Federal Spending & Sequestration
June 12, 2012

Hazen Marshall
The Nickles Group
601 13th Street, NW
Suite 250 North
Washington, DC 20005
Current Budget State of Play

• Payroll tax / SGR / unemployment enacted, largely without offsets.

• House passes budget resolution with appropriations levels $19 billion below Budget Control Act cap, and a comprehensive sequester “replacement” bill.

• Senate fails for a third straight year to pass any budget at all.

• The “Fiscal Cliff”, or “Taxmageddon”, looming:
  – $110 billion sequester
  – Expiration of the Bush tax cuts
  – Imposition of Affordable Care Act tax increases
  – Debt limit
  – FY2013 appropriations bills
  – Already-expired AMT relief & business tax extenders
  – SGR
Fiscal Cliff / Taxmageddon

- CBO predicts the combination of policies under current law will reduce the federal budget deficit by $560 billion between fiscal years 2012 and 2013.

- However, CBO also projects that amount of fiscal change would cause the economy to contract by 1.3 percent in the first half of 2013 and grow by only 0.5 percent for the full year. The impact would likely be enough for NBER to call it a recession.

- CBO projects 4.4 percent economic growth if the Fiscal Cliff is postponed/avoided. However, they note that, “eliminating or reducing the fiscal restraint scheduled to occur next year without imposing comparable restraint in future years would reduce output and income in the longer run relative to what would occur if the scheduled fiscal restraint remained in place.”
Key Dates

- June 25-28, 2012 – Supreme Court on Affordable Care Act
- June 30, 2012 – highway funding expires, student loan interest rates double, flood insurance expires
- September 30, 2012 – TANF & farm bills expire, USPS runs out of money
- October 1, 2012 – Fiscal year 2013 begins
- November 6, 2012 – Election Day
- December ??, 2012 – Potential debt limit expiration?
- December 31, 2012 – Bush tax cuts expire
- January 1, 2013 – health care reform tax increases take effect
- January 2, 2013 – Budget Control Act sequestration
Budget Control Act Consequences – Discretionary Spending

• The failure of the JSC to produce a deficit reduction bill resulted in a reshuffling of discretionary spending caps into “Defense” and “Non-Defense” categories, enforced by sequester.

• Escape valves built into the spending caps – war spending (overseas contingency operations), emergencies are “free”!
Budget Control Act Consequences – The Sequester

• OMB must calculate the reductions and the President must order the reductions for FY 2013 by January 2, 2013.

• Even though three months of FY2013 will already have elapsed when the sequester is ordered, the cuts for FY2013 are not pro-rated.

• Under sequestration, all nonexempt programs must be reduced by a uniform percentage.

• “OMB shall calculate the amount of the deficit reduction required by this section for each of fiscal years 2013 through 2021” as follows:
  – Start with $1.2 trillion;
  – Subtract the amount of deficit reduction enacted into law as a result of the Joint Select Committee’s recommendations;
  – Reduce the difference by 18 percent (to account for net interest savings); and
  – Divide the result by 9 (since the cuts are to be equally distributed over 9 years.
# Sequester impact

The Congressional Budget Office’s estimate of the impact of a $1.2 trillion sequester:

<table>
<thead>
<tr>
<th>Category</th>
<th>2013</th>
<th>2013-2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discretionary defense</td>
<td>-$ 55</td>
<td>-$492</td>
</tr>
<tr>
<td>Discretionary non-defense</td>
<td>-$ 43</td>
<td>-$328</td>
</tr>
<tr>
<td>Medicare</td>
<td>-$ 6</td>
<td>-$117</td>
</tr>
<tr>
<td>Other mandatory</td>
<td>-$ 6</td>
<td>-$ 48</td>
</tr>
<tr>
<td>Non-defense Subtotal</td>
<td>-$ 55</td>
<td>-$492</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>-$110</strong></td>
<td><strong>-$984</strong></td>
</tr>
</tbody>
</table>
Sequester impact

The expected BCA sequester reductions of $984 billion over the period 2013 through 2021 equal 2.5 percent of total spending over that period.

The first year sequester impact of $110 billion equals 3 percent of total spending in that year.

The first year impact on various categories of spending include:
Defense 10.0 percent
Nondefense discretionary 8.5 percent
Medicare 2.0 percent

It is important to note that final sequester calculations and allocations are determined by OMB and the President. OMB’s estimates often differ from CBO’s, and the President has very limited authority to modify the sequester’s impact on military personnel, but not other accounts.
Sequester impact - transportation

• The Balanced Budget and Emergency Deficit Control Act (BBEDCA) defines “sequester” as the cancelation of “budgetary resources”, which are further defined as new budget authority, unobligated balances, direct spending authority, and obligation limitations.

• Sec. 255 (j) of the BBEDCA as added in 2009 exempts “budgetary resources of such programs are subject to obligation limitations in appropriations bills”, including:
  • Federal-Aid Highways
  • Highway Traffic Safety Grants
  • Operations and Research NHTSA and National Driver Register
  • Motor Carrier Safety Operations and Programs
  • Motor Carrier Safety Grants
  • Formula and Bus Grants
  • Grants-In-Aid for Airports

• Thus, we can anticipate that highway and aviation programs for which budget authority is appropriated in an annual appropriations bill or continuing resolution will be subject to the January 2, 2013 sequester, but that the programs listed above will be exempt. However, this has not yet been confirmed by OMB.
Sequester alternatives

Historically, Congress and the President have rarely allowed automatic budget sequesters to occur without acting to modify or replace them with alternatives. Options to change a Budget Control Act sequester include:

• The 112th Congress could amend the Budget Control Act to modify or delay the sequester or how it is calculated. Doing so under the regular order would likely require 60 votes to pass the Senate, and would be subject to a Presidential veto. Consideration post-election may present a different dynamic.

• An obscure provision of the newly-reactivated Gramm-Rudman law provides that 20 days after the final sequester order, the majority leader in either house of Congress may consider a joint resolution to “modify” or “provide an alternative” to the sequester order under fast-track procedures. Not all budget experts agree this provision applies to the January 2013 BCA sequester. (See Nov. 18, 2011 WSJ editorial by Senator Phil Gramm and Mike Solon)

• The 113th Congress – with potentially new leadership in Senate, House or in the White House – could enact legislation via the regular order or pursuant to the budget reconciliation process to modify the spending reductions that occurred under the sequester.
House GOP sequester alternative

- The House-passed budget resolution directed six House committees to submit deficit-reduction recommendations pursuant to a reconciliation-like process. Those committee-reported packages were combined by the House Budget Committee, and the entire package (H.R. 5652) was passed by the House on May 10, 2012 by a vote of 218-199.

- Although the House bill was produced pursuant to reconciliation-like procedures, since there is no House-Senate budget conference agreement, H.R. 5652 cannot receive the special procedural advantages normally afforded a reconciliation bill in the Senate.

- The House-passed bill would “turn-off” the defense discretionary and nondefense-discretionary portions of the 2013 sequester, but leave the mandatory portion of the sequester (including the 2% Medicare cuts) intact.

- In lieu of those cuts, the House bill would reduce deficits by $15.3 billion FY13, and $328 billion over ten years primarily through mandatory spending reductions. Additionally, the bill would reduce the FY13 cap on nondefense spending by $19 billion below existing cap levels.

- The House-passed bill does not modify the sequesters which will otherwise occur in future fiscal years (2014-2021).
# House GOP sequester alternative

## Fiscal 2013 (BA in billions)

<table>
<thead>
<tr>
<th></th>
<th>Current Law</th>
<th>H.R. 5652</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defense discretionary</td>
<td>-55</td>
<td>0</td>
</tr>
<tr>
<td>Nondefense discretionary</td>
<td>-42</td>
<td>-19</td>
</tr>
<tr>
<td>Medicare</td>
<td>-6</td>
<td>-6</td>
</tr>
<tr>
<td>Other mandatory</td>
<td>-6</td>
<td>-6</td>
</tr>
<tr>
<td>House reconciliation</td>
<td>n/a</td>
<td>-25</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>-110</td>
<td>-56</td>
</tr>
</tbody>
</table>

## Fiscal 2013-2021 (BA in billions)

<table>
<thead>
<tr>
<th></th>
<th>Current Law</th>
<th>H.R. 5652</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defense discretionary</td>
<td>-492</td>
<td>-437</td>
</tr>
<tr>
<td>Nondefense discretionary</td>
<td>-328</td>
<td>-309</td>
</tr>
<tr>
<td>Medicare</td>
<td>-117</td>
<td>-117</td>
</tr>
<tr>
<td>Other mandatory</td>
<td>-48</td>
<td>-48</td>
</tr>
<tr>
<td>House reconciliation</td>
<td>n/a</td>
<td>-208</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>-984</td>
<td>-1119</td>
</tr>
</tbody>
</table>

*Note: H.R. 5652 would also increase revenues by $2.3 billion in 2013 and $84.7 billion from 2013 to 2021. All numbers assume enactment of H.R. 5652 after October 1, 2012.*
The budget numbers
CBO’s Alternative Fiscal Scenario assumes expiring tax provisions (other than the payroll tax reduction) are extended, the AMT is indexed for inflation after 2011, Medicare’s payment rates for physicians’ services are held constant at their current level, and automatic spending reductions required by the Budget Control Act do not take effect.
CBO’s Alternative Fiscal Scenario assumes expiring tax provisions (other than the payroll tax reduction) are extended, the AMT is indexed for inflation after 2011, Medicare’s payment rates for physicians’ services are held constant at their current level, and automatic spending reductions required by the Budget Control Act do not take effect.
CBO’s Alternative Fiscal Scenario assumes expiring tax provisions (other than the payroll tax reduction) are extended, the AMT is indexed for inflation after 2011, Medicare’s payment rates for physicians’ services are held constant at their current level, and automatic spending reductions required by the Budget Control Act do not take effect.
CBO’s Alternative Fiscal Scenario assumes expiring tax provisions (other than the payroll tax reduction) are extended, the AMT is indexed for inflation after 2011, Medicare’s payment rates for physicians’ services are held constant at their current level, and automatic spending reductions required by the Budget Control Act do not take effect.