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The Sequestration Process

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Sequestration is the cancellation of budgetary resources for the purpose of enforcing statutory budget limits and pay-as-you-go (PAYGO) requirements. This process is triggered automatically when these statutory limits or PAYGO rules have been violated as a result of legislative actions.

The sequestration process was first established in 1985 by the Balanced Budget and Emergency Deficit Control Act (title II of P.L. 99-177), commonly known as the Gramm-Rudman-Hollings Act. Initially, the sequestration process was tied to annual maximum deficit targets, declining to zero by a date certain, established by the law. If the budget deficit exceeded those target levels (plus a margin-of-error amount in some years), automatic across-the-board spending cuts would be triggered. The process was intended to provide an incentive to Congress and the President to reduce the deficit through legislative action to avoid an automatic sequestration. The law was amended and modified in 1987, 1990, 1993, and 1997. Most notably, the Budget Enforcement Act (BEA) of 1990 (title XIII of P.L. 101-508) changed the focus of the sequestration process. Instead of maximum deficit targets, the BEA of 1990 tied sequestration to new statutory spending limits and PAYGO rules. The change was intended to hold Congress and the President accountable for projected budget outcomes that would result from new legislation, rather than the level of the deficit which could be affected by factors beyond their direct control, such as economic growth, inflation, and demographic changes.

The current process includes two separate sequestration procedures: (1) the discretionary sequestration process, which applies to discretionary spending funded through the annual appropriations process, and (2) the PAYGO sequestration process which applies to direct spending and revenues.

Currently, discretionary spending limits exist for the following categories: highway and mass transit spending for FY2001-2002; conservation spending for FY2002-2006; and other discretionary spending, also called general purpose discretionary spending, for FY2001-2002. For more information on the discretionary spending limits and how they may be adjusted, see CRS Report RS20008, *Discretionary Spending Limits.*

Sequestration is triggered automatically if the applicable spending cap is exceeded through the enactment of legislation. The Office of Management and Budget (OMB) publishes preview and update sequestration reports on the status of discretionary spending and the appropriate limits during the year. The Congressional Budget Office (CBO) publishes similar reports, but these are advisory only. The final OMB sequestration report, published 15 days after the end of each congressional session, is the one that can automatically trigger a sequestration order. If the OMB director determines that a spending limit has been breached, the President is required to issue a sequestration order permanently canceling budgetary resources (except for revolving funds, special funds, trust funds, and certain offsetting collections) by the amount of the breach in nonexempt programs by a uniform percentage in the applicable category. A within-session sequestration is possible if a supplemental appropriations bill causes the spending levels of the current fiscal year to exceed the statutory limit for a particular category. If a violation of a discretionary spending limit occurs in the last quarter of the fiscal year (*i.e.*, July 1 through September 30), the applicable spending limit must be reduced by the amount of the violation for the following fiscal year.

The 1990 BEA created a separate sequestration procedure to enforce PAYGO rules that apply to direct spending and revenues. The PAYGO rules apply to legislation through FY2002, but the PAYGO sequestration procedure applies to the net deficit effects of that legislation through FY2006. PAYGO rules require that an increase in direct spending or a decrease in revenues must be offset by an equal amount of spending reductions, revenue increases, or a combination of the two so that the budgetary effect of new legislation is not projected to increase the deficit, or reduce the surplus, for any fiscal year through FY2006. As with the discretionary spending sequestration process, OMB and CBO publish reports on the status of new legislation affecting direct spending and revenues. OMB also maintains a PAYGO scorecard that keeps track of the net impact on the deficit or surplus resulting from new direct spending and revenue legislation. If the OMB director determines in the final sequestration report that the net effect of new legislation has caused a deficit increase or surplus reduction on the PAYGO scorecard, the President is required to issue a sequestration order reducing most, but not all, nonexempt direct spending programs by a uniform percentage offsetting the amount of the net deficit increase, or surplus reduction.

Social Security benefits, federal deposit insurance guarantee commitments, and any direct spending or revenue legislation the President and Congress designate as an emergency requirement are excluded from PAYGO calculations. While the remaining direct spending programs are included in the PAYGO scorecard calculations, most are exempt from reduction (see section 255 of the Deficit Control Act, as amended). In addition, the Medicare program is limited to a 4% reduction in direct spending. For more information on the PAYGO procedures, see CRS Report RS20006, *Pay-as-you-go Rules in the Federal Budget Process*.

The sequestration process may be suspended in the event of war or a period of low economic growth. First, the sequestration procedures are suspended upon the enactment of a declaration of war by Congress. Second, Congress may enact a joint resolution suspending sequestration procedures whenever CBO issues a low-growth report. As required by section 254(j) of the Deficit Control Act, a low-growth report will be issued when OMB or CBO forecasts two consecutive quarters of negative real economic growth during a six-quarter period, or when the Department of Commerce reports that the actual rate of real economic growth for two consecutive quarters is less than 1%.