Over the weekend, the President and Congress came to an agreement to raise the debt ceiling and make spending cuts of a roughly the same amount. Congressional action is likely today or tomorrow.

Specifically, the bill institutes spending caps on discretionary spending at levels necessary to cut nearly $1 trillion from the current budget baseline over the next ten years. The bill also paves the way for a short term increase in the debt ceiling of $900 billion. The specifics of the discretionary cuts would be determined by the Committees on the Budget and Appropriations through the normal appropriations process for Fiscal Years 2012-2021. In this first phase, Medicare and other mandatory programs would not be affected. However, the proposal would eliminate interest subsidized Stafford loans to graduate and professional students and terminate reduced interest rates for student borrowers that pay off their loans on time.

In the second stage of the proposed process, the House Speaker, Senate Majority Leader, House Minority Leader and Senate Minority Leader would each name three members of Congress to a new Joint Select Committee on Deficit Reduction. This committee would be tasked with making recommendations to further reduce the deficit by $1.5 trillion. Committee recommendations are not limited to spending cuts but may also include entitlement reforms, such as the SGR, and tax increases or loophole closures. The committee would be required to report their recommendations to the Congress by a majority vote no later than November 23, 2011. The Congress would be required to act on the recommendations, without amendment, by December 23, 2011. If the committee achieves savings of between $1.2 and $1.5 trillion, the debt ceiling will be raised again by the corresponding amount.

If the committee fails to report savings or if the Congress fails to enact them, the debt ceiling would be automatically raised by $1.2 trillion and sequestration (across the board cuts) would be triggered in an amount necessary to achieve $1.2 trillion in savings, or in the amount that an enacted committee bill fell short of $1.2 trillion. One half of savings would come from defense spending (Budget Function 050) with the remaining coming from non-defense spending, both discretionary and mandatory, for Fiscal Years 2013-2021.

A wide range of spending, however, is exempted from sequestration, including: Social Security, Medicaid, VA benefits and pensions, federal retirement funds, civil and military pay, child nutrition, SSI, WIC, and other programs.

Medicare would not be exempt from sequestration, although benefits and beneficiary cost sharing would remain unchanged. Providers would bear all the cuts and Medicare savings are limited to 2% of total program costs.

Additionally, both chambers would vote on a balanced budget amendment to the Constitution though debt ceiling increases are not affected by the outcome.

It is important to keep in mind that sequestration is only triggered if the Congress fails to enact a bill reported by the Joint Committee. Given that cuts would be shared equally between defense and domestic spending, both sides have a strong incentive to see that the Committee process is successful. Though the bill today does not replace the SGR, the ability of the Joint Committee on Deficit Reduction to address the SGR as part of its recommendations is preserved. However, the savings levels to be achieved also pose significant challenges in addressing the SGR problem.

We will continue to monitor developments and keep you informed.

Terri Marchiori
Director, Federation Relations
American Medical Association
312.464.5271

terri.marchiori@ama-assn.org

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Sent by: American Medical Association * Helping doctors help patients
515 N. State Street
Chicago, IL 60654