



Mitigating the Impact of a Temporary Sequester

White House could buy time if extended budget negotiations last into January

By Patrick Lester¹
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Unless Congress and the president enact legislation delaying or canceling them, automatic federal spending cuts will begin on Jan. 2, 2013, through a process known as "sequestration." If this occurs, the administration will be tasked with implementing across-the-board spending cuts in non-exempt defense and non-defense programs by an estimated 8-10 percent.

Most analyses of the impact of sequestration are based on an assumption that it will be fully implemented for the remainder of the federal fiscal year. However, it is possible that sequestration might be triggered but later retroactively canceled as part of a broader budget agreement between Congress and the president in early 2013.

This paper reviews options for managing a short-term sequester of this kind. It concludes that if sequestration is triggered, if the administration chooses to take action to lessen its impacts, and if it lasts just a few weeks and is retroactively canceled, then there would be minimal or no damage to most affected federal defense and non-defense programs.

Sequestration Explained

Provisions governing sequestration were included in the Budget Control Act of 2011 (P.L. 112-25), deficit reduction legislation that was passed by Congress and signed into law by President Obama on Aug. 2, 2011.² Among many other provisions, the Budget Control Act established caps on annually appropriated programs that reduced spending by an estimated \$1.5 trillion over 10 years (FY 2013-2022).³ It also established a bipartisan committee, called the Joint Select Committee on Deficit Reduction, to find another \$1.5 trillion in deficit reduction over that same time period.⁴

Sequestration was included as a backstop and enforcement mechanism if the joint committee failed to propose, and Congress failed to enact, legislation to cut the deficit by at least \$1.2 trillion by Jan. 15,

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² Sequestration itself is not new. It traces back to the 1985 Balanced Budget and Emergency Deficit Control Act (BBEDCA), commonly known as the Gramm-Rudman-Hollings Act (P.L. 99-177). Most provisions governing sequestration can be found in sections 255 and 256 of this law, as amended. A review of early sequesters implemented under the law can be found in: Congressional Research Service, *Budget Sequester: A Brief Review*, March 8, 2004. Available online at: http://democrats.rules.house.gov/CRS_Rpt/RS20398.pdf.

³ Richard Kogan, "Congress Has Cut Discretionary Funding by \$1.5 Trillion over Ten Years," Center on Budget and Policy Priorities, Sept. 25, 2012. Available online at: <http://www.cbpp.org/cms/index.cfm?fa=view&id=3840>.

⁴ Congressional Research Service, *The Budget Control Act of 2011*, Aug. 19, 2011, p. 2. Available online at: <http://www.fas.org/sqp/crs/misc/R41965.pdf>.

2012.⁵ Sequestration would achieve the same \$1.2 trillion reduction through \$984 billion in across-the-board spending cuts over nine years from 2013-2021, including \$109 billion in 2013, and an estimated \$216 billion in interest savings.⁶ The joint committee and Congress subsequently failed to achieve the law's deficit-reduction goals, so sequestration will be triggered on Jan. 2, 2013, unless Congress and the president agree to new legislation canceling it.

On Sept. 14, the Obama administration released a congressionally mandated report providing more information on the \$109 billion in spending cuts in 2013.⁷ As required by the Budget Control Act, this amount is divided equally between defense and non-defense programs: \$54.7 billion each. According to the report, the \$54.7 billion in defense cuts will reduce discretionary defense programs that are not exempt by 9.4 percent and mandatory defense programs that are not exempt by 10 percent.

The \$54.7 billion in non-defense cuts will reduce non-exempt discretionary programs by 8.2 percent and non-exempt mandatory programs by 7.6 percent. Medicare is handled separately and would be cut by two percent, with the cuts imposed on Medicare providers and health insurance plans.⁸ These percentages are expressed in annual terms. In practical terms, the percentage cuts will seem higher in 2013 because, by Jan. 2, a quarter of the 2013 federal fiscal year will have already elapsed with few⁹ or no corresponding cuts.¹⁰ Most or all of the year's cuts will need to be compressed into the last three-quarters of the fiscal year.¹¹

Some programs are exempt from sequestration.¹² A partial list of exempt programs includes: Social Security benefits (old-age, survivors, and disability), all programs administered by the Department of Veterans Affairs (VA), military personnel spending (subject to the president's approval, which he has provided), interest on the federal debt, refundable tax credits, and a variety of low-income programs, including Temporary Assistance for Needy Families (TANF), food stamps (the Supplemental Nutrition Assistance Program, or SNAP) and child nutrition programs, mandatory funding under the Child Care and Development Fund, Medicaid, the Children's Health Insurance Program (CHIP), foster care, and the Supplemental Security Income (SSI) program. However, administrative expenses for these programs are subject to sequestration.¹³

For non-exempt programs, the calculated percentage reductions in spending must be applied equally to every "program, project and activity" (PPA) within a budget account. The definition of PPAs is not entirely clear for every program and must be identified by the Office of Management and Budget (OMB) after reviewing the relevant appropriations acts and references in the president's most recently submitted

⁵ Office of Management and Budget, "OMB Report Pursuant to the Sequestration Transparency Act of 2012 (P.L. 1120155)," Sept. 14, 2012, p. 3. Available online at:

http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf.

⁶ Ibid., p. 5.

⁷ Office of Management and Budget, "OMB Report Pursuant to the Sequestration Transparency Act of 2012 (P.L. 1120155)," Sept. 14, 2012. Available online at:

http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf.

⁸ Congressional Research Service, *Budget 'Sequestration' and Selected Program Exemptions and Special Rules*, April 27, 2012, pp. 8-11. Available online at: <http://www.washingtonpost.com/r/2010-2019/WashingtonPost/2012/07/16/National-Politics/Graphics/crs%20report%20on%20sequestration.pdf>.

⁹ Despite OMB's directive, some analysts believe that federal agencies have begun slowing spending on their own.

¹⁰ See National Association of Development Organizations, "Federal Agencies to Continue Normal Spending Despite Upcoming Sequester," Oct. 7, 2012. Available online at: <http://www.nado.org/omb-directs-federal-agencies-to-continue-normal-spending-despite-upcoming-sequester/>. See also Office of Management and Budget Bulletin no. 12-02, "Apportionment of the Continuing Resolutions(s) for Fiscal Year 2013," Sept. 28, 2012. Available at: <http://www.whitehouse.gov/sites/default/files/omb/bulletins/fy2012/b12-02.pdf>.

¹¹ The federal fiscal year runs from Oct. 1 through the following Sept. 30.

¹² Congressional Research Service, *Budget 'Sequestration' and Selected Program Exemptions and Special Rules*, April 27, 2012, pp. 5-7. Available online at: <http://www.washingtonpost.com/r/2010-2019/WashingtonPost/2012/07/16/National-Politics/Graphics/crs%20report%20on%20sequestration.pdf>.

¹³ Ibid., pp. 14-15.

budget.¹⁴ This level of specificity limits OMB's discretion to redirect cuts away from sensitive programs, although OMB's options for addressing this are discussed later in this paper.

In its September report, the Obama administration indicated that "no amount of planning can mitigate the effect of these cuts."¹⁵ Nevertheless, there is evidence that the administration is doing some preliminary planning for sequestration. In a July 31 memo to agency heads, OMB indicated that it would be holding discussions in "coming months" about applicable sequestration rules and reporting requirements.¹⁶

The remainder of this paper is devoted to explaining ways that the administration could, if it chooses, act to mitigate a temporary sequester if it were to occur.

Apportionment

One tool the administration could use to mitigate a possible sequester is its control over the rate of federal spending. While the Constitution gives Congress the authority to determine agency budgets, it is up to the White House (specifically OMB) to administer and dole out this funding to executive branch agencies during the fiscal year. This occurs in a process called apportionment.

Some budget analysts have argued that apportionment alone gives OMB sufficient power to delay the impact of sequestration for several weeks or more.¹⁷ Under this strategy, OMB could decide to continue funding at current rates for the first few days or weeks of the new year, with offsetting reductions planned for later in the year, by which time sequestration may have been canceled. If sequestration were handled by the administration in this manner and then retroactively canceled by an act of Congress, it would have no impact on agency spending.

The extent of OMB's authority to do this, however, is unclear. On the one hand, current law clearly invests power over apportionment for executive branch agencies in OMB¹⁸ and gives OMB the power to conduct apportionment in a manner it "considers appropriate."¹⁹ Under this law – called the Antideficiency Act – such apportionments may take place monthly, quarterly, or for any other time period,²⁰ including all at once at the beginning of the fiscal year.²¹ According to a Government Accountability Office (GAO) report on sequestration released earlier this year, "[t]he execution and impact of any spending reductions will depend on the legal interpretations and actions taken by OMB."²²

On the other hand, OMB's discretion is not unlimited. The primary purpose of the Antideficiency Act is to prevent federal agencies from overspending congressionally appropriated funds or spending them in advance of their availability.²³ Its central requirement is that apportionment be conducted in a manner that

¹⁴ Government Accountability Office, *Agencies Must Continue to Comply with Fiscal Laws Despite the Possibility of Sequestration*, April 25, 2012, pp. 7-9. Available online at: <http://www.gao.gov/assets/600/590395.pdf>.

¹⁵ Office of Management and Budget, "OMB Report Pursuant to the Sequestration Transparency Act of 2012 (P.L. 1120155)," September 14, 2012, p. 1. Available online at: http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf.

¹⁶ Office of Management and Budget, "Issues Raised by Potential Sequestration Pursuant to Section 251A of the Balanced Budget and Emergency Deficit Control Act of 1985," July 31, 2012, p. 1. Available online at: <http://www.whitehouse.gov/sites/default/files/omb/memoranda/2012/m-12-17.pdf>.

¹⁷ Paul Krawzak, "Managing Portion Sizes," *CQ Weekly*, Aug. 4, 2012. Available online at: <http://public.cq.com/docs/weeklyreport/weeklyreport-000004138013.html>.

¹⁸ 31 U.S.C. § 1513(b)(1). See: <http://uscode.house.gov/download/pls/31C15.txt>.

¹⁹ 31 U.S.C. § 1512(b)(2)

²⁰ 31 U.S.C. § 1512(b)(1)

²¹ Government Accountability Office, *Principles of Federal Appropriations Law*, Third Edition, Volume II, pp. 6-126 to 6-127. Available online at: <http://www.gao.gov/special.pubs/d06382sp.pdf>.

²² Government Accountability Office, *Agencies Must Continue to Comply with Fiscal Laws Despite the Possibility of Sequestration*, April 25, 2012. Available online at: <http://www.gao.gov/assets/600/590395.pdf>.

²³ 31 U.S.C. § 1341. See <http://uscode.house.gov/download/pls/31C13.txt>.

will avoid the need for a supplemental appropriation from Congress.²⁴ Furthermore, according to an opinion of the Comptroller General, such apportionments must not only avoid such deficiencies, they must also avoid the need for “a drastic curtailment” of funding for a program at the close of a fiscal period.²⁵

Beyond these general limitations, OMB’s discretion may be further limited in 2013 because the federal government is operating under a continuing resolution that funds federal agencies only through March 27.²⁶ Any accelerated funding that might take place in early January may need to be offset by late March – and would need to be offset by the end of the fiscal year in any event – if sequestration is not canceled.

There is no way to know at this time whether OMB will choose to use its apportionment power to mitigate the impact of sequestration. If OMB does use apportionment for this purpose, its use will probably vary by program and will probably be combined with the other strategies that are described in this paper.

Unobligated Balances

Separate from any OMB action, federal agencies themselves regulate the speed at which they obligate appropriated funds. They can, and often do, carry over unobligated funds from early in a fiscal year to later in a fiscal year. Some budget analysts believe that they are already slowing spending in advance of Jan. 2.²⁷ However, their discretion to do this is limited, and it is not clear how much these actions will cushion the impact of sequestration. According to GAO, “An agency may not set aside funds or intentionally slow down spending in anticipation of proposed cancellations or rescissions of previously appropriated funds.”²⁸

Another, larger source of unobligated funds is those carried over from one year to another. According to OMB, most of these multi-year unobligated balances are “provided for specific uses such as the multi-year construction of a major project and so are not available for new programs. A small part may never be obligated or spent, primarily amounts provided for contingencies that do not occur or reserves that never have to be used.”²⁹

Unobligated balances carried over from prior years for defense programs are subject to sequestration,³⁰ but unobligated balances for non-defense programs are not.³¹ One example of unobligated non-defense balances can be found in the Department of Transportation (DOT). Although DOT’s unobligated balances are not subject to sequestration, 2006 testimony by a DOT official provides a good illustration of how multi-year unobligated balances work:

²⁴ 31 U.S.C. § 1512(a). The need to avoid supplemental appropriations is applicable to programs with appropriations made for fixed periods of time. In the case of indefinite appropriations, apportionments must be made “to achieve the most effective and economical use” of funds.

²⁵ 36 Comp. Gen. 699. Available online at: <http://www.gao.gov/products/431191>.

²⁶ A discussion of apportionment under a continuing resolution can be found at: Government Accountability Office, *Principles of Federal Appropriations Law*, Third Edition, Volume II, pp. 8-18 to 8-19. Available online at: <http://www.gao.gov/special.pubs/d06382sp.pdf>.

²⁷ Author interviews and Paul Krawzak, “Managing Portion Sizes,” *CQ Weekly*, Aug. 4, 2012. Available online at: <http://public.cq.com/docs/weeklyreport/weeklyreport-000004138013.html>.

²⁸ Government Accountability Office, *Agencies Must Continue to Comply with Fiscal Laws Despite the Possibility of Sequestration*, April 25, 2012, p. 6. Available online at: <http://www.gao.gov/assets/600/590395.pdf>.

²⁹ Office of Management and Budget, Budget of the U.S. Government, Fiscal Year 2013, Analytical Perspectives, p. 136. Available online at: <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/concepts.pdf>. See also: OMB, “Balances of Budget Authority: Budget of the U.S. Government,” FY 2013. Available online at: <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/concepts.pdf>.

³⁰ Federal News Radio, “September defense spending spree takes on new urgency,” June 6, 2012. Available online at: <http://www.federalnewsradio.com/513/2892522/September-Defense-spending-sprees-takes-on-new-urgency>.

³¹ Congressional Research Service, “Budget Sequestration and Selected Program Exemptions and Special Rules,” April 27, 2012, p. 5. Available online at: <http://www.washingtonpost.com/r/2010-2019/WashingtonPost/2012/07/16/National-Politics/Graphics/crs%20report%20on%20sequestration.pdf>.

Typically, Federal operating programs, such as those that fund the salaries and expenses of our railroad safety inspectors, are funded year by year through the annual appropriations process and the resources are used during that same year.

At DOT such programs constitute a very small portion of our total budget. Instead, the majority of the Department of Transportation's program dollars support major capital investment projects like highway, transit, and airport construction that generally take several years to complete. As a result, funding for these programs also needs to be available over multiple years and linked to the overall construction cycle. As infrastructure projects progress, the specific funds linked to each project are obligated as they are needed to complete construction phases. Because this often happens over a long period of time, a sizable portion of each year's funding is likely to remain unobligated and unexpended for several years.³²

Unobligated balances, both those managed within the fiscal year for cash-management purposes and those carried over from previous fiscal years, will provide some level of cushion in early 2013 if a temporary sequester were to be implemented.

Transfers and Reprogramming

Federal agencies have limited power to shift funding between appropriations (called transfers) and within appropriations (called reprogramming). Transfers require congressional authorization while reprogramming does not.³³

Authority to reprogram funds within an appropriation is considered to be an implicit part of an agency's responsibility to manage its funds.³⁴ According to the GAO, "as a matter of law, an agency is free to reprogram unobligated funds as long as the expenditures are within the general purpose of the appropriation."³⁵ Reprogramming occurs at the level of "program, project, or activity" (PPA), the same level at which sequestration is implemented.³⁶ While sequestration might impose a spending cut of a certain percentage to a PPA as a whole, reprogramming can be used to move funds within and between PPAs so that sequestration does not affect all activities within the PPA equally. As part of this process, federal agencies usually consult with congressional appropriating committees, although committees do not have a veto.³⁷ Such consultation is not legally binding because formal legislative approval or vetoes of executive branch actions are not constitutional.³⁸

Reprogramming of existing funds is a routine matter that happens every year, not just during sequestration. Transfers, which require congressional authorization, are less frequent, but Pentagon officials have already indicated that they are considering transferring funding within DOD to protect major weapons programs from sequestration, possibly as much as \$15-20 billion, according to one analyst.³⁹

Transfer and reprogramming authority will give agencies substantial ability to redirect cuts away from sensitive areas of spending to other areas that may be less sensitive in the first few weeks of the year.

³² Senate Committee on Homeland Security and Governmental Affairs, "Unobligated Balances: Freeing up funds, setting priorities, and untying agency hands" (Senate Hearing 109-888), May 18, 2006. Available online at: <http://www.gpo.gov/fdsys/pkg/CHRG-109shrg28247/html/CHRG-109shrg28247.htm>.

³³ Government Accountability Office, *Principles of Appropriations Law*, Third Edition, Volume I, pp. 2-24 to 2-33. Available online at: <http://www.gao.gov/legal/redbook/redbook.html>.

³⁴ Government Accountability Office, *Principles of Appropriations Law*, Third Edition, Volume I, p. 2-30. Available online at: <http://www.gao.gov/legal/redbook/redbook.html>.

³⁵ *Ibid.*, p. 2-31.

³⁶ Allen Schick, *The Federal Budget: Politics, Policy, Process*, Brookings Institution Press, 2007 (Third Edition), p. 282.

³⁷ *Ibid.*, p. 2-32.

³⁸ *Immigration & Naturalization Service v. Chadha*, 462 U.S. 919 (1983).

³⁹ Marcus Weisberger, "If cuts happen, troops, major weapons are DOD priorities," *Defense News*, Oct. 8, 2012. Available online at: <http://www.defensenews.com/article/20121008/DEFREG02/310080001/If-Cuts-Happen-Troops-Major-Weapons-DoD-Priorities?odyssey=nav/head>.

However, if sequestration is not reversed, these decisions will only affect how and when the cuts are implemented, not whether they occur.

Federal Employee Furloughs and Reductions in Force (RIFs)

Compared to many other federal funding streams, spending on federal employees is relatively constant. It is more difficult to delay spending on employee compensation and benefits because these costs are incurred throughout the year. Moreover, sequestration-related cuts in personnel costs probably cannot be achieved by reducing statutorily set federal pay rates or benefits costs.⁴⁰

Making matters more difficult, sequestration requires proportional reductions down to the level of “program, project, or activity” (PPA). While reprogramming can help (see the previous section on transfers and reprogramming for more on this generally), some budget accounts are so overwhelmingly dominated by personnel-related costs that avoiding personnel cuts becomes difficult, if not impossible.

Personnel costs can be reduced in a variety of ways, including layoffs through a reduction in force (RIF), furloughs, and delayed hiring and promotions. In general, layoffs through a reduction in force (RIF) save little money in the short term. A RIF requires agencies to pay severance and allows employees to cash out unused annual leave.⁴¹ Furloughs cost less and allow more flexibility, although they are still far from ideal. Moreover, a furlough of more than 30 calendar days or 22 work days is considered a RIF, according to the Office of Personnel Management.⁴² Keeping vacant positions open through delayed hiring and delayed promotions is a better strategy, though not one that is always available or that will necessarily achieve the savings needed to meet the requirements of sequestration.

Despite these many challenges, the administration still has significant flexibility to avoid furloughs and RIFs. First, the Budget Control Act gave the president authority to exempt spending on military personnel, which he has chosen to do.⁴³ Second, for civilian personnel, Section 112 of the continuing resolution that funds federal programs through March 27 (H.J. Res. 117) provides the administration power to accelerate spending as necessary to avoid furloughs as follows:

Sec. 112. Amounts made available under section 101 for civilian personnel compensation and benefits in each department and agency may be apportioned up to the rate for operations necessary to avoid furloughs within such department or agency, consistent with the applicable appropriations Act for fiscal year 2012, except that such authority provided under this section shall not be used until after the department or agency has taken all necessary actions to reduce or defer non-personnel-related administrative expenses.⁴⁴

This authority comes on top of (and reinforces) OMB’s general flexibility to apportion federal funds at varying rates throughout the year. Moreover, the conference report language (H. Rept. 99-433) accompanying the original law that established the sequestration procedures used under the Budget Control Act of 2011 included the following admonition:

⁴⁰ Congressional Research Service, “Budget ‘Sequestration’ and Selected Program Exemptions and Special Rules,” April 27, 2012, p. 14. Available online at: <http://www.washingtonpost.com/r/2010-2019/WashingtonPost/2012/07/16/National-Politics/Graphics/crs%20report%20on%20sequestration.pdf>.

⁴¹ Sean Reilly, “Sequestration would mean tens of thousands of furloughs,” *Federal Times*, Sept. 24, 2012. Available online at: <http://www.federaltimes.com/article/20120924/PERSONNEL03/309240001/Sequestration-would-mean-tens-thousands-furloughs>.

⁴² Kellie Lunney, “Spending cuts likely to trigger furloughs,” *Government Executive*, September 6, 2012. Available online at: <http://www.govexec.com/pay-benefits/2012/09/spending-cuts-likely-trigger-furloughs/57920/>. See also Office of Personnel Management at http://www.opm.gov/reduction_in_force/.

⁴³ July 31, 2012, letter from OMB Acting Director Jeffrey D. Zients notifying Congress of the President’s intent to exempt military personnel accounts from sequestration, available at: <http://www.whitehouse.gov/sites/default/files/omb/legislative/letters/military-personnel-letter-biden.pdf>.

⁴⁴ See <http://www.govtrack.us/congress/bills/112/hjres117/text>.

The conferees urge program managers to employ all other options available to them in order to achieve savings required under a sequestration order and resort to personnel furloughs only if other methods prove insufficient.⁴⁵

Altogether, this legal authority is probably sufficient to avoid furloughs and RIFs for most federal agencies for at least several weeks. However, as is true of every other option described in this paper, just because the administration may have the authority to avoid personnel cuts does not mean that it will choose to use it. For example, Department of Defense officials have indicated that they may choose to furlough some civilian personnel to save money for other priorities.⁴⁶

Federal Contracts

Sequestration is likely to affect new contracts and existing contracts very differently. In general, while the number, size, and timing of new contracts may be affected during the sequestration period, existing contracts are much less likely to be substantially affected.

Existing contracts are less vulnerable because of the nature of sequestration. Sequestration only reduces budget authority – the legal authority that federal agencies have to obligate⁴⁷ federal funds to various projects. Most existing contracts were negotiated in previous years and were fully-funded from budget authority allocated in those years.⁴⁸ Such contracts would not be affected by sequestration, which only reduces new budget authority in 2013 and, in the case of defense, unobligated budget authority left over from previous years.

There are exceptions to this general rule, however, as has been pointed out by some legal experts who are advising federal contractors.⁴⁹ For example, the incremental costs of some ongoing, multi-year contracts are obligated annually, such as utility contracts or large construction projects, and these pre-existing contracts may be affected by sequestration.⁵⁰ Contract options are also considered obligations incurred in the year in which they are exercised, so options exercised after Jan. 2 may be affected by sequestration.⁵¹ A full discussion of the many variations in contracting is beyond the scope of this paper

⁴⁵ *Congressional Record*, vol. 131, Dec. 10, 1985, p. 35776, as cited in Congressional Research Service, "Budget 'Sequestration' and Selected Program Exemptions and Special Rules," April 27, 2012, p. 14. Available online at: <http://www.washingtonpost.com/r/2010-2019/WashingtonPost/2012/07/16/National-Politics/Graphics/crs%20report%20on%20sequestration.pdf>.

⁴⁶ Marcus Weisberger, "If cuts happen, troops, major weapons are DOD priorities," *Defense News*, Oct. 8, 2012. Available online at: <http://www.defensenews.com/article/20121008/DEFREG02/310080001/If-Cuts-Happen-Troops-Major-Weapons-DoD-Priorities?odyssey=nav|head>.

⁴⁷ According to GAO, an obligation is "[a] definite commitment that creates a legal liability of the government for the payment of goods and services ordered or received, or a legal duty on the part of the United States that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States. Payment may be made immediately or in the future. An agency incurs an obligation, for example, when it places an order, signs a contract, awards a grant, purchases a service, or takes other actions that require the government to make payments to the public or from one government account to another." See Government Accountability Office, "A Glossary of Terms Used in the Federal Budget Process," September 2005, p. 70. Available online at: <http://www.gao.gov/new.items/d05734sp.pdf>.

⁴⁸ See OMB Circular A-11 § 31.5, "Full Funding," (2012), p. 3 of Section 31. "Administration policy and the Antideficiency Act require you to have sufficient budget authority or other budgetary resources to cover the full amount of unconditional obligations under any contract." See also p. 3 of Appendix J. See http://www.whitehouse.gov/omb/circulars_a11_current_year_a11_toc.

⁴⁹ Examples include Portfolio Media Inc., "How Sequestration Will Impact Existing Gov't Contracts," at <http://www.crowell.com/files/How-Sequestration-Will-Impact-Existing-Govt-Contracts.pdf>; Venable L.L.P., "Sequestration: What Government Contractors Need to Know," June 2012. Available online at: http://69.63.159.240/chapters/wmacca/upload/VenableLLP_Sequestration-What-Government-Contractors-Need-to-Know.pdf.

⁵⁰ Portfolio Media Inc., p. 1.

⁵¹ *Ibid.*, p. 2.

but, in general, the amount of a contract that has been previously obligated (and is thus immune to sequestration) depends on what the agency has obligated itself to do in the contract.⁵²

Despite the exceptions, there have been many signs that the administration does not plan to substantially rework or reduce funding for existing contracts, even if it has the authority to do so. In a Sept. 28 letter, the Pentagon's Director of Defense Procurement and Acquisition Policy wrote:

The Department does not anticipate having to terminate or significantly modify any contracts on or about January 2, 2013, as a result of sequestration. As you know, sequestration reduces budget authority for the Department's unobligated funds for fiscal year (FY) 2012 and prior years and for all non-exempt appropriated funds for FY 2013. Most department contracts are fully funded; because they are obligated from FY 2012 and prior year funding, they would not be affected by sequestration. For contracts in place that are incrementally funded, any action to adjust funding levels would likely occur, if it occurred at all, several months after sequestration. Further, contracting officers will have some latitude to determine reduced funding requirements, and the Department will have the ability to reprogram dollars if warranted.⁵³

This analysis was backed up by Undersecretary of Defense Robert Hale, the Pentagon's comptroller and Chief Financial Officer, who told Reuters in a Sept. 20 interview that existing contracts would not be renegotiated. "Both because of the law and the way we'd implement it ... I don't see those sorts of large cancellation fees," Hale told Reuters.⁵⁴

At a Sept. 20 hearing of the House Small Business Committee, Michael McCord, Deputy Undersecretary of Defense, said the Pentagon would not reopen existing contracts but might buy less under such contracts if such cutbacks were allowed within the scope of the contract.⁵⁵

Sequestration is more likely to affect new contracts than old ones, specifically their number, size, timing of their announcement (many large contract announcements may be made before Jan. 2 or after sequestration has been reversed), and duration. According to an analysis of defense contracting and sequestration by the Center for Strategic and Budgetary Assessments:

The fact that sequestration acts on budget authority rather than outlays provides some insulation for defense companies because it allows more time for adjustment. If sequestration occurs, defense firms will be able to continue working on contracts already awarded because sequestration does not affect funding that has already been obligated. Sequestration will, however, affect DoD's ability to award new contracts and exercise options on contracts. Over time, this will result in a decline in revenues for defense firms, but it will be three or four years before defense companies feel the full impact of sequestration. This gives industry more time to adjust employment levels through natural attrition and early retirements rather than forcing immediate layoffs.⁵⁶

Even these effects will occur only if sequestration is not retroactively canceled in a budget agreement reached in early 2013. Altogether, the impact of a temporary sequester that is subsequently canceled is likely to range from small to non-existent for most existing and new contracts.

This reality helps explain why both the U.S. Department of Labor and the White House earlier this year discouraged defense contractors from issuing layoff notices to employees under the Worker Adjustment

⁵² Government Accountability Office, *Principles of Appropriations Law*, Third Edition, Volume II, p. 7-23. Available online at: <http://www.gao.gov/legal/redbook/redbook.html>.

⁵³ Available online at: http://www.federalnewsradio.com/pdfs/DPAP_letter.pdf.

⁵⁴ Andrea Shalal-Esa, "Pentagon does not see big cancellation fees from cuts," Reuters, Sept. 20, 2012. Available online at: <http://www.reuters.com/article/2012/09/21/us-usa-budget-contracts-idUSBRE88K00220120921>.

⁵⁵ Ibid.

⁵⁶ Todd Harrison, "Analysis of the FY 2012 Defense Budget and Sequestration," Center on Strategic and Budgetary Assessments, Aug. 24, 2012, p. 13. Available online at: <http://www.csbaonline.org/publications/2012/08/analysis-of-the-fy2013-defense-budget-and-sequestration/>.

and Retraining Notification (WARN) Act, a federal law that otherwise directs large federal contractors to issue such notices 60 days in advance if layoffs are “reasonably foreseeable.”⁵⁷ According to the Department of Labor:

Given that Federal agencies, including DOD, have not announced which contracts will be affected by sequestration were it to occur, and that many contracts may be completely unaffected, the actual contract terminations or cutbacks that will occur in the event of sequestration are unknown. Thus, in the absence of any additional information, potential plant closings or layoffs resulting from such contract terminations or cutbacks are speculative and unforeseeable.

Federal Grants

The treatment of federal grants under sequestration will be very similar to the treatment of contracts.⁵⁸ In general, most pre-existing one-year grants are considered fully obligated at the time they are made (typically when a binding grant agreement is signed)⁵⁹ and thus cannot be sequestered.

For this reason, any sequester of grant funding is likely to fall disproportionately on new grants, possibly affecting their number, size, timing of their announcement, and/or duration. For example, National Institutes of Health (NIH) Director Francis Collins has stated that an 8.2 percent sequestration of NIH funding would result in a cut in the number of new and competing grants by approximately one quarter.⁶⁰

The treatment of pre-existing, multi-year grants depends on how they were funded by Congress at the time they were awarded. Multi-year grant awards are often disbursed on an incremental basis, with award recipients receiving an initial year of funding and then being required to annually reapply for non-competitive “continuation grants.”⁶¹ In cases where these continuation grants draw down budget authority from an earlier year’s appropriation,⁶² the grant should not be affected by sequestration. More commonly, however, continuation grants are made contingent upon the “availability of funds.” In such cases, they generally draw on new budget authority and are thus subject to sequestration.

The Head Start program provides one example. In general, pre-existing grants carried over from 2012 would not be affected by sequestration. However, continuation grants for these grantees would be subject to sequestration when they came up for renewal in 2013. New awards and re-competed grants awarded in 2013 would also be subject to sequestration.

⁵⁷ Office of Management and Budget, “Memorandum for the Chief Financial Officers and Senior Procurement Executives of Executive Departments and Agencies,” Sept. 28, 2012. Available online at: <http://www.whitehouse.gov/sites/default/files/omb/memoranda/2012/m-12-19.pdf>. See also U.S. Department of Labor, “Advisory: Training and Employment Guidance Letter No. 3-12,” July 30, 2012. Available online at: http://wdr.doleta.gov/directives/attach/TEGL/TEGL_3a_12_acc.pdf.

⁵⁸ Government Accountability Office, *Principles of Appropriations Law*, Third Edition, Volume II, pp. 10-6 to 10-13. Available online at: <http://www.gao.gov/legal/redbook/redbook.html>.

⁵⁹ *Ibid.*, pp. 7-25, 10-40, 10-107.

⁶⁰ John Reichard and Jane Norman, “OMB: Sequester Would Slice NIH, Other Discretionary Health Spending by 8.2 percent,” *CQ Healthbeat News*, Sept. 14, 2012. Available at: <http://www.researchamerica.org/app/webroot/uploads/CQHEALTHBEATombsequestrationreport91712.pdf>. See also, Federation of American Societies for Experimental Biology, “Sequestration Would Deal a Devastating Blow to Medical Research,” Sept. 17, 2012. Available online at: <http://www.faseb.org/Portals/0/PDFs/opa/9.17.12%20NIH%20Sequestration%20Analysis%20FINAL.pdf>.

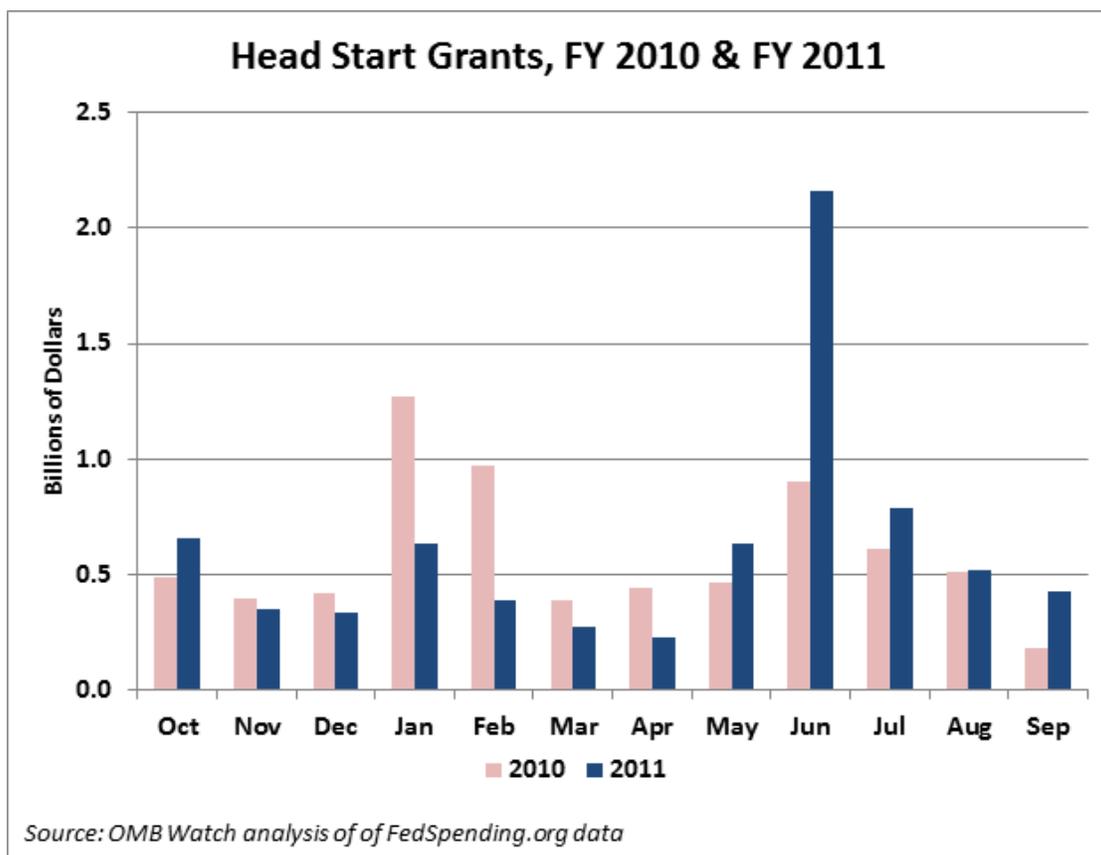
⁶¹ For example, see the rules on non-competing continuation awards at the Health Resources and Services Administration (HRSA) here: <http://www.hrsa.gov/grants/noncompetingcontinuations/index.html> and the Administration on Aging here: <http://www.aoa.gov/AoARoot/Grants/Continuations/index.aspx>.

⁶² A recent example discussed by GAO can be found at: General Accounting Office, “Department of Labor – Replacement Grants,” Aug. 3, 2012. Available online at: <http://www.aoa.gov/AoARoot/Grants/Continuations/index.aspx>. Another example is National Science Foundation standard multi-year awards, in which the entire grant amount is awarded at one time. See <http://www.nsf.gov/sbe/bcs/arch/awdfags.jsp>.

Timing matters. Continuation grants and new awards are made throughout the year. Grants awarded in January may be more vulnerable to sequestration than those awarded later in the year. Figure 1 illustrates the timing of Head Start grants throughout the federal fiscal year, which begins in October. Facing this pending flow of funding obligations, the administration may buy time by prioritizing continuation grants in January while delaying the announcement of new grants until later in the year.⁶³

It is unclear how grantmaking agencies would handle a retroactive cancellation. If grants announced during a sequester were reduced, they might be retroactively increased.⁶⁴ Alternatively, the budget savings might be applied to new grants awarded later in the year.

Figure 1: Distribution of Head Start Grants Throughout the Fiscal Year, FY 2010-FY 2011



Advance Appropriations

In general, programs that receive advance appropriations are substantially less vulnerable to a temporary sequester that is quickly canceled.

⁶³ Federal agencies commonly pursue similar strategies during continuing resolutions. See Government Accountability Office, *Continuing Resolutions: Uncertainty Limited Management Options and Increased Workload in Selected Agencies*, September 2009, pp. 15-16. Available online at: <http://www.gao.gov/new.items/d09879.pdf>.

⁶⁴ Ibid., pp. 18-19. See also: Government Accountability Office, *Principles of Appropriations Law*, Third Edition, Volume II, p. 10-108. Available online at: <http://www.gao.gov/legal/redbook/redbook.html>.

Advance appropriations are funds that Congress appropriates for use in a future fiscal year. A good example can be found in education, where advance appropriations are used to overcome differences between the federal fiscal year, which begins Oct. 1, and local school years, which begin earlier. Federal funding for the 2012-2013 school year, for example, was covered in part by FY 2012 regular appropriations, which became available in July, and by advance appropriations for FY 2013 enacted in 2012, which became available in October. Five major federal education programs are funded this way – ESEA Title I and II, Impact Aid, IDEA Part B, and Career and Technical Education State Grants – and 75 percent of their funding comes in the form of advance funding.⁶⁵

Programs that receive advance appropriations are less vulnerable to sequestration because of the greater time lag between appropriations decisions and actual spending and because of the discretion the administration has in implementing sequestration. In the case of advance-appropriated education programs, the U.S. Department of Education has indicated that if sequestration were to occur, sequestered funds would be taken entirely from regular FY 2013 appropriations, which would not be made available until July 2013 for the 2013-2014 school year.⁶⁶ If sequestration was subsequently canceled, the cancellation would almost certainly occur well before July and would thus have no impact on the state share of these funds (U.S. Department of Education employee-related costs may be handled differently, as explained elsewhere in this paper).

Transfers to State and Local Governments

Grants to state and local governments comprise a large share of spending by the federal government. In the president's FY 2013 budget, the administration estimated that total new budget authority for aid to state and local governments would be \$553 billion,⁶⁷ an amount approaching the \$614 billion in estimated budget authority for defense in that same year.⁶⁸ If an across-the-board 8.2 percent cut were applied equally to all federal aid to state and local governments, the impact would be comparable to cuts being imposed by sequestration on defense programs.

In reality, however, most federal aid to state and local governments is exempt from sequestration. The single largest source of federal aid is Medicaid, which by itself (\$269.4 billion) comprises about half of total federal aid for state and local governments⁶⁹ and is exempt. Other sources of exempt federal aid to state and local governments, according to the Sept. 14 report from OMB, include mandatory child nutrition programs (\$19.7 billion), Temporary Assistance for Needy Families (\$16.7 billion), the Children's Health Insurance Program (\$11.0 billion), foster care and adoption assistance (\$6.9 billion), child support enforcement (\$3.9 billion), and child care entitlement to states (\$2.9 billion).⁷⁰

Moreover, for non-defense programs, sequestration exempts unobligated funds carried over from previous years, so most highway funding (\$39.4 billion) and mass transit formula grant funding (\$8.4 billion) is

⁶⁵ Brustain & Manasevit, PLLC, "Sequestration Cheat Sheet." July 2012. Available online at: <http://www.azed.gov/no-child-left-behind/files/2012/07/sequestration-cheat-sheet.pdf>.

⁶⁶ U.S. Department of Education, Memorandum to Chief State School Officers, July 20, 2012. Available online at: <http://www2.ed.gov/policy/gen/guid/secletter/120720.html>.

⁶⁷ Office of Management and Budget, Budget of the United States Government, FY 2013, "Special Topic: Aid to State and Local Governments," Table 18-1, pp. 302. Available online at: <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/topics.pdf>.

⁶⁸ Office of Management and Budget, Budget of the United States Government, FY 2013, "Department of Defense," p. 84. Available online at: <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/defense.pdf>.

⁶⁹ Office of Management and Budget, Budget of the United States Government, FY 2013, "Special Topic: Aid to State and Local Governments," Table 18-1, pp. 299. Available online at: <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/topics.pdf>.

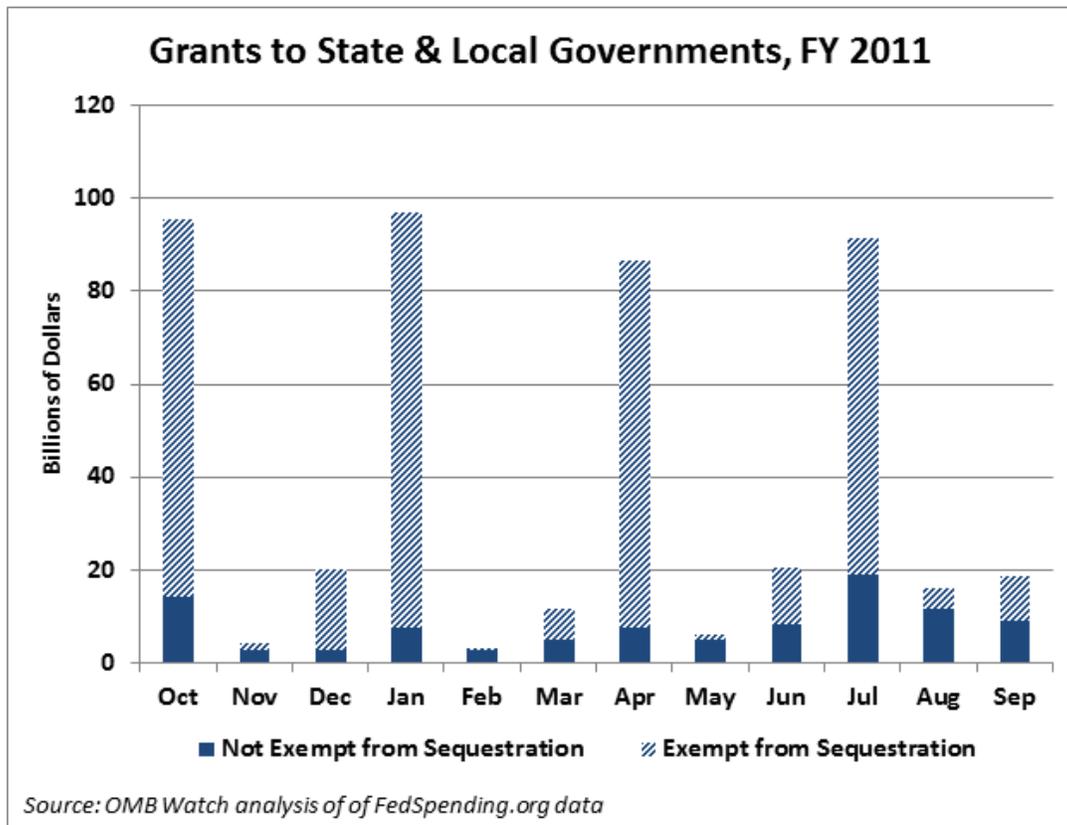
⁷⁰ Office of Management and Budget, *OMB Report Pursuant to the Sequestration Transparency Act of 2012* (P.L. 112-155), p. 131. Available online at: http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf.

exempt. Finally, as mentioned in the previous section, most education funding to states (about \$30 billion) is advance-appropriated, which means that it will not be affected by sequestration until July.⁷¹

While most federal aid to state and local governments is exempt, much is not. Major sources of aid that are subject to sequestration include tenant-based rental assistance from HUD (\$18.6 billion), children and families service programs at the Administration for Children and Families (\$9.9 billion), FEMA’s state and local programs and disaster relief (\$9.3 billion), the Women, Infants, and Children (WIC) program (\$6.6 billion), public housing operating funds from the Department of Housing and Urban Development (HUD) (\$4.0 billion), training and employment services programs at the Department of Labor (\$3.2 billion), EPA’s State and Tribal Assistance grants (\$3.6 billion), the Low-Income Home Energy Assistance Program (LIHEAP) (\$3.5 billion), HUD’s Community Development Fund programs (\$3.4 billion), mineral leasing payments (\$2.2 billion), the Social Services Block Grant (\$1.8 billion), and aging service programs at the Administration on Aging (\$1.5 billion).⁷²

In FY 2011, the last fiscal year for which detailed data is available, total federal grants to state, county, and municipal governments totaled \$472 billion (see Figure 2). Of this amount, \$376 billion (80 percent) was distributed through programs that are exempt from sequestration. Much of this funding, including Medicaid, is distributed quarterly on Oct. 1, Jan. 1, April 1, and July 1, which explains spikes in funding in those months. Funding for non-exempt programs, however, is distributed more evenly throughout the year.

Figure 2: Exempt and Non-exempt Funding to States, Counties, and Municipalities, FY 2011



⁷¹ Ibid.
⁷² Ibid.

Of the \$96 billion (20 percent) in funding that would be subject to sequestration, about \$7.7 billion was distributed in January – less than two percent of all federal aid to state and local governments that year. In general, if a temporary sequester occurred in January, its effects on this portion of state and local funding could be mitigated using strategies described elsewhere in this paper.

Payments for Individuals

Total federal spending on payments for individuals will be an estimated \$2.49 trillion in 2013, according to OMB estimates.⁷³ Excluding Medicare, at least 90 percent of these payments for individuals are exempt from sequestration.

Using OMB's definitions and projections for outlays in 2013,⁷⁴ programs with significant payments for individuals that are exempt from sequestration include: Social Security old age, survivors, and disability (\$819 billion in outlays), Medicaid (\$283 billion), federal employee and military retirement and insurance (\$201 billion), Supplemental Nutrition Assistance Program, or SNAP (\$83 billion), exempt regular state unemployment insurance payments (\$52 billion),⁷⁵ payments under the earned income tax credit (\$53 billion), Supplemental Security Income (\$51 billion), hospital and medical care for veterans (\$45 billion), Pell Grants (\$36 billion),⁷⁶ child tax credit payments (\$23 billion), child nutrition programs (\$20 billion), the Children's Health Insurance Program (\$10 billion), foster care and adoption assistance (\$7 billion), and child care entitlements (\$3 billion).

Medicare is subject to sequestration, but the reduction is capped at two percent (about \$11 billion), and it is applicable only to payments to providers such as hospitals and physicians (Medicare Parts A and B) and health insurance plans (Medicare Parts C and D, including Medicare Advantage plans and prescription drug insurance). Medicare's benefit structure and coverage for individuals will remain unchanged.⁷⁷ If Medicare payments for individuals are included in the analysis and treated as unaffected, over 92 percent of *all* federal outlays for individuals will be effectively exempt from sequestration in 2013.

Nevertheless, there are still some programs with significant payments for individuals that remain subject to sequestration. Two significant examples include the Low-Income Heating and Energy Assistance Program (LIHEAP) and Women, Infants, and Children (WIC) program. For these programs, the administration might be required to resort to accelerated apportionment (described earlier) to prevent cuts from being felt in early 2013.

Conclusion

This paper has described several ways that the president and his administration can, if they choose, manage and mitigate the impact of a short-term sequester in early 2013. This authority is not unlimited. It depends on sequestration lasting a relatively short period of time – perhaps no more than a month – and on the president and Congress agreeing to cancel sequestration retroactively to the beginning of the year.

⁷³ Office of Management and Budget, Budget of the United States Government, *FY 2013 Historical Tables*, Table 11.3, p. 248. Available online at: <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/hist.pdf>.

⁷⁴ Ibid.

⁷⁵ OMB Watch estimate based on OMB's estimate of exempt budget authority for the unemployment insurance program in 2013. See Office of Management and Budget, *OMB Report Pursuant to the Sequestration Transparency Act of 2012* (P.L. 112-155), p. 131. Available online at: http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf.

⁷⁶ This figure is a subset of student assistance outlays and is based on information in the president's proposed education budget for FY 2013. See Office of Management and Budget, Education, p. 66. Available online at: <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/education.pdf>.

⁷⁷ Congressional Research Service, *Budget 'Sequestration' and Selected Program Exemptions and Special Rules*, April 27, 2012, pp. 8-11. Available online at: <http://www.washingtonpost.com/r/2010-2019/WashingtonPost/2012/07/16/National-Politics/Graphics/crs%20report%20on%20sequestration.pdf>.

Current law gives the administration substantial power to mitigate sequestration, but if a sequester were to last more than a few weeks, its effects would be felt. Predicted program cuts and job losses would eventually materialize.⁷⁸

In its September report to Congress, the Obama administration labeled sequestration “a blunt, indiscriminate instrument and not a responsible way to make policy.”⁷⁹ This judgment remains true. If triggered, the worst effects of sequestration may be avoided temporarily – long enough for Congress to consider alternatives – but they can only be postponed for a while.

⁷⁸ Congressional Budget Office, “An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022,” Aug. 22, 2012, pp. 25, 36. Available online at: http://www.cbo.gov/sites/default/files/cbofiles/attachments/08-22-2012-Update_to_Outlook.pdf.

⁷⁹ Office of Management and Budget, *OMB Report Pursuant to the Sequestration Transparency Act of 2012* (P.L. 112-155), p. 4. Available online at: http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf.