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# THE SEQUESTER: MECHANICS AND IMPACT

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- **Background**

- The broader budget picture
- How did we get here?

- **Mechanics and Impact**

- What is a sequester?
- How does the sequester work?
- Where do the cuts come from and what are the percentages?
- What will the impact of these cuts be?
- What important issues relating to execution of the sequester are still pending?
- How will the cuts affect particular domestic programs?

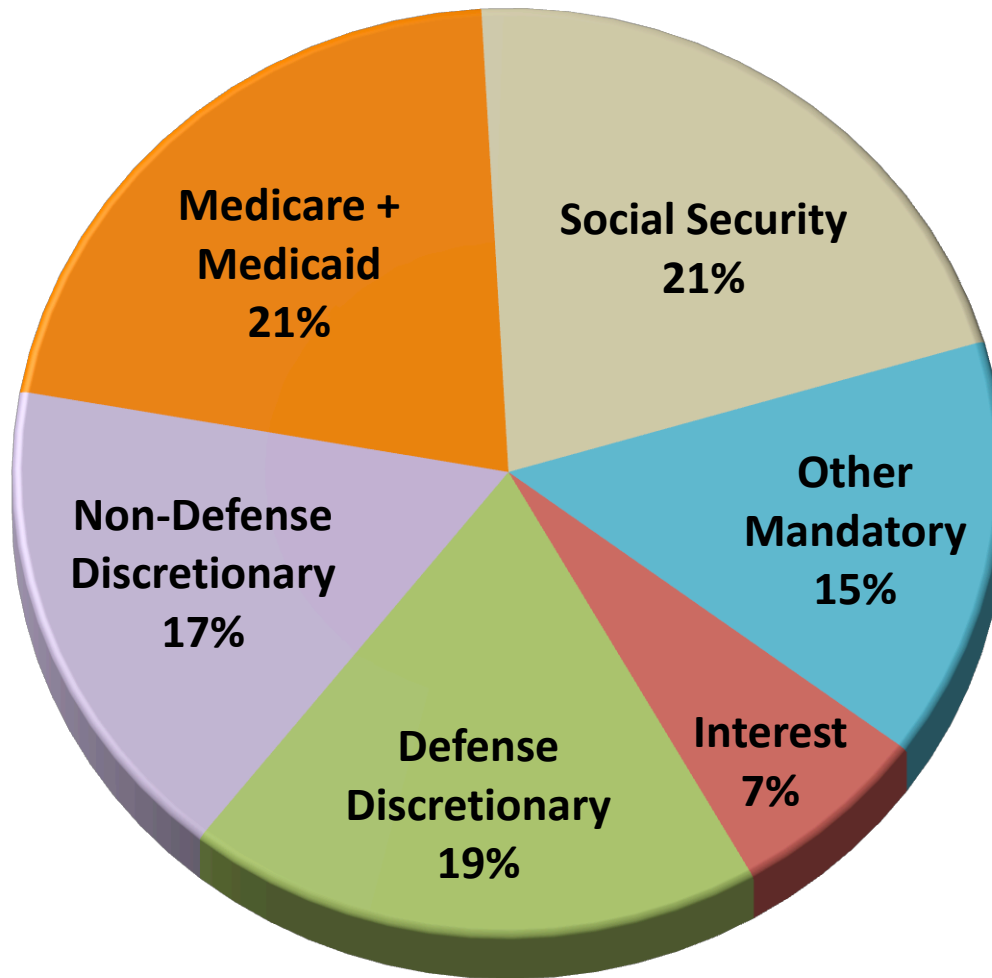
- **Outlook**

- Current political situation – where does it go from here?

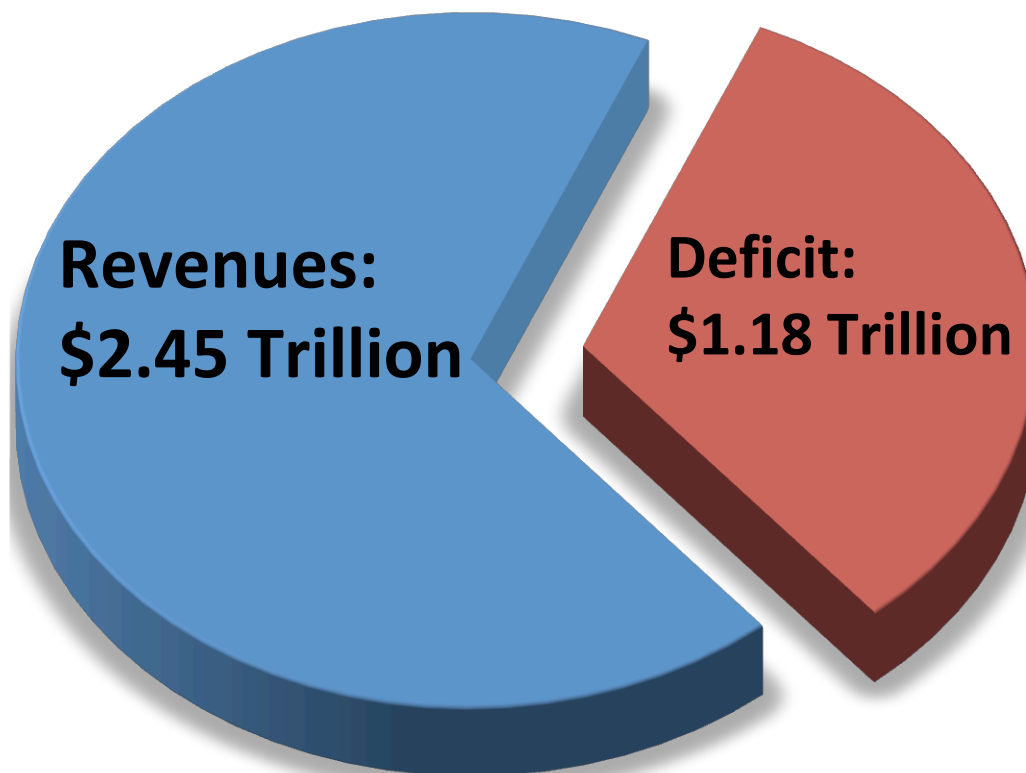


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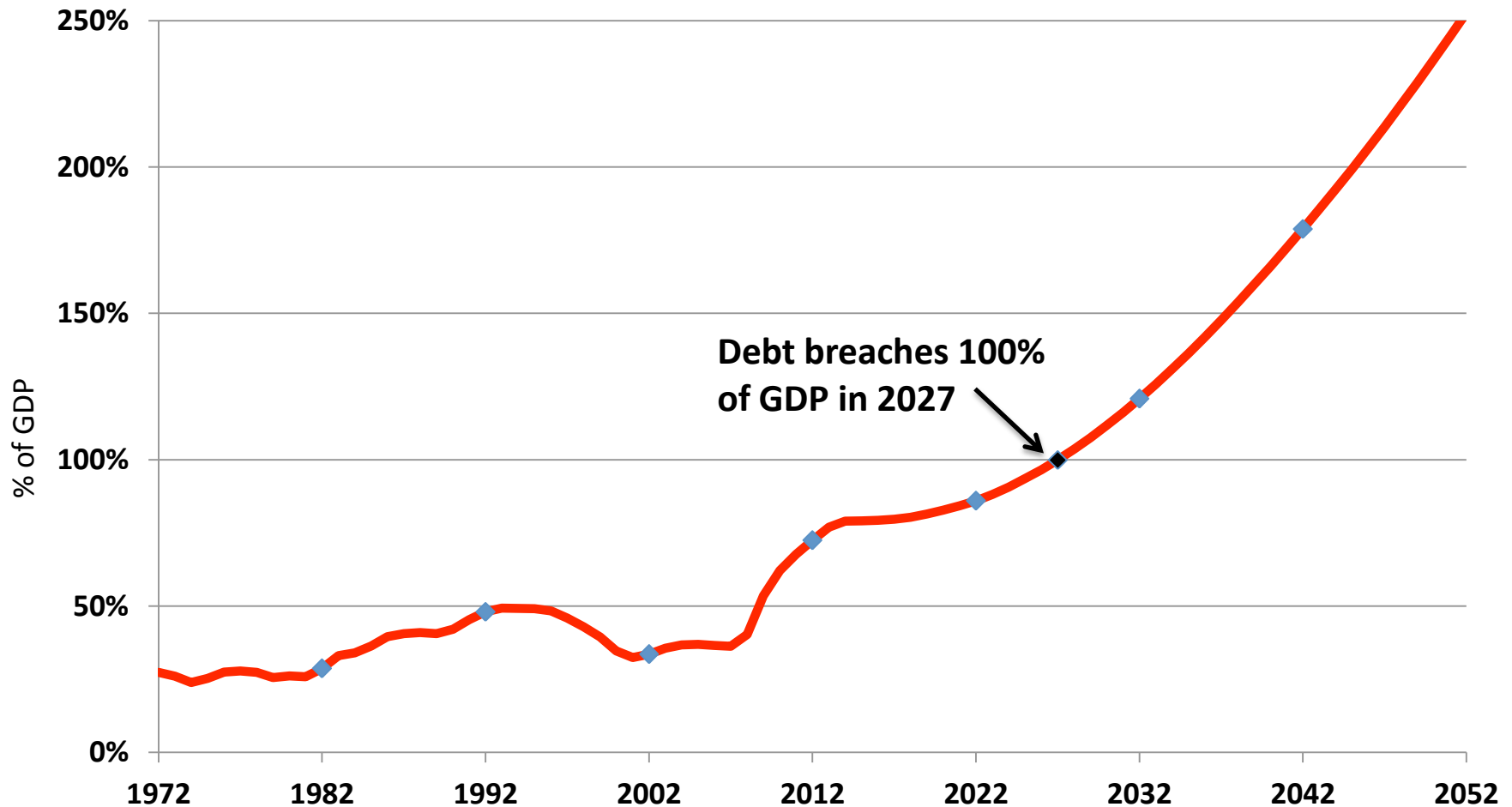
# The Broader Budget Picture



## Fiscal Year 2012 Outlays: \$3.63 Trillion

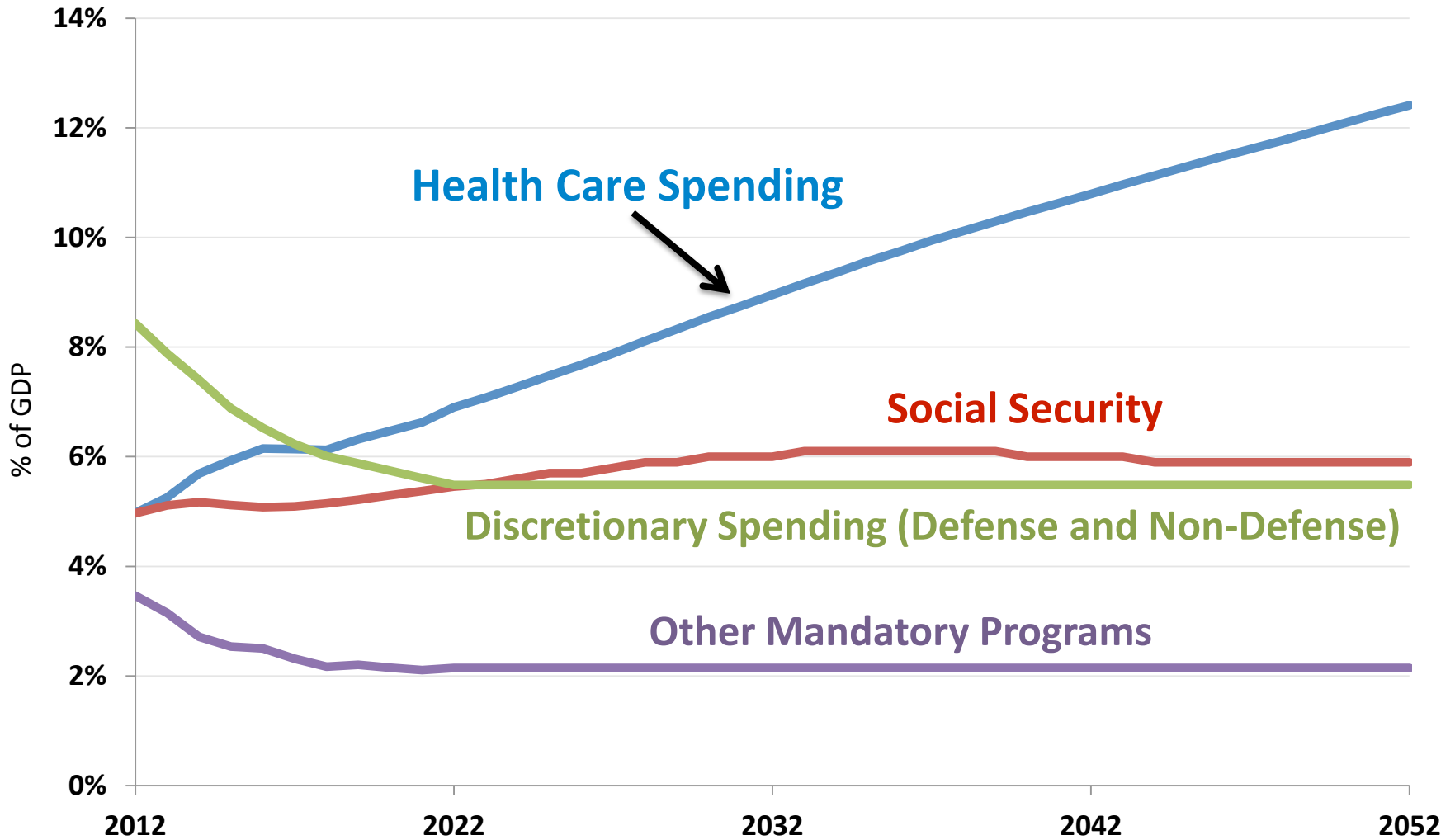


*Source: Congressional Budget Office (January 2012)*

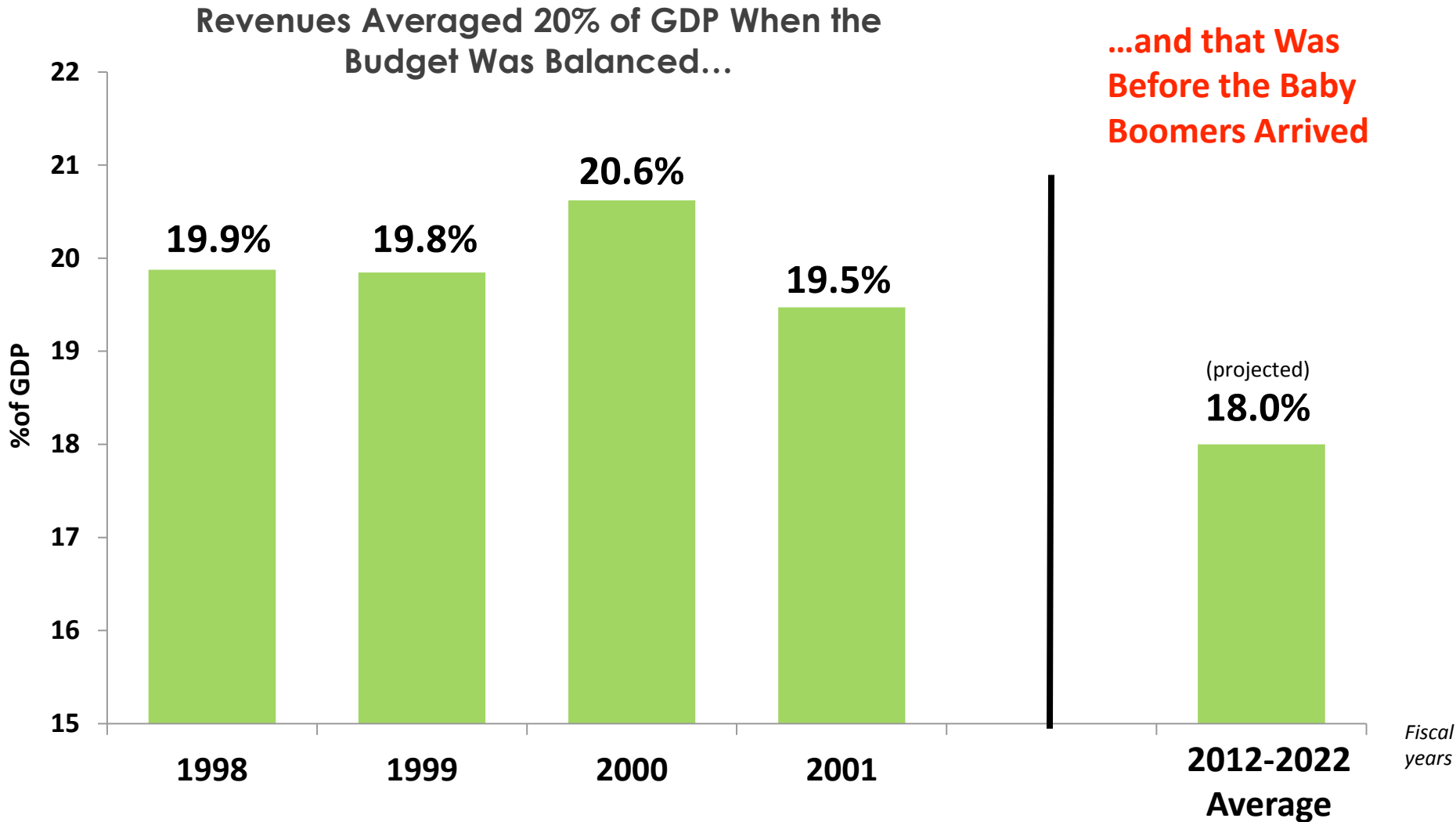


Note: Unlike current law, the Bipartisan Policy Center’s Plausible Baseline assumes that the 2001, 2003, and 2010 tax cuts are extended, the AMT is indexed to inflation, Medicare’s physician payment rates are maintained at their current rate (the “doc fix”), the looming sequester from the Budget Control Act of 2011 is lifted, and troops stationed overseas decline to 45,000 by 2015

Sources: Congressional Budget Office (January 2012) and Bipartisan Policy Center extrapolations



Sources: Congressional Budget Office's Alternative Fiscal Scenario (January 2012), additionally assuming that troops overseas decline to 45,000 by 2015; Bipartisan Policy Center extrapolations



Source: Congressional Budget Office alternative fiscal scenario (January 2012)

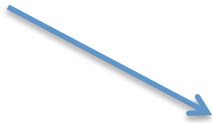




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# How Did We Get Here?

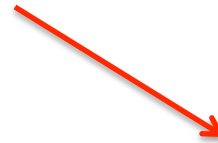
- **Debt Ceiling**



- **Budget Control Act (BCA)**



- **Super committee failure**



- **Sequester**



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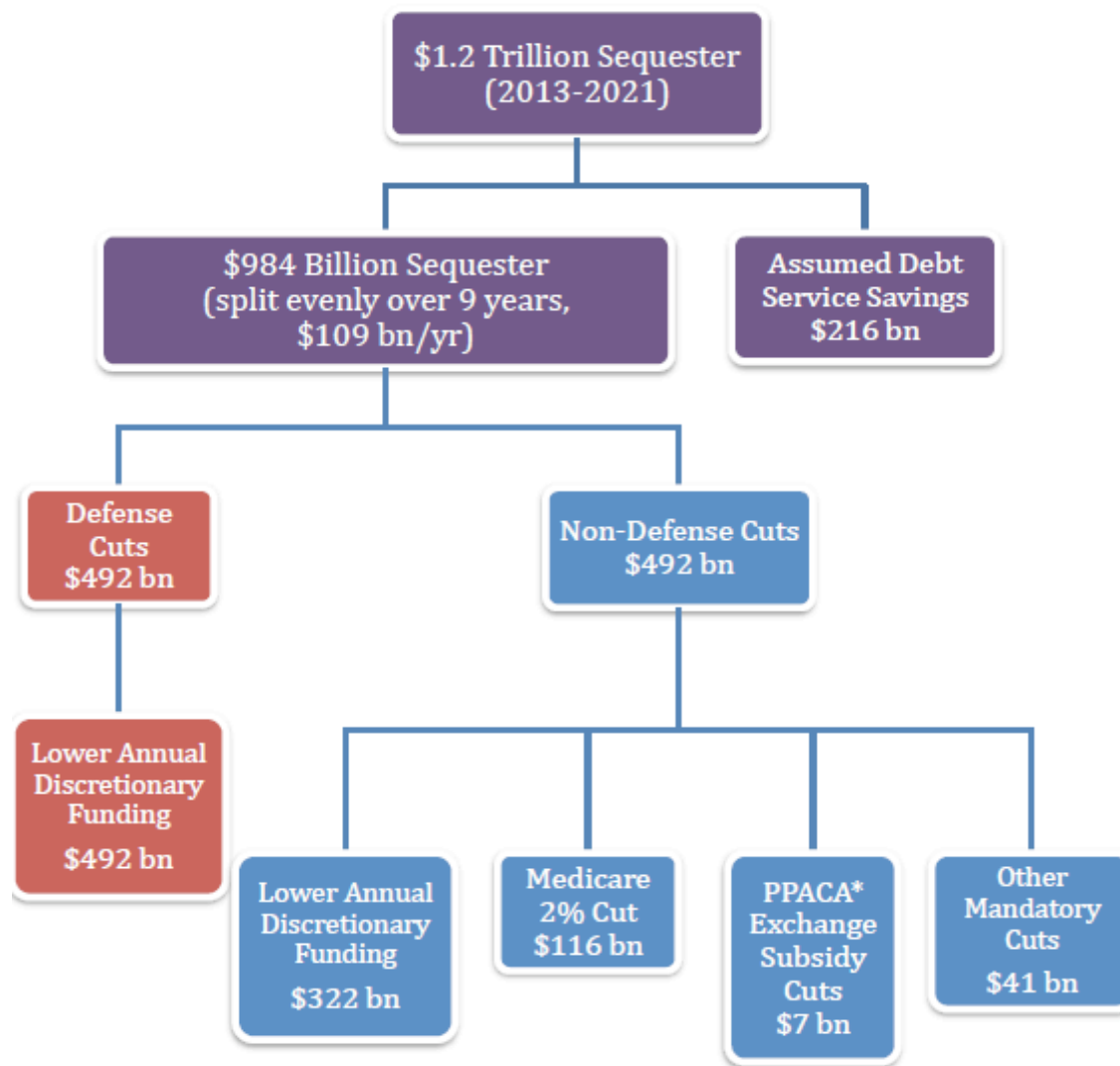
# What Is a Sequester?

- **Automatic reduction to federal government spending for a given fiscal year**
- **Gramm-Rudman-Hollings – Balanced Budget and Emergency Deficit Control Act of 1985**
  - Phil Gramm: “It was never the objective of [GRH] to trigger the sequester; the objective of [GRH] was to have the threat of the sequester force compromise and action.”
  - ‘80s and ‘90s sequesters were rarely carried out, but pushed Congress to achieve fiscal goals in ‘90s



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# How Does the Sequester Work?



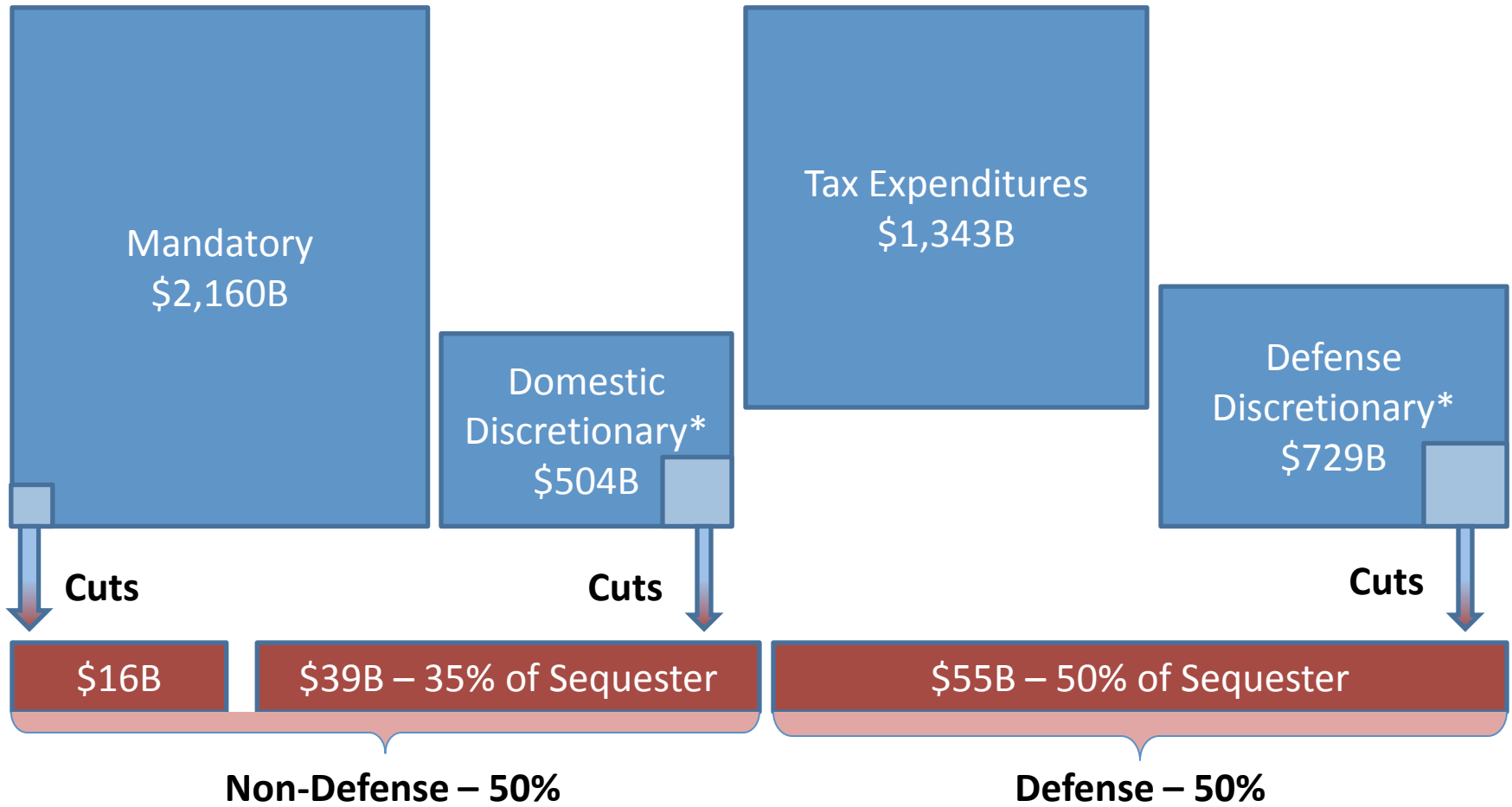
- **What is unique about FY 2013?**
  - Cuts occur in the middle of the fiscal year
  - Discretionary cuts occur no matter what Congress appropriates
  - Sequester cuts happen at “program-project-activity” (PPA) level. But many departments don’t define what a PPA is.
  
- **Across-the-board cuts difficult for many PPAs:**
  - Accounts that are nearly all personnel costs, like those for Border Patrol Agents;
  - Large procurement or construction projects.
  
- **Sequester will produce unintended costs**
  - Higher per-unit procurement costs
  - Increased future costs for delayed procurement
  - Increased unemployment insurance



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# Where Do the Cuts Come From and What Are the Percentages?





\* These amounts include all discretionary budgetary resources for the duration of FY 2013, not solely the non-exempt monies that are subject to sequester. Additionally, the figures assume that a continuing resolution at FY 2012 levels is enacted for FY 2013, that war funding (Overseas Contingency Operations funds) is provided at the level requested by the president. Defense discretionary funds include unobligated balances from prior years, which are subject to sequester.

Sources: Congressional Budget Office, Donald Marron and Tax Policy Center using data from the Office of Management and Budget and Treasury

- **War costs, or Overseas Contingency Operations, are technically subject to the sequester, but we assume in our calculations that they will be exempted**
- **We assume that a continuing resolution (CR) at 2012 funding levels will be in effect**
- **Unobligated balances in defense accounts are subject to sequester, but are *not* for non-defense accounts**
- **One-quarter of the fiscal year will already have passed by January 2, 2013, when the sequester is set to take effect**
  - For simplicity, we assume that 25% of the annual funding will be obligated by that point

- **Most mandatory spending and some non-defense discretionary (NDD) programs are exempt from the sequester**
  - Since the absolute dollar cuts required - \$55 billion to each of defense and domestic – are explicit in the law, these exemptions mean heavier cuts elsewhere

### Mandatory Exemptions

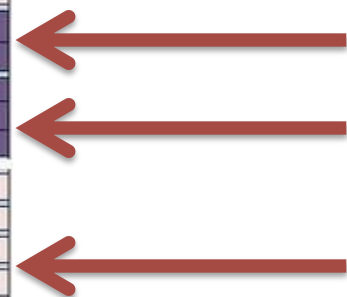
- Social Security
- Medicaid
- Food stamps (SNAP)
- Medicare annual cuts are limited to 2% and are made to provider payments

### NDD Exemptions

- Pell grants
- Department of Veterans' Affairs programs
- Transportation programs paid for by the Highway Trust Fund
- Cuts to Indian health and migrant health centers are capped at 2%

- **IMPOSSIBLE** to know precise percentages and how the cuts will fall (so anyone who says they know for sure is wrong and any calculations made should be taken with a grain of salt)
  - There are pending issues that prevent certainty in this type of forecast
  - **IMPORTANT:** Implementation ultimately up to OMB
- **BPC estimates:**
  - Defense cut = **15%** (on an annualized basis: 11%)
  - NDD cut = **12%** (on an annualized basis: 9%)
  - Mandatory cut = **10%** (on an annualized basis: 8%)

<b>Non-Defense Sequester in FY 2013: What's In, What's Out?<sup>(a)</sup></b>		
	<b>Amount of Funds (\$B)</b>	<b>% Cut</b>
<b>Non-defense Discretionary Spending</b>		
Size of Cut - The Sequester	\$38.7	
Non-Defense Discretionary Funds	\$489	
Pell Grants + Veterans Affairs, <b>Exempted</b> (estimate)	\$73	
Indian Health + Health Centers, <b>2% Limit</b> (estimate)	\$6	2.0%
Size of Cut to Non-exempt Programs	\$38.6	
<b>Additional Resources Subject to Sequestration</b>		
Program Integrity + Disaster Funding	\$7	
<b>Likely to be Exempted, but Uncertain<sup>(b)</sup></b>		
War Funding	\$8	
Resources Subject to Sequestration w/ War Funding	\$425	9.1%
Resources Subject to Sequestration w/o War Funding	\$417	9.3%
<b>On Jan. 2, 2013<sup>(c)</sup></b>		
Remaining Sequester Base w/ War Funding	\$319	12.1%
Remaining Sequester Base w/o War Funding	\$313	12.3%
<b>Non-exempt Non-defense Mandatory Spending</b>		
Size of Cut - The Sequester	\$11.2	
Medicare Provider/MA Plan Payments, <b>2% Limit<sup>(d)</sup></b>	\$317	2.0%
Other Mandatory Programs	\$63	7.7%
<p><i>Sources: Office of Management and Budget, Budget Control Act of 2011, Bipartisan Policy Center Calculations</i></p> <p>Note: Numbers may not add due to rounding</p> <p>a. This table is based off of the following assumptions: that a continuing resolution at FY 2012 levels is enacted for FY 2013, that war funding (Overseas Contingency Operations funds) is provided at the level requested by the president, and that funds are obligated uniformly throughout the duration of the relevant appropriations bill.</p> <p>b. While war funding appears to be subject to the sequester, there also appears to be enough room for OMB to interpret otherwise. Regardless, we assume that policymakers would pass legislation to exempt war funding from the sequester.</p> <p>c. The FY 2013 sequester is not implemented until Jan. 2, 2013. Therefore, we assume that roughly one-quarter of the fiscal year's funds already would have been obligated, and thus the percentage cut to the remaining monies would be greater.</p> <p>d. As highlighted by the Congressional Budget Office, the sequester of Medicare does not begin until February 1, 2013, and therefore the 2 percent cut to providers and MA plans achieves less savings than if it was in effect for the entire fiscal year. Due to a provision in the Statutory Pay-As-You-Go Act of 2010 that the Budget Control Act of 2011 references, however, the amount cut from Medicare over a full 12-month period beginning in February counts toward reaching the \$54.7 billion that must be sequestered from non-defense programs in FY 2013. Therefore, the actual cut to non-defense programs in FY 2013 is only \$50 billion, since approximately \$5 billion of the cuts to Medicare occur after the end of the fiscal year.</p>		



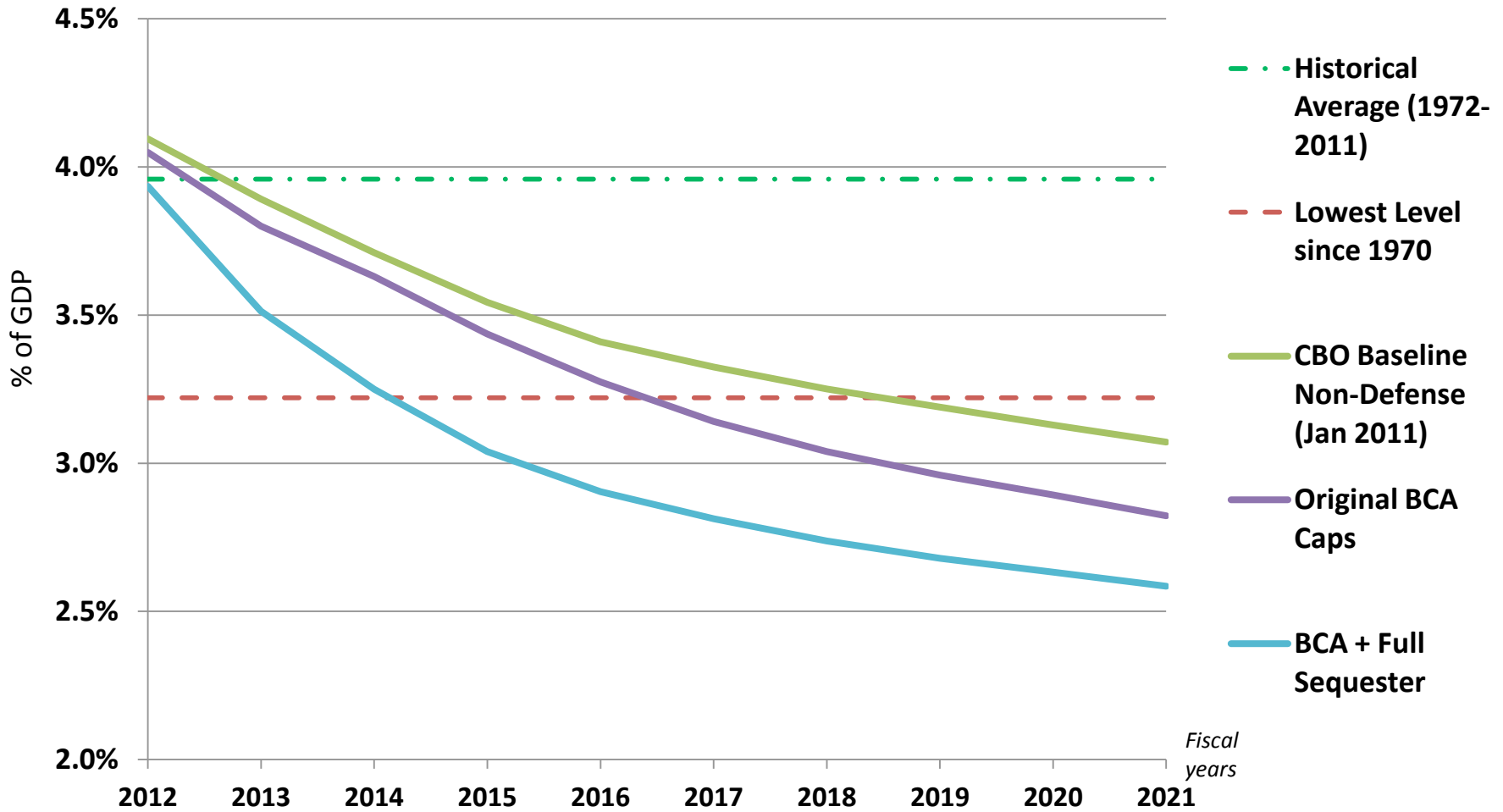


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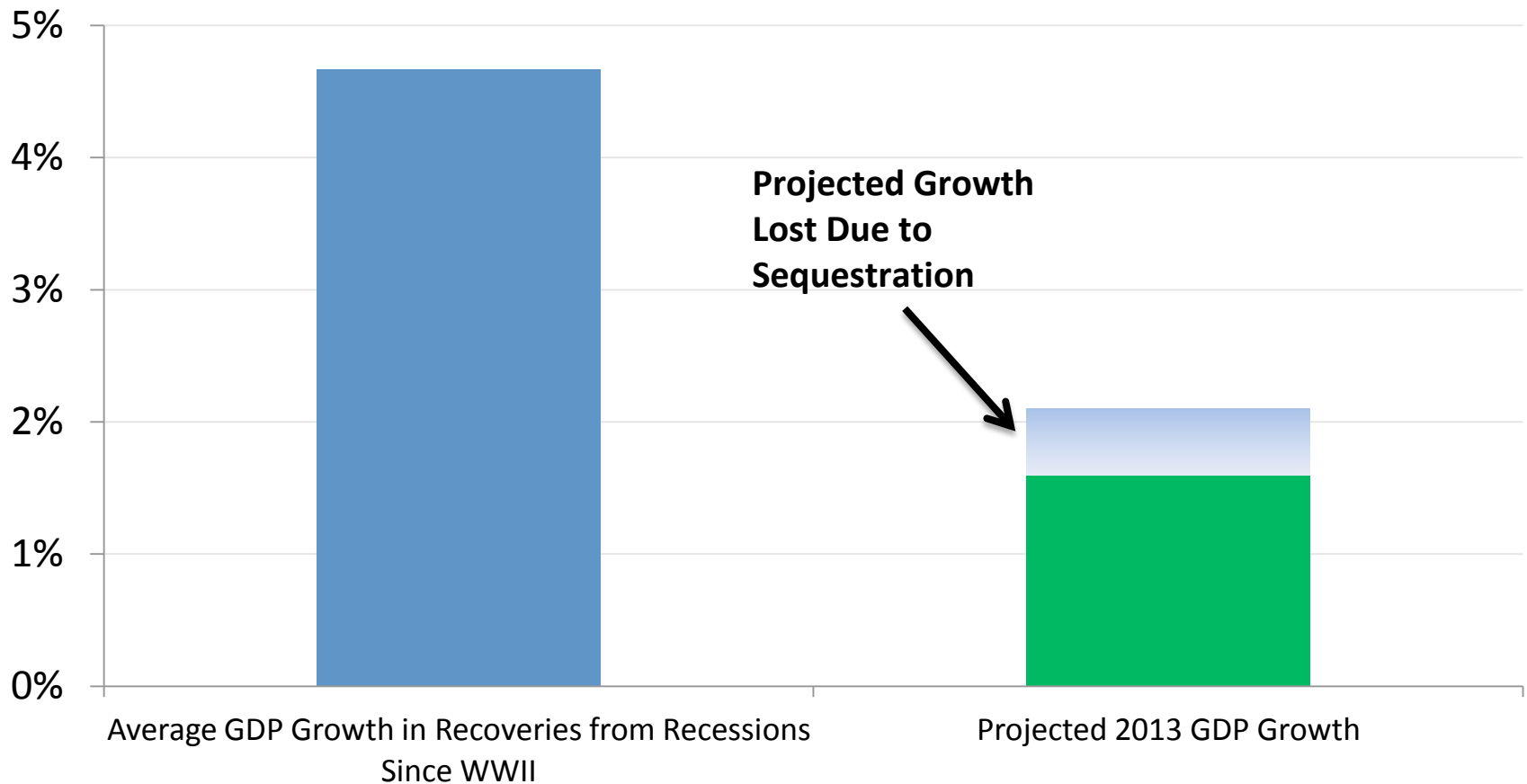
# What are some of the impacts?

# DOMESTIC DISCRETIONARY SPENDING WOULD BE CUT TO THE BONE

## Non-Defense Discretionary Spending



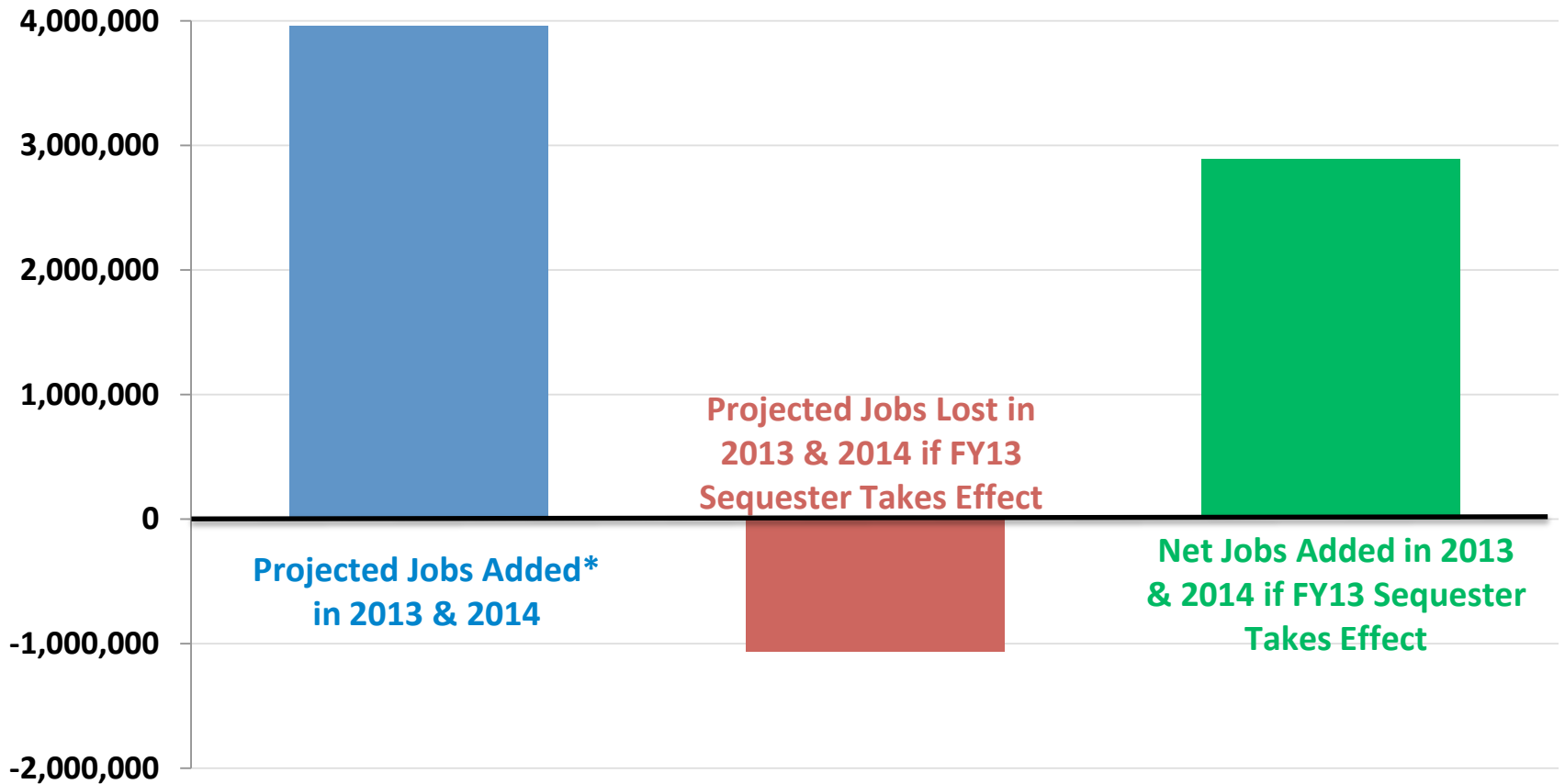
Source: Congressional Budget Office



Note: Historic recovery growth was calculated by averaging growth from the four years following each recession since WWII (up to 2001), excluding years in which the country quickly experienced another recession. This selection of years is meant to represent what a modest to strong recovery has looked like in the past.

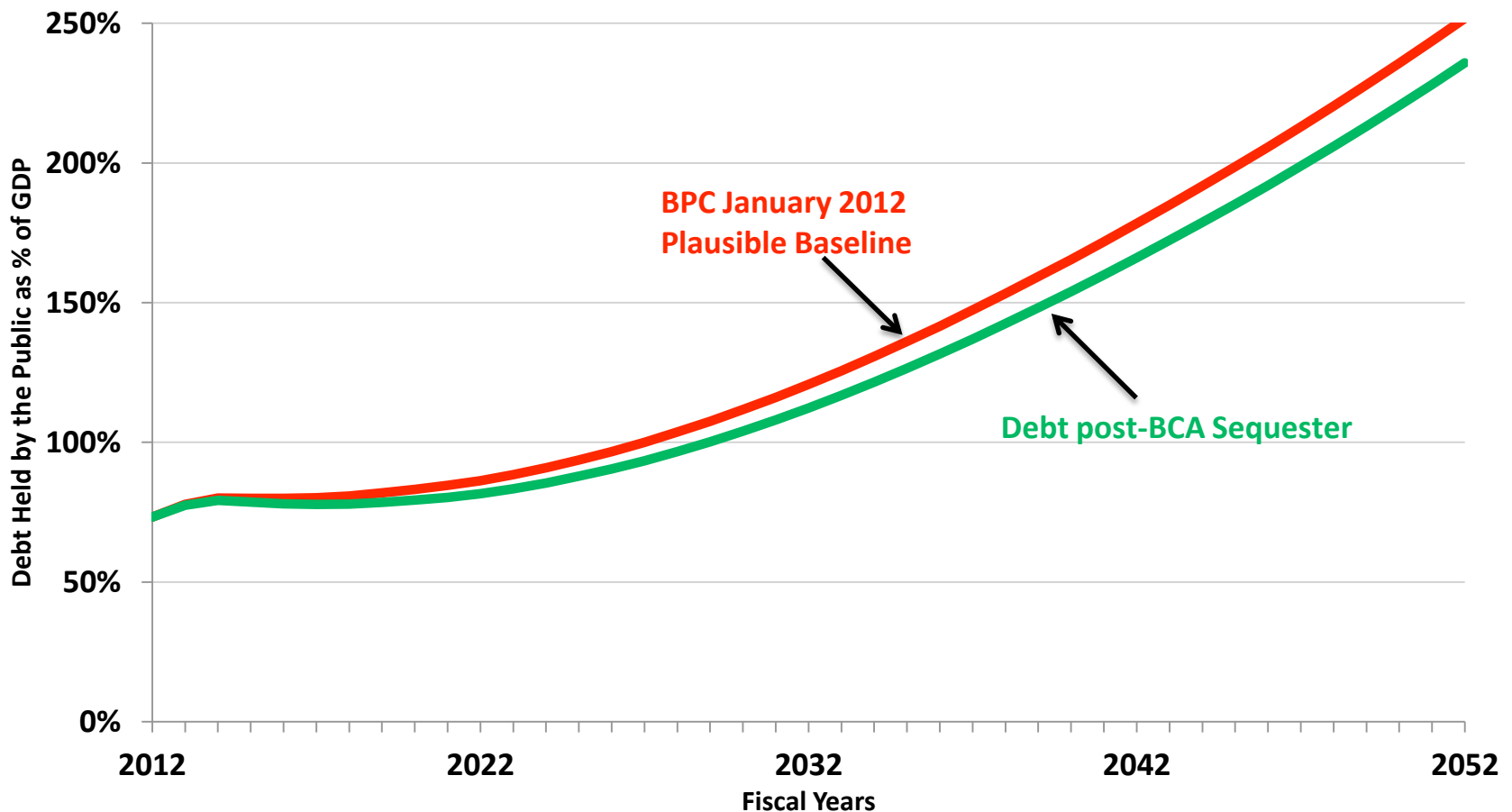
Source: BPC calculations based on St. Louis Federal Reserve data (FRED II) and Congressional Budget Office projections and economic multipliers





•The projection for jobs added averages the first five months of job growth in 2012 – 165,000 jobs/month – and assumes that level of growth continues through the end of 2014.

Sources: BPC calculations based on Bureau of Labor Statistics data and Congressional Budget Office projections and economic multipliers.



Note: The Bipartisan Policy Center’s (BPC) January 2012 Plausible Baseline assumes that the 2001, 2003, and 2010 tax cuts are extended permanently, Medicare physician payments are frozen (the “doc fix”), the AMT is indexed to inflation, and overseas combat operations wind down.

Sources: Congressional Budget Office; Bipartisan Policy Center projections



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# Important Pending Issues

- **Fiscal Year 2013 appropriations**
- **WARN Act**
- **PPA definitions**
- **Reprogramming & transfer authority**
- **Reapportionment**

- **Discretionary funding levels for Fiscal Year 2012 that are currently in effect:**

<b>Security</b>	<b>\$684 billion</b>
<b>Non-security</b>	<b>\$359 billion</b>

- **Two parties seem to have agreement on a six-month continuing resolution (CR) at current funding levels**

- **Federal statute requires large employers to notify employees at least 60 days in advance of foreseeable "mass layoff event"**
  - 60 days prior to Jan. 2 comes out just days before the election
- **Department of Labor has issued guidance stating that WARN Act does not apply to sequestration**
- **Some defense contractors are saying that they won't take the risk and will issue notices anyway**

- **How they are defined will have significant impact on amount of flexibility for agencies & distribution of cuts**
- **BCA states that they are defined as in appropriations bills and accompanying reports**
  - Problem is that in many cases (i.e., for many agencies), these definitions don't currently exist
  - Defense as example
- **Well...how was it done in the 1980s?**

- **Might slow down obligations in order to have more flexibility**
  - If a particular PPA has \$100 million for the year, and needs to cut \$9 million on Jan 2, better to cut that from \$95 million remaining than from \$75 million remaining
  - This also allows agencies to minimize the disruption caused if the sequester ultimately is waived
- **OMB has stated that it will instruct agencies to continue spending as usual (as if sequester were not pending)**



- Reprogramming = moving funds within budget account

Transfer authority = moving funds between budget accounts

- What are limitations on these?
- How much flexibility will they provide to the agencies?

- **Office of Management and Budget (OMB) in charge of "apportioning" to agencies - i.e., telling them how much of their funding they can use in each quarter of the fiscal year**
- **Since sequester cuts must total \$109 billion in FY 2013, but not till end of year, OMB could push most cuts till later in year**
  - Gives Congress additional time to address sequester, but carries risks (both perceived and actual)

- **Recently passed both houses of Congress on bipartisan basis, and was signed by President Obama**
- **Requires OMB to issue official sequestration report by Sep. 6**
- **Should shed some light on many of these pending questions**



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# How Will Cuts Affect Particular Domestic Programs?

# IMPORTANT DOMESTIC PROGRAMS FACE A 12-PERCENT CUT IN 2013

Program	Continuing Resolution at FY 2012 Levels (\$B)	Funds Available after January 2nd	12% Sequester Cut
National Institutes of Health (NIH)	\$30.7	\$23.0	\$2.8
Section 8 Rental Assistance	\$27.4	\$20.6	\$2.5
Air Transportation Security and Traffic Control	\$17.8	\$13.4	\$1.6
Education for the Disadvantaged	\$15.7	\$11.8	\$1.5
Special Education	\$11.9	\$8.9	\$1.1
Scientific Research	\$11.8	\$8.9	\$1.1
Disaster Relief	\$7.1	\$5.3	\$0.7
Disease Control	\$5.5	\$4.1	\$0.5
Food and Drug Safety	\$3.5	\$2.6	\$0.3
Mental Health Services	\$3.3	\$2.5	\$0.3

Sources: Office of Management and Budget, Bipartisan Policy Center calculations

- **Keep in mind the caveat from earlier**
  
- **Community Development Block Grant (CDBG)**
  - Mandatory portion cut approximately \$161 million from \$2.07 billion
  - Discretionary portion cut approximately \$80 million from \$880 million

# CDBG STATE BY STATE SEQUESTER CUTS

	FY 2012 Enacted	Sequester Cut	FY 2013 spending w/ sequester cut		FY 2012 Enacted	Sequester Cut	FY 2013 spending w/ sequester cut
Alabama	\$39,246	-\$3,354	\$35,892	Montana	\$7,348	-\$654	\$6,694
Al a s ka	\$3,843	-\$330	\$3,513	Nebraska	\$16,399	-\$1,422	\$14,977
Arizona	\$46,405	-\$3,716	\$42,689	Neva da	\$17,633	-\$1,393	\$16,240
Arkansas	\$23,434	-\$2,066	\$21,368	New Hampshire	\$10,832	-\$958	\$9,874
Ca li forni a	\$351,573	-\$27,545	\$324,028	New Jers ey	\$77,709	-\$6,074	\$71,635
Col ora do	\$32,933	-\$2,663	\$30,270	New Mexi co	\$14,165	-\$1,226	\$12,939
Connecti cut	\$34,326	-\$2,821	\$31,505	New York	\$281,664	-\$22,338	\$259,326
Del a wa re	\$6,234	-\$509	\$5,725	North Ca rol i na	\$65,386	-\$5,691	\$59,695
District of Columbi a	\$13,905	-\$1,071	\$12,834	North Da kota	\$4,926	-\$437	\$4,489
Florida	\$123,354	-\$9,864	\$113,490	Ohi o	\$135,321	-\$11,068	\$124,253
Georgi a	\$72,332	-\$6,122	\$66,210	Ok l a homa	\$24,943	-\$2,129	\$22,814
Ha wa i i	\$12,204	-\$940	\$11,264	Oregon	\$30,259	-\$2,522	\$27,737
Ida ho	\$10,660	-\$939	\$9,721	Penns yl va ni a	\$167,974	-\$13,535	\$154,439
Illinois	\$146,421	-\$11,693	\$134,728	Rhode Is l a nd	\$14,662	-\$1,202	\$13,460
Indiana	\$59,843	-\$5,042	\$54,801	South Ca rol i na	\$32,603	-\$2,800	\$29,803
Iowa	\$32,858	-\$2,867	\$29,991	South Da kota	\$6,552	-\$589	\$5,963
Kansas	\$23,399	-\$2,020	\$21,379	Tennes s ee	\$44,564	-\$3,823	\$40,741
Kentucky	\$38,295	-\$3,318	\$34,977	Texa s	\$215,435	-\$17,541	\$197,894
Loui si a na	\$45,354	-\$3,825	\$41,529	Uta h	\$18,142	-\$1,462	\$16,680
Ma i ne	\$16,106	-\$1,409	\$14,697	Vermont	\$6,837	-\$626	\$6,211
Ma ryl a nd	\$42,441	-\$3,376	\$39,065	Vi rgi ni a	\$48,667	-\$4,011	\$44,656
Ma s s a chus etts	\$88,975	-\$7,295	\$81,680	Wa s hi ngton	\$48,830	-\$3,954	\$44,876
Mi chi ga n	\$111,621	-\$9,078	\$102,543	Wes t Vi rgi ni a	\$19,137	-\$1,684	\$17,453
Mi nnes ota	\$47,038	-\$3,890	\$43,148	Wi s cons i n	\$54,536	-\$4,575	\$49,961
Mi s s i s s i ppi	\$27,513	-\$2,500	\$25,013	Wyomi ng	\$3,196	-\$287	\$2,909
Mi s s ouri	\$56,651	-\$4,683	\$51,968	Puerto Ri co	\$66,984	-\$5,611	\$61,373
				<b>TOTAL</b>	<b>\$2,948,666</b>	<b>-\$241,090</b>	<b>\$2,705,505</b>

Source: Federal Funds Information for States, Bipartisan Policy Center calculations

- **Various workforce programs and the EDA will face roughly 9% cuts on an annualized basis (i.e., from full-year funding levels)**
- **Department of Transportation programs funded by the Highway Trust Fund are exempt**
  - Others are likely subject to sequester – according to FFIS, only state transportation spending subject to cuts are the Capital Investment Grants for New Starts
- **For more information – particularly, state-by-state examples – see the Federal Funds Information for States (FFIS) report titled “The VIP Series: Potential Impact of BCA Sequester,” from June 2012 (may be behind a pay wall)**





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# Current Political Situation – Where Does it Go From Here?

## SEPTEMBER 2012

- 9/30/12 - Appropriations to fund the government for Fiscal Year 2013
- 9/30/12 - Expiration of the Temporary Assistance for Needy Families (TANF) authorization

## NOVEMBER 2012

- 11/3/12 - 60-day advance notification deadline for layoffs under the WARN Act
- 11/6/12 - Election Day

## DECEMBER 2012

- 12/31/12 - Expiration of the Bush tax cuts
- 12/31/12 - Expiration of the Sustainable Growth Rate "Doc Fix"
- 12/31/12 - Expiration of extended Unemployment Insurance benefits
- 12/31/12 - Expiration of the Alternative Minimum Tax 'Patch'
- 12/31/12 - Expiration of the current estate and gift tax rates
- 12/31/12 - Deadline for addressing tax extenders

## JANUARY 2013

- 1/2/13 - Sequestration

## FEBRUARY 2013

- Estimated breach of the \$16.394 trillion debt ceiling (post-extraordinary measures)

## Upcoming Current Law Changes:

• Bush Tax Cuts + AMT	\$235 b
• Payroll Tax Cut	\$90 b
• Unemployment Insurance	\$25 b
• Tax Extenders & Business Depreciation	\$80 b
• The Sequester	\$60 b
• Affordable Care Act Taxes	\$25 b
• Doc Fix	\$10 b
• The Debt Ceiling	<u>!?!?!?</u>

**TOTAL: \$525 b**

- **House GOP “reconciliation” bill**
- **Senate Dems and Obama insist on revenues being part of solution**
  - President advancing his own budget proposal to replace sequester
- **That said, there *are* members of Congress looking to work across the aisle and seriously address the problem**



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