CORNERSTONE
GOVERNMENT AFFAIRS

MEMORANDUM

TO: CORY KENNEDY, RICE UNIVERSITY

FROM: SUSAN SWEAT, CORNERSTONE GOVERNMENT AFFAIRS

SUBJECT: OVERVIEW OF OMB'S FY2013 SEQUESTRATION GUIDANCE

DATE: SEPTEMBER 18, 2012

MAJOR TAKE-AWAYS:

1) The OMB Sequestration Report sets only a minimum level of cuts to expect. It:
   - Projects 9.4 percent cuts to most discretionary defense spending programs
   - Projects 8.2 percent cuts to most nondefense discretionary programs
   - Exempts some military personnel accounts from sequester
   - Is flawed because:
     - Its baseline is the FY12 level, not the higher CR level the government will be operating under through March
     - It does not include sufficient detail to show how specific accounts will be treated

2) No efforts to stop sequestration will occur until after the election, and even then competing priorities and changes in the political landscape could thwart those efforts.

3) Even if Congress makes changes to sequestration, it is likely that nondefense accounts will be cut even more.

BACKGROUND:

As you know, the Budget Control Act of 2011 (BCA), enacted in August 2011 after heated negotiations, sets caps on discretionary spending and creates a series of automatic spending cuts, known as sequestration. An automatic sequestration of $1.2 trillion will be triggered on January 2, 2013. Approximately $109 billion will be sequestered from discretionary programs in Fiscal Year 2013, half from defense accounts and half from non-defense accounts. The caps on spending for FY14-FY21, after the initial FY13 sequestration cuts, will achieve the balance of the savings.

The BCA does not lay out any specific program funding cuts but does require cuts among large categories of spending. The BCA requires cuts to mandatory spending amounting to approximately 29 percent of the $1.2 trillion in reductions. Of this, 16 percent of savings will be due to lower debt service and 13 percent will come from an automatic sequestration of mandatory spending. Several mandatory programs, and portions of programs, are exempt

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from the sequestration process, including Social Security benefits and Medicaid. There also is a limit of 2 percent on cuts to Medicare.

For FY12 and FY13, the BCA created two caps on discretionary spending, a "security" spending cap and a "non-security" spending cap. The security category is mostly limited to the Department of Defense. After FY13, there is just one overall cap. If Congress adheres to the caps for the entire 10 years, it will appropriate about $825 billion less than if it appropriated the same level of resources, adjusted for inflation, as in FY11.

OMB GUIDANCE:
Under the BCA, the White House Office of Management and Budget (OMB) is tasked with calculating the sequestration and annual spending cap targets. Therefore, OMB will have some responsibility in interpreting which programs and portions of programs are exempt from sequestration – unless Congress intervenes.

On Friday, September 14, the Office of Management and Budget (OMB) provided ***limited*** details on the accounts impacted sequestration. The report projects a 9.4-percent cut in most defense discretionary spending programs and an 8.2-percent cut in most domestic discretionary spending programs. Congress exempted certain low-income programs from cuts, which the report reflects. In addition, OMB identifies military personnel accounts that the President indicated his intent to exempt from sequestration under section. Of course, **the number of programs exempted from sequester will only increase the impact the cuts have on the remaining programs.**

Here are the top-line cuts to programs heavily utilized for university research:

National Institutes of Health	$2.5 billion
National Science Foundation (NSF), research	$469 million
NASA, science	$417 million
National Institutes for Standards and Technology (NIST), research	$47 million
Department of Energy, science	$400 million

The OMB report only provides sequestration numbers for top level budget accounts. Further OMB guidance (not likely to be released until after the election) is necessary to show reductions for each account at the program, project, and activity (PPA) level. This PPA level guidance will allow stakeholders to estimate cuts with a higher level of fidelity. For instance, the National Institutes of Health (NIH) budget is expected to be cut by over $2 billion. However, the OMB report did not break these cuts out by Institute, nor did it outline whether or not cuts are expected to come from existing grants, personnel accounts, or future grants. The BCA protected "unobligated balances, carried over from prior years, for nondefense programs" from sequestration. And since we believe that the NIH will resist laying-off its own staff, **we anticipate that future extramural grants will be targeted to bear the brunt of the cuts.** We have some concern that non-competitive renewal grants could also be impacted to a lesser degree. These concerns are relevant across almost all agencies due to a lack of detailed PPA-level information. **We anticipate that future guidance at the PPA level will exempt more accounts and continue to shift the burden of cuts.**

As previously stated, the BCA made many programs targeting low-income Americans exempt from sequestration, including the Pell Grant program. However, most other financial aid programs would be cut and student loan origination fees made under the Federal Direct Loan (DL) program, which includes Subsidized and Unsubsidized Stafford Loans, and PLUS Loans, will increase by 7.6 percent.

INTERACTION WITH THE CONTINUING RESOLUTION (CR):
Congress is finalizing a Continuing Resolution (CR), which will fund the government through March 31, 2013 – the first half of FY13. The CR funding level is slightly *higher* than the FY12 funding level. The OMB sequestration guidance report reflects cuts to the FY12 level. OMB has issued guidance to agencies urging them to continue spending as if sequestration will not occur and notified them that if sequestration does occur, it will <u>not</u> pull back FY13 CR monies. **The net result is that cuts will likely be even deeper than anticipated in the OMB report since they will almost all be felt in the second half of a fiscal year which started with funding increases.**

FUTURE:
While Congress could act to replace sequestration with some other formula or method of cutting, it is unlikely given the previous failed attempts at compromise and the current state of play. If Congress does consider changes to the sequestration it will be addressed in the lame duck session after the election and with a group of other policies, collectively known as the "Fiscal Cliff." Those policies include the expiring Bush-era tax cuts and the need to raise the statutory debt ceiling. President Obama has threatened to veto any legislation which delays sequestration, and he has made it a main tenet of his campaign that he will allow taxes to increase for the top rate. Also, Speaker Boehner has made it clear in private negotiations that he will not allow the debt ceiling to increase again without additional budget cuts, and he will have difficulty with much of his caucus on the issue of delaying sequestration.

To the extent that sequestration is addressed in any Fiscal Cliff legislation in the lame duck, it is likely to focus on the impact of cuts to the Department of Defense. Defense hawks in Congress and the Administration have had been working to avoid sequestration cuts in national security accounts for over a year. **Many bipartisan, coordinate efforts are underway to shift DoD funding cuts to the discretionary nondefense accounts.** Many view those efforts as the most likely to achieve any measure of success in avoiding sequestration.

The House passed a bill last week that requires the president to send to Congress by Oct. 15, legislation to replace the automatic, across-the-board spending cuts with more targeted cuts. The bill does not allow the president's legislative alternative to include revenue increases. The administration opposes the bill, which is unlikely to be considered in the Senate.

Until OMB issues more detailed guidance and negotiations resume after the election, we believe that our previous recommendation made in January 2012 is still relevant:

> ***While it is unlikely that these cuts will result in reductions to existing grants, it is highly probable that renewals could be canceled and future awards drastically reduced. In addition, research centers enjoying annual appropriations support could see their funding eliminated as well. It is our recommendation at this time that Rice prepare for <u>at least</u> proportional cuts of 8 percent for NIH- and NSF-supported research and 10 percent to DoD-supported research to its federal portfolio.***

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As always, please do not hesitate to contact us with questions or concerns.