



Abel Financial Strategies
Augustus W. Abel, CFP®
Financial Advisor
3775 Attucks Dr.
Powell, OH 43065
phone (614) 389-2075
Cell (614) 499-1201
aw@awabelfinancial.com
www.awabelfinancial.com

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Strategies*



Understanding "Sequestration"



If you like political drama, you're in luck. It seems like just yesterday the news was filled with references to the fiscal cliff. Now, coming to theaters everywhere, is "sequestration." Look for more political confrontation to unfold as sequestration gets under way.

What exactly is sequestration?

"Sequestration" refers to a series of automatic, across-the-board spending cuts to federal government agencies that are scheduled to take place in fiscal years 2013 through 2021. The cuts, totaling \$1.2 trillion, will be split evenly between defense and domestic discretionary spending. The cuts are effective March 1. (The cuts were originally scheduled to take effect January 1 but were postponed to March 1 as part of the last-minute fiscal cliff deal reached on New Year's Day.)

How did sequestration come into being?

Sequestration was created from the August 2011 standoff over the U.S. debt ceiling. In conjunction with agreeing to raise the debt ceiling (which allowed the U.S. Treasury to pay its monetary obligations and avoid a default), Congress imposed approximately \$2 trillion worth of spending cuts--\$1 trillion that was spelled out in the debt ceiling bill (the Budget Control Act of 2011) and another approximately \$1 trillion that would be implemented through sequestration--a broad, across-the-board series of default spending cuts that would take effect beginning in 2013.

The idea was that sequestration would be a measure of last resort, and that Congress could act to replace the sequestration cuts with an equal amount of alternate spending reductions. Indeed, the Budget Control Act of 2011 created a deficit reduction "supercommittee" that was charged with reaching consensus on additional budget cuts that would avoid sequestration. The supercommittee failed, paving the way for sequestration to take effect.

What's going to be cut?

The automatic cuts are effective March 1, 2013. From 2013 through 2021, sequestration is scheduled to cut \$1.2 trillion from government agencies, split evenly between defense and domestic programs. More than \$500 billion is scheduled to be cut from the Defense Department and other national security agencies. The remaining cuts will affect a variety of domestic programs, including education, public safety, energy, national parks, food inspections, housing aid, transportation, and law enforcement.

Social Security, Medicaid, and Medicare benefits are exempt from sequestration. Although cuts to Medicare provider payments are on the table, they can't exceed 2% of current payments.

In 2013, the cuts will total \$85 billion (sequestration originally called for approximately \$109 billion in cuts this year, but the American Taxpayer Relief Act of 2012 reduced the required cuts by \$24 billion). The Congressional Budget Office estimates that in 2013, funds for defense spending (other than spending for military personnel) will be cut by about 8%, and nondefense spending subject to automatic reductions will be cut by between 5% and 6%. (Source: Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2013 to 2023*, February 2013)

You may have heard a great deal about what's going to happen as a result of the sequester, and much of it has likely been alarming. It's important to understand, though, that the government will not be shutting down. In fact, while it's hard to know exactly how things will play out as the cuts are implemented, most individuals are probably not going to notice a significant, immediate effect. Federal agencies will notify employees of possible furloughs, and the Defense Department will do the same with civilian employees, but those furloughs likely won't take effect for at least a month. In addition to potential layoffs and furloughs, individual agencies will begin

announcing and implementing other cost-saving measures.

Wait, there's more ...

While it hasn't received the same level of attention as sequestration, there's another problem rapidly approaching--the government is running out of money again. Federal funding for the current fiscal year expires on March 27, 2013. Unless Congress authorizes additional funding, a partial government shutdown would result.

In addition, a few months later, expect another debt ceiling debate. The federal government reached its \$16.394 trillion debt ceiling limit at the end of 2012. Congress subsequently suspended the debt ceiling limit until May 19, 2013, and although the U.S. Treasury has some ability to continue operations beyond that date, at some point the debt ceiling debate will need to be addressed. Thus, it's conceivable that any short-term agreement on sequestration would include provisions that address these deadlines as well.

Whether Congress addresses some or all of these issues over the coming weeks or months is anyone's guess. So stay tuned. And pass the popcorn.

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