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INFORMED BUDGETEER: SEQUESTRATION AFTER THE FISCAL CLIFF

- Needless to say, the sequestration mechanisms in the Budget Control Act (BCA) have kept Congress, the Administration and your *Budget Bulletin* writers busy since its enactment in August 2011. With Congress passing and the President signing H.R. 8, the American Taxpayer Relief Act of 2012 (ATRA), it is time for budgeteers to take a look at what happened to the sequesters (that's right, there were two) that had been slated to occur this month.

So, what was going to happen on the spending side of the cliff?

- Aside from the tax issues that received most of the attention during the fiscal cliff negotiations, there were two sequesters slated to occur in January 2013 that would have cut budget authority (BA) by $120 billion in FY 2013 alone. More familiar to most budgeteers was the BCA fallback sequester, which resulted from the failure of the Joint Select Committee on Deficit Reduction to report, and the Congress to adopt, legislation to reduce the deficit by $1.2 trillion. This meant that on January 2, 2013, the Office of Management and Budget (OMB) was to issue a sequester order of $109 billion. (Full details on how this sequester would have worked can be found here.)
- The second sequester, known as the "after session sequester" (see section 251(a) of the Balanced Budget and Emergency Deficit Control Act), was scheduled to occur 15 days after the 112th Congress adjourned on January 3, 2013. This sequester was supposed to occur not because of the failure of a supercommittee, but rather because Congress and the President agreed to a continuing resolution (CR) for the first half of FY 2013 that breached the statutory spending limit on discretionary appropriations for the defense category. Remember that the BCA statutory limit for discretionary defense spending in FY 2013 was $546 billion. But the CR provided $557 billion for defense, a breach of $11 billion. This breach would have been remedied through an across-the-board cut to the defense category only, as required in the law. (More information on this sequester can be found here.)

It's January, but no sequesters. At least not yet.

- With the passage of H.R. 8, Congress and the Administration pushed back the dates on which the sequesters will occur.
- The fallback sequester was pushed back two months until March 1, 2013. Coincidentally (or not), the Treasury will be able to continue to borrow for roughly the first two months of CY 2013 (according to the January 14 letter from Secretary Geithner) before running out of borrowing room.
- In addition, H.R. 8 pushed the after session sequester back to March 27, 2013, which coincides with the expiration of the 6-month CR currently in effect.

What is set to occur on March 1?

- H.R. 8 not only postponed the date of the fallback sequester by two months, but also cancelled $24 billion, reducing the amount to be sequestered to $85 billion, down from $109 billion.
- Why did H.R. 8 reduce the fallback sequester by $24 billion? This amount represents two months of the $109 billion sequester. ($109 billion / 9 months remaining in the FY = $12.1 billion per month. Why 9 months? Because OMB told agencies to spend at the full rate for the first three months of the fiscal year as if the sequester was not going to occur, so if the sequester had occurred on January 2, 2013, agencies would have had to absorb the full-year amount of the sequester in only nine months.) The Congressional Budget Office (CBO) scored this reduction as a $24 billion spending increase. But H.R. 8 attempted to "buy back" the two-month cancellation with a $12 billion increase in revenues and $12 billion in reductions to the discretionary spending caps in FY 2013 and FY 2014, which CBO said will actually save $10 billion subject to future appropriations.
- H.R. 8 shifts $12 billion in revenues into the FY 2013-2022 period by moving future revenue into the budget window. The revenue would be generated by allowing retirement plan participants to convert any amount in a non-Roth account to a Roth account – therefore shifting the timing of the taxes paid on the amount from the future to sometime in the next 10 years.
- H.R. 8 also reduced the BCA's statutory caps on discretionary spending in FY 2013 and FY 2014 by a total of $12 billion. The FY 2013 caps are now reduced by $4 billion, the FY 2014 caps by $8 billion, split equally between defense and non-defense.
- In addition to lowering the caps, H.R. 8 redefined the set of accounts that comprise the security and non-security categories. Recall that the initial spending limits put in place by the BCA defined security as:

> ...discretionary appropriations associated with agency budgets for the Department of Defense, the Department of Homeland Security, the Department of Veterans Affairs, the National Nuclear Security Administration, the intelligence community management account, and all budget accounts in budget function 150 (international affairs).

- After the failure of the Supercommittee, OMB was required to redefine the security category to include only the accounts in budget function 050 (national defense) and the non-security category to include all non-defense accounts. H.R. 8 returns the security category to its original definition for FY 2013 (solely for the after session sequester; the fallback sequester will still use the function 050 security cap as its starting point). The FY 2014-2021 caps would still use the definition of security that only includes accounts from budget function 050.
- The evolution of the discretionary caps for the after session sequestration is shown in the tables below:

Evolution of the FY 2013 Discretionary Caps ($ billions, BA)

	Initial BCA Limits	BCA Revised	H.R. 8 Revision
Security	686	546	684
Non-Security	361	501	359
Total	1,047	1,047	1,043
Security Definition	Agency-Based	Function 050	Agency-Based

Evolution of the FY 2014 Discretionary Caps ($ billions, BA)

	Initial BCA Limits	BCA Revised	H.R. 8 Revision
Security	-	556	552
Non-Security	-	510	506
Total	1,066*	1,066	1,058
Security Definition	Agency-Based	Function 050	Function 050

*The initial BCA caps for FY 2014 provided only one overall discretionary cap. The security/non-security split only occurred after the failure of the Supercommittee.

- Taking ATRA and the pending Hurricane Sandy supplemental into account, non-exempt non-defense discretionary and mandatory spending now will face cuts of about 5.2% each in FY 2013. Non-exempt defense discretionary and mandatory will face cuts of about 7.7% and 7.8%, respectively. Medicare and certain health programs with special rules continue to be cut by two percent. The percentage reductions for all defense spending and non-defense mandatory spending are down about two percentage points from cuts estimated in OMB's Sequestration Transparency Report. Non-defense discretionary spending is down three percentage points, largely because of the supplemental. Keep in mind that these percentages are only a rough approximation as OMB will ultimately decide what the percentage reductions are based on available non-exempt funding available for cuts at the time the sequestration order goes into effect.

After Session Sequester FY 2013 ($ billions, BA)

	BCA Limit	Annualized CR	Amount Over (+)/Under (-) Limit	H.R. 8 Revised Limit	Annualized CR	Amount Over (+)/Under (-) Limit
Security	546	557	11	684	691	7
Non-Security	501	490	-11	359	356	-3
Total	1,047	1,047	-	1,043	1,047	
Security Definition	Function 050	Function 050		Agency-Based	Agency-Based	

What is set to occur on March 27?

- The BA reduction of $4 billion for FY 2013 and the change in the definition of the two caps affect the after session sequester now scheduled to occur on March 27.
- This sequester originally would have imposed across-the-board cuts of $11 billion to non-exempt spending in budget function 050 (national defense). The redefinition now means that the enforceable spending limit for security is now $684 billion, which reflects the shift of some spending outside of function 050 back to the security category. After the change in definitions, security spending in the CR for FY 2013 exceeds the cap by $7 billion instead of $11 billion. H.R. 8's impact on the after session sequester is shown above.
- Of course, the delay provided by H.R. 8 allows Congress to avoid this sequester altogether through enactment of full-year appropriations for FY 2013 at levels that do not exceed the security and non-security discretionary spending limits currently in law (a task made easier through the security category redefinition, which reduces pressure on the Department of Defense's budget).

In like a lion.

- March is shaping up to be one busy month. Congress will have to deal with:
  - o Appropriations, as the current CR ends on March 27. This may or may not lead to the after session sequester, depending on whether Congress reduces appropriations for the security category for the year by $7 billion or further changes the levels of the caps;
  - o The fallback sequester, either modifying or turning it off;
  - o The debt limit increase, as Treasury is expected to exhaust its extraordinary measures in a few weeks after hitting the debt limit at the end of December; and
  - o Possibly a budget resolution, as the chairman of the Senate Budget Committee has indicated.

Newbie Corner

- In the last Newbie Corner we talked about how budget functions allow budgeteers to organize budget data, such as budget authority and outlays, based on federal goals and needs. So now that we know we can organize them, what exactly are budget authority and outlays? Let's consult the Government Accountability Office's *A Glossary of Terms Used in the Federal Budget Process:*

  Budget Authority (BA): Authority provided by federal law to enter into financial obligations that will result in immediate or future outlays involving federal government funds… Budget authority may be classified by its duration (1-year, multiple-year, or no-year), by the timing provided in the legislation (current or permanent), by the manner of determining the amount available (definite or indefinite), or by its availability for new obligations.

  Outlays (OT): The issuance of checks, disbursement of cash, or electronic transfer of funds made to liquidate a federal obligation…Outlays during a fiscal year may be for payment of obligations incurred in prior years (prior-year obligations) or in the same year. Outlays, therefore, flow in part from unexpended balances of prior-year budgetary resources and in part from budgetary resources provided for the year in which the money is spent.

- In a nutshell, budget authority is the authority to enter into contracts to purchase goods or services, and outlays are the actual disbursing of funds via check once the goods or services have been provided to the government. The budget authority informs how much you can spend while the outlays represent the disbursement of funds for a good or service.
- So when somebody asks you how much something costs, should you tell them budget authority or outlays? That depends on the situation. When you are asked about the actual deficit impact of a proposal it is correct to use outlays. The use of budget authority is generally reserved for discussing discretionary spending on programs, which are found in the annual appropriations bills. For instance, the BCA spending limits, which limit future discretionary spending, are set out in budget authority.