



# How Sequestration Would Work

## Estimating the Consequences of Sequestration on Agency Performance, Personnel, and the Employees of Federal Contractors

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### Introduction

Much has been written about the automatic, across-the-board budget cuts contained in the Budget Control Act of 2011, otherwise known as “sequestration,” but many critical questions remain regarding official interpretations of the legislation and how it will actually be implemented on an agency-by-agency basis. These include questions as to exactly which governmental spending accounts are or are not subject to sequestration, how deep the percentage reduction will be in the accounts that are subject to sequestration, how much latitude agencies have in selecting the specific expenditures that will be cut, and what the offsetting expenditures will be in implementing the proposed cuts.

It is nonetheless critical that policymakers begin to understand the possible implications of the legislation particularly with regard to critical governmental services that may impact the broader economy and public safety as well as the degree to which specific sectors of the economy will be impacted and the long-term implications for performing the missions assigned to government agencies in an efficient and cost-effective manner. To do so, however, requires considerable degree of subjective judgment at this point in time. This issue brief examines some of these judgments.

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### Understanding the legislative intent of sequestration

Various estimates of the across-the-board cuts that would be required in programs subject to sequestration range between 8.5 percent and 10 percent for fiscal year 2013. Those numbers vary largely on how the estimator interprets some of the more vague portions of the legislative language that describes which programs and activities are to be included or excluded from the cuts. It should be noted, however, that while the next fiscal year begins on October 1, 2012, the sequestration does not begin until January 2, 2013. As a result, programs that operate at a fairly steady spending level during each month of the year

would have to make cuts during the nine-month period that the sequestration is in effect. On a percentage basis the cuts would have to be about a third larger than the 8.5 percent to 10 percent required for the year as a whole. Such programs would face cuts of between 11.3 percent and 13.3 percent during that nine-month period.

But sequestration would impact different programs across the government in very different ways. With government grant programs such as Title I of the Elementary and Secondary Education Act, the impact can be estimated with some degree of precision. If an omnibus appropriations bill or a continuing resolution is enacted this fall to fund this program at the current annual level of \$14.5 billion (the president's request for fiscal year 2013), then a sequestration of 9 percent would result in \$1.3 billion less being disbursed to the states. The formal allocation of those funds will not occur until toward the end of fiscal year 2013—a year from this coming August—and will fund school districts for the 2013-14 school year. If one knows the amount of Title I funding a particular school district is now receiving, they can estimate that they will get about 91 percent of that amount in the school year that begins a year from this coming September.

With federal government contracts, however, the question becomes much more complicated. The original sequestration language was added to the Congressional Budget Act of 1974 by the Gramm-Rudman-Hollings amendment of 1985. Last August's debt ceiling legislation—the Budget Control Act ([page 42, line 13](#))—requires that sequestration be implemented in exactly the manner prescribed in Gramm-Rudman-Hollings, which requires that across-the-board cuts be applied evenly by “program, project and activity.” Precisely what that phrase means varies by department, agency, and program.

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## Different consequences for different agencies

In the Department of Defense, activities within the procurement budget are defined very narrowly. Most budget analysts who have examined the issue believe that each ship funded in the Navy budget would be defined as a separate activity. As a result, if the Navy were budgeted to issue contracts on 10 ships in fiscal year 2013, then it would not be permitted to cancel one of the ships but would have to apply the cuts equally across each of the 10 ships. In some instances it is possible that this will push a construction project below a pace of operations that makes ship construction far more expensive.

In contrast, Department of Defense operations and maintenance accounts, which are used to buy spare parts, fuel, and cover repair costs, have very broad definitions of program, project, and activity. As a result, the department might be able to choose among dozens or perhaps hundreds of contracts to reduce or cancel completely in meeting the reduced spending requirement.

In many instances there will be serious repercussions for the government of reducing specific contracts as a result of the wording of an underlying agreement between the government and the federal contractor or as a result of the nature of the product or the service being provided. Budget officers would be obliged to examine each contract and attempt to make reductions in ways that inflict the least harm on the taxpayer or the ability of the government to buy important services or products in the future. As a result, predicting the impact of sequestration on contracts is highly complex and uncertain.

In the end we know that we have more than \$500 billion in contracts and that sequestration will cancel or reduce about \$50 billion of them. Beyond that it will take many months of painstaking review to know how deeply any one contract is likely to be cut.

The Office of Management and Budget recently estimated that each \$92,000 in federal expenditures creates one job. If that math is applied to the contract budget, then the \$530 billion we were reported to have spent on contracts last year would have created about 5.8 million jobs. Sequestration could be expected to result in layoffs or reductions in force for about half a million of those employees. But because of the uncertainty that we are likely to continue to face with respect to which contract will be affected and by how much, layoff notices may likely be sent to several times that number of people.

Perhaps the greatest uncertainty exists with respect to how sequestration will impact the federal work-force. In some instances agency personnel may be integrated into agency contract spending or grant disbursements. In those instances it may be possible to protect needed staff by applying a disproportionate reduction to grants and contracts. But in many critical activities of the federal government, the entire budget of an activity is for the salaries and expenses of the workforce.

An example I have used repeatedly is the Food Safety Inspection Service but there are hundreds if not thousands of other agencies throughout the government with the same problem. For instance, since the modernization of the equipment used in air traffic control is likely to be ruled a separate activity from personnel expenditures required to operate the system, the Federal Aviation Administration will likely be forced to make very substantial reductions in the payroll expenditures for air traffic controllers. The same situation exists with respect to agents and the Federal Bureau of Investigation, Internal Revenue Service auditors, Social Security Administration personnel, and so forth.

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### Layoffs versus furloughs

There are several methods by which these payroll savings may be accomplished. One would be a reduction in force—a formal process by which an employee is terminated from the payroll of an agency. Since the sequestration could theoretically last for

multiple years, this might seem like a sensible course for many agencies to take. The problem, however, is that the government, just like employers in the private sector, faces significant termination costs when employees are RIF'ed.

In many instances half or more of the first year's savings from a reduction in force are lost in termination costs. An RIF initiated in the second quarter of a fiscal year is likely to produce little or no savings in that fiscal year. As a result, an RIF eliminating the entire workforce of the FBI or the Food Safety and Inspection Service might not achieve a 9 percent or 10 percent savings as mandated by the Budget Control Act.

Budget officers at these and other agencies, however, believe that they have found a way around this through the massive use of furloughs, or the temporary layoff of employees. Since the 8.5 percent to 10 percent annual savings mandated by sequestration must be attained within nine months or over a 39-week period, the reduction in payroll required in that period would be about 12 percent. If every employee in an agency were furloughed for 4.7 weeks during that nine-month period, then theoretically those savings could be achieved.

But what about the cost of implementing this massive and perhaps intermittent schedule of furloughs? The Office of Personnel Management told me that they know of no analysis that has been performed anywhere inside the government estimating such costs, which in fact might be very significant. Anyone familiar with the administrative and human resource challenges associated with layoffs—and in this instance repeated layoffs—recognize that they require significant amounts of planning, coordination, and communication.

Further, each employee that is furloughed has certain rights under federal law to appeal the furlough and the cost of reviewing the appeal could be substantial. Obviously, the more costs associated with furloughs, the more weeks of furlough that will be required to meet the sequestration mandate.

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## Conclusion

This discussion provides only approximate guidance based on numerous—almost always off the record—conversations with a wide range of budget professionals. In many instances the judgments they shared with me were speculations based on only partial information. This is, however, the best information I have been able to uncover about how this extraordinary process will unfold. There is a great deal of work that will need to be done if this nonsensical legislation is to be implemented in a manner that does the least damage to the government and the country.

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