COMMITTEE ON THE BUDGET
BUDGET BULLETIN
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INFORMED BUDGETEER

SEQUESTERS: NOW AND THEN

- As debate over how to increase the debt limit continues over the next months, several budget-process proposals are in play: the Corker-McCaskill cap on outlays, the President's "debt failsafe," and the Fiscal Commission's (advocated by the Gang of Six/Five) debt stabilization process. All of these devices involve sequestration as a mechanism to require deficit reduction if some specified event occurs.

- Sequestration is a cancellation of spending authority that would be required by law if certain conditions apply.

- This *Bulletin* provides historical background on sequestration and summarizes how recent budget process proposals would employ that mechanism.

ORIGINS

- Ten years ago, the Congressional Research Service (CRS) produced a summary of sequestration procedures that remains useful today. Much of the following discussion draws from that work.

- When Sequestration was invented in 1985 as part of the Gramm-Rudman-Hollings law, which was added to a bill increasing the debt limit.

- Why The idea behind sequestration was to create an automatic backstop that would reduce spending in a subset of programs if Congress did not take action to produce a desired outcome. In the case of the Gramm–Rudman law, the desired outcome was to hit declining deficit targets for each year starting in 1986. Avoiding the across-the-board reduction in spending resulting from sequestration was supposed to be an incentive for Congress to enact laws that would produce deficits that would not exceed the target.

- Who To decide whether there should be a sequester, the Office of Management and Budget (OMB) projected at the beginning of the fiscal year whether the deficit under the laws in place at that time would exceed the deficit target. If the projected deficit was higher than the target, then the President issued a sequester order that permanently canceled sufficient spending authority so that outlays (and deficits) would be commensurately lower than what OMB had otherwise projected.

- What Under this original sequestration process, about two-thirds of all federal outlays were exempt. The law required that, across the remaining one-third of spending, half of the sequester amount be applied to defense accounts and the other half to non-defense accounts (both discretionary and mandatory). There were special rules for a small subset of accounts – for example, Medicare could not be cut by more than 2 percent.

- For the years that Gramm-Rudman was in effect (1986-1990), none of the three automatic sequester orders that the law required the President to issue were allowed to stand unchanged. The Supreme Court invalidated the first one because it was unconstitutional (so Congress and the President enacted a law to accomplish the reductions instead), and Congress and the President obviated the other two by enacting replacement spending reduction plans (one saved more and one saved less than the sequesters that were supposed to occur).

BUDGET ENFORCEMENT ACT (BEA)

- The 1990 reconciliation bill included provisions that cut spending and increased revenues to reduce the deficit and turn off a sequester that had been required under Gramm-Rudman. It also included the BEA, with mechanisms to "lock-in" the deficit reduction provisions elsewhere in the bill. While Gramm-Rudman used a deficit target to trigger a sequester, the BEA set up two different triggers for causing a sequester.

- First, the BEA defined accounts on the spending side of the budget as either mandatory (resulting from legislation produced by authorizing committees) or discretionary (resulting from legislation produced by the Appropriations committees), and created statutory caps (or limits) on the latter. If appropriation bills enacted an amount higher than the annual limit on appropriations, then the President was required to issue a sequester order to reduce discretionary appropriations across the board to the level of the cap for that year.

- Second, BEA created the pay-as-you-go (PAYGO) system. Statutory PAYGO required OMB to keep track of all enacted legislation that affected mandatory spending or revenues and to maintain a running balance of the amount that projected deficits or surpluses changed in each year as a result of that legislation.

- If, at the end of the year, the deficit had been increased (or the surplus reduced) as a result of the legislation, then the President was required to issue a sequester order that would reduce mandatory spending across the board (exempting certain programs). Unlike Gramm-Rudman, this PAYGO system held Congress and the President accountable only for legislative action, but not for other changes in spending or revenue (such as those caused by the economy) that might affect the overall deficit.

- The BEA was revised and extended twice (in 1993 and 1997) and remained in effect from 1991-2002.

- In that time, the President issued only two sequester orders affecting discretionary spending (both in FY1991), but Congress and the President passed a law restoring the appropriations that had been reduced by one of the sequesters. The other sequester, which was allowed to stand, reduced 1991 appropriations by a total of only $2.4 million.

- In 2000, Congress enacted an appropriation bill that would have triggered a sequester (to reduce outlays by $6.8 billion), but that same bill included a provision barring the President from issuing a sequestration order.

- Under PAYGO, no sequester of mandatory programs was triggered from 1992-1998.

- From1999-2001, Congress enacted laws that directed the President to prevent enacted legislation from being put on the PAYGO scorecard or to remove the effects of enacted legislation from the PAYGO scorecard (totaling about $45 billion) so that the President would not be required to issue a sequester order.

- In 2001, the CBO baseline projected surpluses for each year in the 10-year budget window. Congress enacted a tax cut bill that was not offset and that reduced those projected surpluses. PAYGO required a sequester to occur regardless of whether legislation reduced surpluses or increased deficits; therefore, the President was required to issue a sequester order for each of the subsequent five years (2002-2006).

- How would the sequester have worked in any single year? According to another CRS report, for FY2003, OMB said the universe of non-exempt spending accounts that would be subject to a sequester amounted to about only $31 billion (or 2.5 percent out of $1.2 trillion in mandatory spending). But the amount of sequester that was required because of legislation that reduced the surplus was $126 billion. Spending from all the non-exempt accounts would have had to be reduced to zero, and still that would have satisfied only one-fourth of the required sequester amount.

Sequestration is an automatic mechanism where the Office of Management Budget issues an order reducing non-exempt spending across-the-board if a certain triggering event occurs. The key word is "non-exempt." The larger the universe of spending accounts that would be subject to a sequester, the smaller the across-the-board cut needed to achieve the required amount of spending reduction. If the amount of spending exempt from sequestration is large, then the universe of spending that will have to absorb any sequestration will be smaller, and the size of the across-the-board reduction needed to accomplish the spending reduction will be larger. The various sequestration mechanisms that have previously been enacted or that have been recently proposed have varied in the kinds of spending that are exempt from sequestration. The following table provides examples of some of the differences in the largest categories of spending.

Is The Category Of Spending Exempt From Sequestration Under The Following Statutory Budget Enforcement Mechanisms?

Spending Category	Gramm-Rudman	BEA	PAYGO 2010	CAP Act
Interest on the Debt	yes	yes	yes	yes
Social Security	yes	yes	yes	no
Medicare	reduction limited to 2%	reduction limited to 2%	reduction limited to 4%	no
Medicaid	yes	yes	yes	no
Discretionary	no	no	yes	no
Military Personnel	w/notification by the President	w/notification by the President	yes	no

- But instead of allowing the required sequesters to occur, Congress enacted several laws in 2002 that either preempted or removed about $800 billion in surplus reductions or deficit increases (over 2002-2006) from the PAYGO scorecard. Therefore, no PAYGO sequester ever occurred during the 15 years covered by that mechanism.

- The BEA expired at the end of 2002. OMB had no discretionary caps to enforce and stopped keeping track of legislation affecting the deficit for statutory PAYGO purposes. (The Senate continued to have a PAYGO point of order, but that was a parallel enforcement process that had nothing to do with sequestration.)

CURRENT-LAW PAYGO

- In February 2010, Congress enacted a revised form of statutory PAYGO (but not statutory caps on discretionary spending) along with the most recent increase to the debt limit. There are several exemptions that allow certain legislation (e.g., extension of some tax cuts, doc fix) to increase the deficit without going on the PAYGO scorecard. The universe of accounts exempt from sequestration is essentially the same as under BEA.

- Currently, the statutory PAYGO scorecard for 2012-2020 has surpluses averaging $5.4 billion per year because of the deficit reduction scored to the health bills a year ago. The Administration claimed that the health bills would reduce the deficit, but instead, their scored effects represent a "bank" that remains available to offset future legislation that increases the deficit (by up to $49 billion over the next nine years), without triggering a sequester.

PROPOSALS USING SEQUESTRATION AS AN ENFORCEMENT MECHANISM

Corker-McCaskill Commitment to American Prosperity (CAP) Act

- The sponsors argue that the purpose of the bill is to encourage Congress and the President to negotiate legislation that reduces the deficit so that the sequestration mechanism of this bill does not need to kick in. But it is helpful to go through an example to understand how the mechanism would work if allowed to kick in.

- The CAP Act would first apply for fiscal year 2013, when total outlays could not exceed $3.649 trillion (22.25 percent of GDP). However, CBO's most recent baseline projects that, under current law, outlays in 2013 will be $3.779 trillion. Therefore, if the CAP Act becomes law, and no other laws are enacted between now and then (except appropriation bills), the President would have to issue a sequester order to reduce outlays in 2013 by $120 billion to get down to the $3.649 trillion spending limit.

- No program, even Social Security, would be exempt from sequestration (except for interest on the debt) under the CAP Act. However, if there is a sequester, it would work differently than previous sequestration procedures. Under the CAP Act, the rate of reduction would not be the same for all programs.

- OMB would be required to divide programs into three categories: mandatory, discretionary security, and discretionary non-security. (Note that the CAP Act does not define what is in the security category and what is in the non-security category, and the matter seems open to interpretation. For example, the President's 2012 budget and the House-passed budget resolution have different definitions of what is in each category.) The amount of reduction for each category would have to be in proportion to the rate of growth from the previous year in each category.

- Let's take 2013 as an example. Since mandatory spending grows the fastest and accounts for most (84 percent) of the overall projected increase in outlays from 2012 to 2013, it would receive the largest reduction under a CAP Act sequester – a 5.2 percent cut (about $100 billion) in 2013. Both security and non-security discretionary outlays would be reduced by only 1.5 percent – or about $10 billion each.

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SEQUESTERS: NOW AND THEN (CONTINUED)

“Debt Failsafe” Under President’s April 13 “Framework”

- In his April 13th speech, the President proposed a “debt failsafe.” The speech was thin on specifics, but it appears the failsafe might work along the following lines.

- Beginning in 2014, OMB would assess whether the federal government’s projected debt-to-GDP ratio is **stabilized and declining** “towards the end of the decade.” If OMB decides debt is not stabilized and declining, then OMB would be required to reduce both spending and tax expenditures by an amount necessary to bring annual deficits in the second half of the decade down to no more than 2.8% of GDP.

- The “trigger” for the President’s debt failsafe is vague and weak. Under the President’s own projections of his budget (not CBO’s), debt held by public rises from 72% of GDP in 2011 to remain essentially flat at 76.2% of GDP for 2013-2018, and then starts rising again to 76.4% of GDP in 2019 and to 77% of GDP in 2021.

- If 2018 is considered to be “toward the end of the decade,” then it is possible that OMB might conclude that the debt is “stabilized,” even though the President’s 2012 budget would add $9.5 trillion to the debt by 2021. If OMB decided the debt was stabilized, then it would not have to pull the trigger for the debt failsafe.

- But if OMB were to decide that the projected debt was not stabilized and declining and that the President should issue a sequester order, the failsafe would exempt most mandatory spending, including Social Security and Medicare, which are politically sensitive but which are also primary drivers of future increases in the debt. The President’s failsafe appears to attempt to stabilize the debt by a combination of non-Medicare, non-Social Security, non-low income program spending cuts and tax increases.

Fiscal Commission/Gang of Six (Five)

- Because the Fiscal Commission submitted its report in early December without the support needed for the House and Senate leaders to agree to bring it to a vote, the Gang of Six has been meeting since then to turn the Commission’s report into legislative language that could be voted on in the 112th Congress. But thus far, the Gang has not released any legislative proposal, so this discussion relies on the details provided in the Commission’s *Moment of Truth*.

- On the discretionary side of the budget, the Fiscal Commission proposed statutory caps on discretionary spending, with OMB enforcing the caps by sequestration, just like under the BEA from 1991-2002.

- However, the Fiscal Commission did not come up with any new sequester mechanism that would apply to mandatory spending (like the CAP Act and the President’s debt failsafe propose) or require tax increases (like the President’s debt failsafe proposes).

- While the Commission believes that the debt would be stabilized if all its policy recommendations were enacted, it also outlines a process for Congress and the President to “remain vigilant to ensure the budget remains” on that course.

- The Fiscal Commission process is essentially a set of “fast-track procedures to facilitate changes in law” that would make sure the debt becomes or remains stabilized:

> At the beginning of each year, OMB would report to the President and CBO would report to the Congress whether
>
> 1) the budget is projected to be in primary balance in 2015;
>
> 2) whether the debt held by the public as a percentage of GDP is projected to be stable at 2015 levels for the following five years; and
>
> 3) beginning in fiscal year 2016, whether the actual debt-to-GDP ratio will exceed the prior year’s ratio.
>
> In a year in which OMB indicates any one of these conditions has not been met, the President’s budget would be required to include legislative recommendations that would restore primary balance in 2015 or, after 2015, stabilize the debt-to-GDP ratio.

- But Congress is not required to act on the proposals in the President’s budget, and, under the Fiscal Commission’s process, Congress would not be required to act on the President’s recommendations that would meet the conditions.

- Congress, however is required to do its own annual budget resolution. Therefore, the Fiscal Commission’s debt stabilization process (which would have to be put into place by enacting new legislation) would require that if the baseline for the budget resolution shows that any one of the three conditions is not met over the period of time covered by the budget resolution, then there would be new fast-track process (like reconciliation) where the budget resolution would include instructions to committees to produce legislation that would reduce the deficit and achieve all three conditions. (The *Moment of Truth* report does not specify this process at quite this level of detail, but discussions with the Fiscal Commission staff have clarified how this process is intended to work.)

- If Congress does not produce a budget resolution, the Fiscal Commission’s report hints at a back-up plan. If CBO’s baseline estimates that one of the conditions is not met, then any member of the House or Senate may introduce debt stabilization legislation. How such legislation would ever be considered in the same fast-track way as would be possible through budget resolution instructions is not explained in the Commission’s report. Since, under current law, any member may introduce any legislation anyway, the suggested back-up plan appears to lack a fast-track component.