BUDGET CONTROL and SEQUESTRATION

Considerations and Potential Impacts

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Laws and Legislation

LAWS AND LEGISLATION

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PREFACE

Sequestration is a process of automatic, largely across-the-board spending reductions to meet or enforce certain budget policy goals. In the 1990s, sequestration was used to enforce statutory limits on discretionary spending and a pay-as-you-go (PAYGO) requirement on direct spending and revenue legislation. In general, sequestration entails the permanent cancellation of budgetary resources by a uniform percentage. This book examines the new considerations and potential impacts of budget control and sequestration with a focus on select program exemptions and special rules; the Budget Control Act of 2011; and the potential impact of automatic spending reduction procedures on health reform spending.

Chapter 1 - "Sequestration" is a process of automatic, largely across-the-board spending reductions under which budgetary resources are permanently canceled to enforce certain budget policy goals. It was first authorized by Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA, Title II of P.L. 99-177, commonly known as Gramm-Rudman-Hollings Act).

The sequestration process is of current interest because it was included as an enforcement mechanism in the Budget Control Act of 2011 (BCA, P.L. 112-25). Sequestration can also occur under provisions of the Statutory Pay-As-You-Go Act of 2010 (Statutory PAYGO, Title I of P.L. 111-139). In either case, certain programs are exempt from sequestration, and special rules govern the effects of sequestration on others. For the most part, these provisions are found in Sections 255 and 256 of BBEDCA, as amended.

The following two components of the BCA could result in automatic sequestration:

- Establishment of discretionary spending limits, or caps, for each of FY2012- FY2021. If Congress appropriates more than allowed under these spending limits in any given year, the automatic process of sequestration would cancel the excess amount.
- Failure of Congress to enact legislation developed by a Joint Select Committee on Deficit Reduction, by January 15, 2012, to reduce the deficit by at least $1.2 trillion. The BCA provides that such failure would trigger a series of automatic spending reductions, including sequestration of mandatory spending in each of FY2013-FY2021, a one-year sequestration of discretionary spending for FY2013, and lower discretionary spending limits for each of FY2014-FY2021.

In fact, the Joint Committee did not develop legislation to achieve the necessary deficit reduction and Congress did not meet the January 15, 2012, deadline. Thus, the first automatic spending cuts under the BCA are now scheduled to take effect on January 2, 2013.

Under the Statutory PAYGO Act, sequestration is part of a budget enforcement mechanism that is intended to prevent enactment of mandatory spending and revenue legislation that would increase the federal deficit. This act requires the Office of Management and Budget (OMB) to track costs and savings associated with enacted legislation and to determine at the end of each congressional session if net total costs exceed net total savings. If so, a sequestration will be triggered.

If sequestration is triggered—either under the BCA or Statutory PAYGO Act—the exemptions and special rules of Sections 255 and 256 of BBEDCA apply. Most exempt programs are mandatory, and include Social Security and Medicaid; refundable tax credits to individuals; and low-income programs such as the Children's Health Insurance Program, Supplemental Nutrition Assistance Program, Temporary Assistance for Needy Families, and Supplemental Security Income. Some discretionary programs also are exempt, notably all programs administered by the Department of Veterans Affairs. Also, subject to notification of Congress by the President, military personnel accounts may either be exempt or reduced by a lower percentage.

Special rules also apply to several, primarily mandatory, programs. For example, under Section 256 of BBEDCA, Medicare may not be sequestered by more than 4%. However, the BCA further limits sequestration of Medicare to no more than 2%.

Chapter 2 – Following a lengthy debate over raising the debt limit, the Budget Control Act of 2011 (BCA; P.L. 112-25) was signed into law by President Obama on August 2, 2011. In addition to including a mechanism to increase the debt limit, the BCA contained a variety of measures intended to reduce the budget deficit through spending reductions. Combined, these measures are projected to reduce the deficit by roughly $2 trillion over the FY2012-FY2021 period.

There are two main groups of spending reductions in the BCA: (1) discretionary spending caps that came into effect in FY2012; and (2) a $1.2 trillion automatic spending reduction process (sometimes referred to as the "trigger") that will come into effect on January 2, 2013, unless new legislation is enacted to prevent it. H.R. 4966, the Sequester Replacement Act of 2012, and the President's FY2013 Budget both propose eliminating the trigger and replacing it with alternative measures to reduce the deficit.

To provide context for this debate, this report discusses the effects of the BCA on spending and the deficit, assuming that the January 2013 automatic spending reductions proceed as scheduled. The BCA spending cuts mainly apply to discretionary spending—$0.8 trillion in cuts to defense programs and $0.7 trillion in cuts to non-defense programs over 10 years. Mandatory spending is cut by less than $0.2 trillion over 10 years, with most of the savings from Medicare. Many mandatory programs are exempt from these cuts, as are certain types of discretionary programs. More than half of the spending cuts are through the "trigger" process, which has not yet come into effect. In FY2013, the first year of the "trigger," defense discretionary budget authority subject to the BCA caps would decline by 11.5%, and non-defense would decline by 9.8%. In FY2013, real (inflation-adjusted) defense discretionary spending subject to the BCA caps is lower than its FY2005 levels, and real non-defense discretionary is lower than its FY2003 levels. After FY2013, the discretionary caps would rise by about the rate of inflation in subsequent years. As a result, discretionary spending subject to the caps does not return to its FY2011 level until FY2018 in *nominal terms* and will not return to its FY2011 levels in real terms at any point in the 10-year budget window. Defense and non-defense discretionary spending subject to the caps will also not return to FY2011 levels in *real terms* during the budget window.

The effects of the BCA on overall discretionary spending will depend on what levels of spending Congress chooses for categories of discretionary spending not subject to the caps, namely overseas contingency operations (OCO), disaster spending, and emergency spending. From FY2018 on, overall discretionary spending would be below its lowest share of gross domestic product (GDP) since data were first collected in 1962, assuming current levels of OCO and disaster spending. Mandatory spending, by contrast, is projected to continue to grow in nominal terms, real terms, and as a percentage of GDP over the next 10 years. Because of the projected growth in mandatory spending, total federal spending would be above its post-World War II average share of GDP at the end of the 10-year budget window.

When fully implemented, the BCA reduces deficits by about 1% of GDP each year. Under a current law baseline, the budget is on a sustainable path, in the sense that the publicly held debt would decline as a share of GDP (although it would continue to rise in dollar terms). Under a current policy baseline, where expiring tax cuts, the alternative minimum tax patch, and the Medicare "doc fix" are assumed to be extended, deficits are unsustainably large even after enactment of the BCA.

Chapter 3 – The Budget Control Act of 2011 (BCA; P.L. 112-25) established new budget enforcement mechanisms for reducing the federal deficit by at least $2.1 trillion over the 10-year period FY2012-FY2021. The BCA placed statutory limits, or caps, on discretionary spending for each of those 10 fiscal years, which will save an estimated $0.9 trillion during that period. In addition, it created a Joint Select Committee on Deficit Reduction (Joint Committee) with instructions to develop legislation to reduce the federal deficit by at least another $1.5 trillion through FY2021. On November 21, 2011, the Joint Committee announced that it was unable to agree on a legislative package of deficit cuts, which raises the likelihood of automatic annual spending reductions beginning in FY2013. Under the BCA, the reductions would be achieved by a combination of sequestration—an automatic across-the-board cancellation of budgetary resources (i.e., spending cuts) for nonexempt direct spending programs—and lowering the caps on discretionary spending.

The potential impact of spending reductions triggered by the BCA on health reform spending under the Patient Protection and Affordable Care Act (ACA) would appear to be somewhat limited. ACA sought to increase access to affordable health insurance by expanding the Medicaid program and by restructuring the private health insurance market. It set minimum standards for private insurance coverage, created a mandate for most U.S. residents to obtain coverage, and provided for the establishment by 2014 of state-based insurance exchanges for the purchase of health insurance. Certain individuals and families will be able to receive federal subsidies to reduce the cost of purchasing coverage through the exchanges. The new law included direct spending to subsidize the purchase of health insurance coverage through the exchanges, as well as increased outlays for the Medicaid expansion. Under the rules governing sequestration, Medicaid spending would be exempt from any reduction, and cuts to Medicare would be capped at 2%.

ACA also included numerous mandatory appropriations that provide billions of dollars to support temporary programs to increase coverage and funding for targeted groups, provide funds to states to plan and establish exchanges, and support many other research and demonstration programs and activities. These appropriations would, in general, be subject to direct spending reductions under a sequestration order. However, for any given fiscal year in which sequestration was ordered, only new budget authority for that year (including advance appropriations that first become available for obligation in that year) would be reduced. Unobligated balances carried over from previous fiscal years would be exempt from sequestration.

ACA is likely to affect discretionary spending subject to the annual appropriations process. The law reauthorized appropriations for numerous existing discretionary grant programs and activities authorized under the Public Health Service Act, permanently reauthorized funding for the Indian Health Service (IHS), and created a number of new grant programs and provided for each an authorization of appropriations. In addition, the Congressional Budget Office projected that both the Department of Health and Human Services and the Internal Revenue Service will incur substantial administrative costs to implement the policies and programs established by ACA. Those costs will have to be funded largely through the annual appropriations process. Most of the ACA-related discretionary spending would be subject to automatic spending reductions triggered by the BCA.

Chapter 4 – The Budget Control Act (BCA) is the result of negotiations between the President and Congress held in response to the federal government having nearly reached its borrowing capacity.

The BCA authorized increases in the debt limit of at least $2.1 trillion dollars (and up to $2.4 trillion under certain conditions), subject to a disapproval process that would likely require securing the support of two-thirds of each chamber to prevent a debt limit increase. It established caps on the amount of money that could be spent through the annual appropriations process for the next 10 years, which the Congressional Budget Office (CBO) estimates will reduce federal spending by $917 billion. The BCA also created a Joint Select Committee on Deficit Reduction that is instructed to develop a bill to reduce the federal deficit by at least another $1.5 trillion over the 10 year period ending in FY2021.

The legislation resulting from the joint committee recommendations can be considered under special procedures that prevent amendment and limit debate in both chambers. These procedures could have a significant impact in the Senate because they allow the bill to advance with simple majority support; under regular Senate procedures it can be necessary to obtain agreement among at least three-fifths of the Senate (normally 60 Senators) to advance consideration of legislation.

If a joint committee proposal cutting the deficit by at least $1.2 trillion is not enacted by January 15, 2012, then the BCA established an automatic spending reduction process that includes sequestration (the cancellation of budgetary resources). The process presumably is intended to encourage agreement on deficit reduction, either by enacting the joint committee legislation by early 2012, or possibly by enacting other legislation (presumably through existing congressional procedures) by the beginning of 2013, when the automatic process would make reductions. If the enacted bill cuts the deficit by more than $1.2 trillion, an additional increase in the debt limit becomes available in the amount of the excess, up to $0.3 trillion.

The Budget Control Act has two additional elements. First, it directs that the House and Senate must each vote on a proposal to amend the Constitution to require that the budget of the federal government be balanced. The BCA does not alter the procedures for taking up such a measure in the Senate, and therefore the Senate might not be able to vote on passage of a constitutional amendment unless the support of 60 Senators can be secured to begin consideration. The only procedural consequence of not voting specified in the BCA is that, if Congress does not approve a constitutional amendment, the second of two conditions under which the act would permit an additional increase of $0.3 trillion in the debt ceiling, will not be available.

Second, the BCA also makes changes to the William D. Ford Federal Direct Loan (DL) program and the Federal Pell Grant program, two federal student aid programs authorized under Title IV of the Higher Education Act of 1965, as amended (HEA; P.L. 89-329). Effective July 1, 2012, the BCA eliminates the availability of Subsidized Stafford Loans to graduate and professional students and eliminates all but one type of repayment incentives on future DL program loans. CBO estimates these changes would reduce direct spending by $21.6 billion over the FY2012- FY2021 period. Approximately $17 billion of the $21.6 billion in estimated savings from the changes in the DL program would be directed to the Pell Grant program for future general use in FY2012 and FY2013.

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Chapter 1

BUDGET "SEQUESTRATION" AND SELECTED PROGRAM EXEMPTIONS AND SPECIAL RULES*

Karen Spar

SUMMARY

"Sequestration" is a process of automatic, largely across-the-board spending reductions under which budgetary resources are permanently canceled to enforce certain budget policy goals. It was first authorized by the Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA, Title II of P.L. 99-177, commonly known as the Gramm-Rudman-Hollings Act).

The sequestration process is of current interest because it was included as an enforcement mechanism in the Budget Control Act of 2011 (BCA, P.L. 112-25). Sequestration can also occur under provisions of the Statutory Pay-As-You-Go Act of 2010 (Statutory PAYGO, Title I of P.L. 111-139). In either case, certain programs are exempt from sequestration, and special rules govern the effects of sequestration on others. For the most part, these provisions are found in Sections 255 and 256 of BBEDCA, as amended.

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* This is an edited, reformatted and augmented version of Congressional Research Service, Publication No. R42050, dated April 27, 2012.

The following two components of the BCA could result in automatic sequestration:

- Establishment of discretionary spending limits, or caps, for each of FY2012- FY2021. If Congress appropriates more than allowed under these spending limits in any given year, the automatic process of sequestration would cancel the excess amount.
- Failure of Congress to enact legislation developed by a Joint Select Committee on Deficit Reduction, by January 15, 2012, to reduce the deficit by at least $1.2 trillion. The BCA provides that such failure would trigger a series of automatic spending reductions, including sequestration of mandatory spending in each of FY2013-FY2021, a one-year sequestration of discretionary spending for FY2013, and lower discretionary spending limits for each of FY2014-FY2021.

In fact, the Joint Committee did not develop legislation to achieve the necessary deficit reduction and Congress did not meet the January 15, 2012, deadline. Thus, the first automatic spending cuts under the BCA are now scheduled to take effect on January 2, 2013.

Under the Statutory PAYGO Act, sequestration is part of a budget enforcement mechanism that is intended to prevent enactment of mandatory spending and revenue legislation that would increase the federal deficit. This act requires the Office of Management and Budget (OMB) to track costs and savings associated with enacted legislation and to determine at the end of each congressional session if net total costs exceed net total savings. If so, a sequestration will be triggered.

If sequestration is triggered—either under the BCA or Statutory PAYGO Act—the exemptions and special rules of Sections 255 and 256 of BBEDCA apply. Most exempt programs are mandatory, and include Social Security and Medicaid; refundable tax credits to individuals; and low-income programs such as the Children's Health Insurance Program, Supplemental Nutrition Assistance Program, Temporary Assistance for Needy Families, and Supplemental Security Income. Some discretionary programs also are exempt, notably all programs administered by the Department of Veterans Affairs. Also, subject to notification of Congress by the President, military personnel accounts may either be exempt or reduced by a lower percentage.

Special rules also apply to several, primarily mandatory, programs. For example, under Section 256 of BBEDCA, Medicare may not be sequestered by more than 4%. However, the BCA further limits sequestration of Medicare to no more than 2%.

INTRODUCTION

"Sequestration" is a process of automatic, largely across-the-board spending reductions to meet or enforce certain budget policy goals.[1] It was first established by the Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA, Title II of P.L. 99-177, 2 U.S.C. 900-922) to enforce deficit targets. In the 1990s, sequestration was used to enforce statutory limits on discretionary spending and a pay-as-you-go (PAYGO) requirement on direct spending and revenue legislation. After effectively expiring in 2002, sequestration was reestablished by the Statutory Pay-As-You-Go Act of 2010 (P.L. 111-139) to enforce a modified PAYGO requirement on direct spending and revenue legislation. Most recently, under the Budget Control Act of 2011 (BCA, P.L. 112-25), sequestration was tied to enforcement of new statutory limits on discretionary spending and achievement of the budget goal established for the Joint Select Committee on Deficit Reduction. Under current law, a sequestration triggered by the BCA is scheduled to occur on January 2, 2013, and will affect spending for FY2013.

In general, sequestration entails the permanent cancellation of budgetary resources by a uniform percentage.[2] Moreover, this uniform percentage reduction is applied to all programs, projects, and activities within a budget account.[3] However, the current sequestration procedures, as in previous iterations of such procedures, provide for exemptions and special rules. That is, certain programs and activities are exempt from sequestration, and certain other programs are governed by special rules regarding the application of a sequester. This report provides an overview of those exemptions and special rules, which are generally found in Sections 255 and 256 of BBEDCA, as amended (2 U.S.C. 905 and 906).

CURRENT SEQUESTRATION TRIGGERS

As noted above, sequestration is tied to certain budget goals established in the Budget Control Act of 2011, as well as the Statutory PAYGO Act of 2010. To provide some context for the exemptions and special rules applicable to the current sequestration procedures, brief descriptions of the budget goals that may be enforced by sequestration are provided below.

SEQUESTRATION TRIGGERS UNDER THE BCA

The Budget Control Act of 2011 (BCA) was enacted on August 2, 2011. It provided for increases in the debt limit and established procedures designed to reduce the federal budget deficit.[4] The BCA has two primary components designed to trigger a sequestration of discretionary and/or mandatory (or direct) spending:[5]

- Title I of the BCA established discretionary spending limits, or caps, for each of FY2012-FY2021.[6] If Congress appropriates more than allowed under these spending limits in any given year, the automatic reduction process of sequestration will cancel the excess amount. For FY2012 and FY2013, the spending limits were divided into "security" and "nonsecurity" categories, with security defined broadly to include the Departments of Veterans Affairs (VA), Homeland Security (DHS), and State, in addition to the Department of Defense and certain other activities.[7] For FY2014 and subsequent years, no distinction was made between security and nonsecurity, and Title I of the law established a single discretionary spending limit for each year.
- Title IV of the BCA established a bipartisan Joint Select Committee on Deficit Reduction. Failure by Congress to enact legislation by January 15, 2012, developed by the Joint Committee and reducing the deficit by at least $1.2 trillion, would trigger a series of automatic spending reductions intended to achieve that level of savings over the FY2013-FY2021 period. These automatic reductions include sequestration of mandatory spending for each of FY2013- FY2021, a one-year sequestration of discretionary spending for FY2013, and lower discretionary spending limits for FY2014-FY2021. Spending reductions would be divided equally between security and nonsecurity. However, *these terms are redefined*, so that "security" consists only of budget function 050 (effectively, the Department of Defense), and "nonsecurity" includes all other government spending (including the VA, DHS, and State). The distinction between security and nonsecurity (*as redefined*) remains for each of FY2014- FY2021.

The security-nonsecurity distinction is significant because sequestration is imposed within these categories. For example, under the spending limits established under Title I of the BCA, if Congress appropriated more than allowed for either category in FY2012 or FY2013, the excess spending would be canceled in the category where the breach occurred. As noted above, security was defined broadly under Title I, and spending was divided between the two categories only for two years; a single discretionary spending limit was set for FY2014 and subsequent years.

Because the Joint Committee did not, in fact, develop legislation to achieve the specified level of deficit reduction by the deadline set in the BCA, and Congress did not subsequently enact such legislation by January 15, 2012, the automatic budget enforcement procedures provided by the law are now scheduled to occur.[8] The first fiscal year these procedures will affect is FY2013; sequestration of excess spending for that fiscal year (as outlined in the second bullet on the previous page) is scheduled to happen on January 2, 2013.

The automatic procedures triggered by failure of the Joint Committee process will affect both mandatory and discretionary spending, and will result in the security and nonsecurity categories being reduced by an equal amount of spending in each of FY2013 through FY2021. Because the definition of "security" is revised to mean primarily the Department of Defense, this means that half of the necessary spending reductions will come from that department while the other half will come from the rest of the federal budget. In addition to lowering the discretionary spending limits, these automatic procedures maintain separate spending limits for security and nonsecurity, as those terms have been revised, for each year through FY2021.[9]

Sequestration Trigger under Statutory PAYGO

The Statutory Pay-As-You-Go Act of 2010 was enacted on February 12, 2010, as Title I of P.L. 111-139.[10] It established a permanent budget enforcement mechanism intended to prevent mandatory (i.e., direct) spending and revenue legislation that would increase the deficit from being passed and signed into law. (Statutory PAYGO does not apply to discretionary spending.) The act requires various scorekeeping procedures, including five-year and 10-year scorecards that track costs and savings associated with enacted legislation.

At the end of each congressional session, the Office of Management and Budget (OMB) generally must determine whether the net effect of direct spending and revenue legislation enacted during the session has increased the deficit, and if so, a sequestration will be triggered.