

**Date:** September 18, 2012

**Subject:** Federal Budget Sequestration Update

The Budget Control Act (BCA) of 2011 (PL 112-25) identified a number of actions and deadlines aimed at ending the 2011 debt-ceiling crisis and preventing sovereign default. The BCA set discretionary spending caps, outlined procedures for increasing the federal debt limit, and tasked a bipartisan Congressional Joint Select Committee on Deficit Reduction with determining an additional \$1.5 trillion in deficit reduction. To encourage the Committee's success, the BCA included a penalty for failing to reach an agreement: automatic spending cuts imposed on discretionary and mandatory federal programs to ensure that at least \$1.2 trillion in deficit reduction (beyond the discretionary caps) is achieved between 2012 and 2021 – also known as the 'sequester.' As the Committee did indeed fail to reach an agreement, some \$110 billion in cuts – equally divided between defense and domestic programs – will take place on January 2, 2013 if Congress does not take action to "turn off" or otherwise modify the sequester. While some federal programs will be exempt from the sequester, such as social security, Medicaid, food stamps, and veterans' benefits, virtually all of the programs that fund university-based research and training will feel the effects of sequestration.

Last Friday, the federal Office of Management and Budget (OMB) released a report estimating the sequester's impacts at 8.2 percent across the board spending cuts in all non-exempt, nondefense discretionary spending. Additionally, defense-funded research and development will experience cuts of 9.4 percent. These cuts will occur if Congress cannot determine an alternative to the sequester before January 2, 2013, such as delaying the cuts or replacing them with targeted cuts to specific program areas.

**The threat of sequestration occurs during an already difficult federal fiscal year:**

- Congress already cut \$900 billion in federal funding last year as part of the BCA.
- The Congressional Budget Office (CBO) estimates the federal deficit for FY12 will total \$1.1 trillion, the fourth year in a row with a deficit of more than \$1 trillion.
- Federal debt held by the public will reach 73 percent of GDP—the highest since 1950 and approximately twice the percent measured in 2007.<sup>1</sup>

**Potential impact on the economy:**

A large decrease in federal spending and simultaneous increase in income taxes (when Bush-era tax cuts expire on January 1, 2013) could create a "fiscal cliff," dropping a still fragile economy back into recession. CBO forecasts that the nation will enter a deep, second recession in 2013 if Congress does not address the sequester and expiring tax cuts.

**What this means for the UW: loss of federal grants and subsidized aid for students.**

- Reductions in federal research grants and contracts. Federal agencies that provide research grants and contracts for the UW community are expected to receive between 7.6 and 9.4 percent in cuts for FY13 depending on funding source.<sup>2</sup> For example, the recent OMB report states that the National Institutes of Health (NIH) and Health Resources and Services Administration (HRSA) will be subject to 8.2 percent in discretionary program cuts and 7.6 percent mandatory appropriations. The UW community should plan accordingly for these cuts as well as

---

<sup>1</sup> <http://www.cbo.gov/publication/43539>

<sup>2</sup> <http://www.cbo.gov/publication/42754>

potential cuts to research centers benefiting from multi-year funding.<sup>3</sup> Overall, the sequester could reduce UW's federal grant and contract support by an estimated \$85 million during FY13.

- Student loans may suffer even more. In FY13, all federal student aid programs except for Pell Grants will experience 8.2 percent in budget cuts (the BCA specifically protects FY13 Pell funding at this time). Unfortunately, financial straits have already caused the federal government to eliminate many student loan benefits this year. As of July 1<sup>st</sup>, students no longer receive a six-month, interest-free grace period for loan repayment; graduate students no longer qualify for subsidized Stafford Loans; and incentives for early loan repayment (such as reduced interest rates) have been discontinued.<sup>4,5</sup>

#### **In the coming months:**

- In September, Congress will approve a six-month continuing resolution (CR) to delay FY13 spending decisions until next year and free up time for legislators to deal with expiring tax cuts and the budget sequester. The goal of the CR is to avert a government shutdown when the new fiscal year begins October 1<sup>st</sup>. The CR will fund federal programs at roughly FY12 levels through March 27, 2013 or until Congress takes further action on the FY13 budget.
- In November, election results will dictate much of the final outcome. Depending on the outcome of the November elections, Republicans could gain more control in Congress or the White House and then advance their priorities to drastically cut discretionary spending and shore up defense spending. If Democrats maintain control of the White House and Senate, they will certainly demand that taxes be considered as a way to reduce the deficit. They may also allow all of the Bush-era tax cuts to expire, including the American Opportunity Tax Credit (AOTC) and employer-provided educational assistance benefits.
- In December, Congress will reconvene for a "lame duck" session. Congress needs to address several issues before the end of the calendar year. In addition to the expiring Bush-era tax cuts and possible action to modify the sequester, Congress must take action on Medicare payments to physicians (Sustainable Growth Rate, or SGR) and emergency unemployment insurance.

#### **Next steps for the UW:**

- Formal planning process: The UW may establish a formal process for assessing updates related to the sequester and planning its operations and actions accordingly.
- Communicating with the UW community: The Offices of Research, Federal Relations, and Planning & Budgeting will release additional information as it becomes available. Following the elections in November, we will be able to provide more concrete details regarding how the sequester will affect the community.

For more information about the sequester and to monitor ongoing developments related to federal budget reductions, please visit the UW's Federal Relations blog at: [www.washington.edu/federalrelations/](http://www.washington.edu/federalrelations/).

<sup>3</sup> [www.washington.edu/federalrelations/?fedr=Sequestration\\_Details.pdf](http://www.washington.edu/federalrelations/?fedr=Sequestration_Details.pdf)

<sup>4</sup> <http://www.staffordloan.com/stafford-loan-info/graduate-stafford-loan.php>

<sup>5</sup> <http://www.npr.org/2012/06/30/156024236/the-flip-side-of-the-federal-student-loans-deal>