part.

Of course, this would be a high-stakes game of chicken for both the White House and Congress. It would seriously disrupt planning throughout the Department of Defense and the defense industry, potentially shake market confidence in the United States and limit U.S. economic growth. But recent reports have indicated that the effects of defense sequestration, tax hikes and spending cuts would be slower and less damaging in the short term than the rhetoric would suggest (see text box). That would leave room to go off the cliff and cut a deal early in the 113th Congress without causing lasting damage to the economy, national security or domestic programs.[21] Lawmakers from both parties might therefore see going off the cliff as a way of reaching a broader consensus in 2013 about balancing the nation's revenues and expenditures.

Sequestration's Effects in Fiscal Year 2013

The exact consequences of allowing sequestration to take effect on January 2, 2013 still remain unclear, but they are likely to occur more gradually than is generally understood. Sequestration mandates a $52.3 billion reduction of Department of Defense (DOD) spending in Fiscal Year (FY) 2013, which amounts to a 9.4 percent cut from nonexempt accounts during the nine remaining months of the fiscal year.[22]

However, focusing on cuts to defense budget authority distorts how sequestration would affect defense spending for the rest of FY 2013.[23] Budget authority is often spread across multiple years, and therefore is the wrong metric for examining the immediate economic effects of cuts.[24] Instead, outlays – money actually spent – provide a better measure as they account for money paid out by the Treasury Department in the current year.

Some of the key ways that sequestration could affect defense during the rest of FY 2013 include:

THE DOD CIVILIAN WORKFORCE

As spending on civilian personnel is largely consumed in the first outlay year, the civilian workforce potentially faces significant layoffs or furloughs.[25] Unlike uniformed personnel, civilian personnel are not exempt from sequestration. Experts have estimated that if sequestration goes into effect, DOD would need to reduce its civilian workforce by as much as 13.7 percent during the rest of the fiscal year.[26]

MILITARY HEALTH CARE

Military health care services are subject to sequestration since they are primarily funded through nonexempt operations and maintenance accounts. This could result in delayed payments to providers and possible denial of services.[27]

PROGRAM CANCELLATIONS

Although this area receives the most attention regarding the potential effects of sequestration, most procurement programs will not be affected right away.[28] Sequestration does not affect prior-year funding obligations, so already authorized purchases will go ahead as scheduled. Sequestration allows already funded programs to continue, but over time it would reduce quantities bought, delay deliveries and increase unit prices.

MILITARY END STRENGTH

Since President Obama exercised his authority to shield military personnel accounts from sequestration, pay and benefits would remain intact and end strength would not be cut beyond already-planned levels for FY 2013.[29]

DOD would likely try to mitigate some of these effects by asking Congress for liberal reprogramming authority, in order to shift money from one account to another. If Congress grants this authority, DOD would be able to allocate these defense cuts strategically rather than being forced to cut each plan, program and activity equally during FY 2013 as sequestration requires. DOD would likely shift funds away from lower-priority base budget operations and maintenance accounts to resource higher priorities such as the Overseas Contingency Operations budget that supports deployed troops.

DOD might also mitigate these effects by deferring any cuts until the fourth quarter of FY 2013. Under such a plan, it would continue operating at planned FY 2013 spending levels as specified in the continuing resolution until a decision is made by Congress and signed by the president to undo the cuts.[30] This would allow DOD to continue resourcing ongoing operations and maintain readiness at existing levels for the near term. Of course, this would be a very high-stakes gamble. If Congress did not reverse sequestration or increase the defense budget for the fourth quarter, the effects would be devastating since DOD would simply run out of money.

Conclusion

The fate of sequestration cuts, and defense cuts in particular, is inextricably linked with the resolution of the larger set of fiscal cliff changes. The prospects for a grand bargain are miniscule during the lame duck session of the 112th Congress, due to tight time constraints and unresolved partisan divisions over government spending and revenues. Congress and the president may be able to reach an agreement that delays some or all of the fiscal cliff changes, including sequestration, if the external financial and political pressures are strong enough. But they could just as easily fail to reach an agreement. If lawmakers from both parties conclude that going off the cliff will give them an advantage in negotiations during 2013, and that most of the short-term negative effects could be retroactively reversed, going off the fiscal cliff becomes increasingly likely. U.S. defense officials and the broader defense community must therefore prepare for the very real possibility that sequestration will take effect on January 2 – and that tremendous uncertainty about the final FY 2013 defense budget will extend well into the new year.

After Tuesday's elections, the United States approaches the end of 2012 with seemingly little changed between Congress and the White House. To date, Democrats and Republicans have been flatly unable to find a path to fiscal solvency that better balances revenues and government spending. This must now change, and the impasse must be broken. Going of the fiscal cliff at the end of this year, even with mitigating measures in place, presents enormous and in part unknowable risk to the U.S. economy, defense strategy and global reputation. Lawmakers' failure to reach a comprehensive agreement, now or very soon in 2013, would accelerate the nation's current slide toward fiscal insolvency. These issues must be resolved – and soon. Steady leadership and the ability to solve complex problems have traditionally been a strategic advantage of the United States. Congress and the president must find consensus and put the nation on a sustainable fiscal path.

Lawmakers' failure to reach a comprehensive agreement, now or very soon in 2013, would accelerate the nation's current slide toward fiscal insolvency.

Lieutenant General David W. Barno, USA (Ret.) is a Senior Advisor and Senior Fellow; Dr. Nora Bensahel is Deputy Director of Studies and a Senior Fellow; Joel Smith is a Research Assistant; and Jacob Stokes is a Research Assistant at the Center for a New American Security.

Acknowledgements

The authors would like to thank the many selfless and talented people who contributed to this report. First and foremost, we thank Liz Fontaine for her creative report design and flexibility in the final layout. We thank Kay King and Sara Conneighton for their agility in accelerating its publication. We thank Shawn Brimley, Kristin Lord, Travis Sharp and Will Rogers for commenting on earlier drafts, and we thank Nathan Sherfinski for his many research contributions. In addition, we thank Russell Rumbaugh, Todd Harrison and Leo Mackay for sharing their thoughts and commenting on previous drafts. Several equally generous external reviewers elected to remain anonymous. Their assistance does not imply any responsibility for the final product, which rests solely with the authors.

ENDNOTES

1. Executive Office of the President of the United States, *OMB Report Pursuant to the Sequestration Transparency Act of 2012 (P. L. 112–155)* (September 14, 2012), http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf.

2. Catherine Hollander, "Treasury Says Debt Limit Likely Hit by End of Year," NationalJournal.com, October 31, 2012, http://www.nationaljournal.com/budget/treasury-says-debt-limit-likely-hit-by-end-of-year-20121031.

3. They also estimate that taxes on the average household, including all income levels, would increase by $3,500. Roberton Williams et al., "Toppling Off the Fiscal Cliff: Whose Taxes Rise and How Much?" (Tax Policy Center, October 2012), http://www.taxpolicycenter.org/UploadedPDF/412666-toppling-off-the-fiscal-cliff.pdf.

4. Congressional Budget Office, *An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022* (August 22, 2012), http://www.cbo.gov/publication/43544.

5. Martin Fackler, "I.M.F. Urges Leaders to Act Decisively on Debt," NYTimes.com, October 13, 2012, http://www.nytimes.com/2012/10/14/business/global/imf-urges-us-and-europe-to-act-decisively-on-debt.html.

6. Jennifer Steinhauer, "Congress Nearing End of Session Where Partisan Input Impeded Output," *The New York Times*, September 19, 2012; and Susan Davis, "This Congress could be least productive since 1947," USAToday.com, August 15, 2012, http://usatoday30.usatoday.com/news/washington/story/2012-08-14/unproductive-congress-not-passing-bills/57060096/1.

7. Mindy R. Levit and D. Andrew Austin, "The Debt Limit: History and Recent Increases," RL31967 (Congressional Research Service, May 22, 2012), http://www.fas.org/sgp/crs/misc/RL31967.pdf; and Rachelle Younglai, "U.S. government poised to hit debt limit before 2013," Reuters.com, October 31, 2012, http://www.reuters.com/article/2012/10/31/us-usa-debt-idUSBRE89U0RH20121031.

8. Elahe Izadi, "Bipartisan Group of Senators Sound the Sequester Alarm," NationalJournal.com, September 24, 2012, http://influencealley.nationaljournal.com/2012/09/bipartisan-group-of-senators-s.php.

9. Stan Collender, "Expect Less, Not More, in Lame-Duck Session," RollCall.com, April 17, 2012, http://www.rollcall.com/issues/57_122/expect-less-not-more-lame-duck-session-213814-1.html; and Cardiff Garcia, "The logistical problems of Grand Bargaineering," Alphaville blog on FT.com, October 9, 2012, http://ftalphaville.ft.com/2012/10/09/1200821/the-logistical-problems-of-grand-bargaineering/.

10. However, it is also possible that the markets have already "priced in" the possibility of a delay, in which case the markets might not react strongly to this scenario.

11. Jim Puzzanghera, "Fitch Ratings warns of U.S. credit downgrade from fiscal cliff," LATimes.com, November 7, 2012, http://www.latimes.com/business/money/la-fi-mo-fitch-credit-rating-fiscal-cliff-obama-20121107,0,6939564.story

12. Pete Domenici and Sam Nunn, "Building a better 'fiscal cliff'," *The Washington Post,* October 26, 2012, http://www.washingtonpost.com/opinions/pete-domenici-and-sam-nunn-building-a-better-fiscal-cliff/2012/10/26/caf63816-1e11-11e2-ba31-3083ca97c314_story.html.

13. Lori Montgomery and Paul Kane, "White House, congressional leaders reach debt-limit deal," *The Washington Post,* July 31, 2011, http://www.washingtonpost.com/National-Economy/reid-signs-off-on-debt-deal-hopes-for-vote/2011/07/31/gIQALCW4lI_story.html.

14. Executive Office of the President of the United States, *OMB Report Pursuant to the Sequestration Transparency Act of 2012 (P. L. 112–155)*.

15. Kate Wiltrout, "Obama calls for compromise to avoid military cuts," *The Virginian-Pilot*, August 21, 2012, http://hamptonroads.com/2012/08/virginianpilot-military-editor-interview-obama.

16. "Transcript of the Third Presidential Debate," NYTimes.com, October 22, 2012, http://www.nytimes.com/2012/10/22/us/politics/transcript-of-the-third-presidential-debate-in-boca-raton-fla.html?pagewanted=all.

17. Philip Ewing, "D.C. caught off guard by Obama sequester vow," Politico.com, October 23, 2012, http://www.politico.com/news/stories/1012/82736.html.

18. Jonathan Allen, "Senate conservatives may block sequester solution," Politico.com, September 25, 2012, http://www.politico.com/news/stories/0912/81668.html.

19. Tim Mak, "Norquist, conservatives would block sequester punt," Politico.com, October 26, 2012.

20. Roberton Williams, "Explainer: Extending the Bush Tax Cuts," (Tax Policy Center, September 7, 2010), http://www.taxpolicycenter.org/publications/url.cfm?ID=500185.

21. Todd Harrison, "Analysis of FY2013 Defense Budget and Sequestration" (Center for Strategic and Budgetary Assessments, August 24, 2012), http://www.csbaonline.org/publications/2012/08/analysis-of-the-fy2013-defense-budget-and-sequestration/; and Annie Lowrey, "Fiscal Cliff May Be Felt Gradually, Analysts Say," *The New York Times*, October 10, 2012.

22. The $52.3 billion cuts will be taken from budget authority for FY 2013 and unobligated funding from previous years. This figure was published before the continuing resolution was passed, but assumed that DOD would be funded at the FY 2012 level. See Robert F. Hale, Under Secretary of Defense; General Lloyd J. Austin III, U.S. Army Vice Chief of Staff; Admiral Mark Ferguson, Vice Chief of Naval Operations; General Joseph F. Dunford, Assistant Commandant of the U.S. Marine Corps; and General Larry O. Spencer, Air Force Vice Chief of Staff,

testimony to the Armed Services Committee, U.S. House of Representatives, September 20, 2012.

23. Todd Harrison recently estimated that sequestration would cut outlays by 4.6 percent across the major accounts for FY 2013. This estimate assumed that Congress would approve the president's FY 2013 request. Harrison, "Analysis of FY2013 Defense Budget and Sequestration," 12.

24. This holds true for some accounts more than others. For instance, DOD estimates that 69 percent of FY 2013 budget authority for operations and maintenance will be spent in FY 2013 whereas only 22 percent will be spent on procurement this year. For more detailed information on outlay rates, see Department of Defense, *Financial Summary Tables* (February 2012), Section F, http://comptroller.defense.gov/defbudget/fy2013/FY2013_Financial_Summary_Tables.pdf.

25. Harrison, "Analysis of FY2013 Defense Budget and Sequestration," 13. Also see Joyce Tsai, "Experts Say Sequestration Would Target Civilian Jobs," Stripes.com, October 25, 2012, http://www.stripes.com/news/experts-say-sequestration-would-target-civilian-jobs-1.194581.

26. The longer that DOD takes to cut civilian personnel after the sequester takes effect, the greater the damage during the final months of the fiscal year. Harrison, "Analysis of FY2013 Defense Budget and Sequestration," 13.

27. See Hale et al., testimony to the Armed Services Committee.

28. While the current-year effects of sequestration on procurement might be manageable, if similar cuts continue over the future (or if the out-year cuts are not offset), DOD modernization plans could face structural problems.

29. Executive Office of the President, "Letter from Office of Management and Budget Director Jeffrey D. Zients to President of the Senate Joseph R. Biden, Jr.," (July 31, 2012), http://www.whitehouse.gov/sites/default/files/omb/legislative/letters/military-personnel-letter-biden.pdf.

30. The continuing resolution expires in March at which point Congress and the White House will need to come to an agreement on how to fund the government for the remainder of the fiscal year.

About the Center for a New American Security

The mission of the Center for a New American Security (CNAS) is to develop strong, pragmatic and principled national security and defense policies. Building on the expertise and experience of its staff and advisors, CNAS engages policymakers, experts and the public with innovative, fact-based research, ideas and analysis to shape and elevate the national security debate. A key part of our mission is to inform and prepare the national security leaders of today and tomorrow.

CNAS is located in Washington, and was established in February 2007 by co-founders Kurt M. Campbell and Michèle A. Flournoy. CNAS is a 501(c)3 tax-exempt nonprofit organization. Its research is independent and non-partisan. CNAS does not take institutional positions on policy issues. The views expressed in this report are those of the authors and do not represent the official policy or position of the Department of Defense or the U.S. government.

Center for a New American Security
1301 Pennsylvania Avenue, NW
Suite 403
Washington, DC 20004

TEL 202.457.9400
FAX 202.457.9401
EMAIL info@cnas.org
www.cnas.org

Contacts
Kay King
Senior Advisor and
Director of External Relations
kking@cnas.org, 202.457.9408

Sara Conneighton
Deputy Director of External Relations
sconneighton@cnas.org, 202.457.9429

Cover image by iStockphoto.