



Update on Federal Sequestration

A Briefing for the Senate Finance Committee

Richard D. Brown
Secretary of Finance
Commonwealth of Virginia
www.finance.virginia.gov

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Why is Federal Fiscal Policy Important

Virginia's Ranking Among the States for Per Capita Amounts of Federal Government Expenditures Fiscal Year 2009

<u>Category</u>	<u>Rank (Highest=1)</u>
Retirement and Disability	5
Other Direct Payments	39
Grants	49
Procurement	1
Salaries and Wages	4
Total Expenditures	2

Milestones on Sequestration Timeline

- **August 2, 2011:** The Budget Control Act of 2011 was signed into law. This act provided that, if a Joint Select Committee did not produce bipartisan budget reduction legislation, across-the-board spending cuts would take effect on January 2, 2013.
- **January 2, 2013:** The American Taxpayer Relief Act of 2012 was signed into law, delaying the sequester until March 1, 2013.
- **March 1, 2013:** With no budget deal reached, President Obama signed an order putting the sequestration cuts into effect.
- **March 6, 2013:** A Continuing Resolution was passed to fund the government at current levels, adjusted by the cuts for sequestration.

Milestones on Sequestration Timeline

- **June 13, 2013:** Department of Defense projected furloughs on civilian employees revised downward from 22 days originally to only 6 days.
- **October 1, 2013:** If no budget deal, much of the federal government would shut down. Congress could pass another Continuing Resolution, funding the government at last year's levels.
- **Mid-October:** Timeframe for when debt ceiling will be hit, without some agreement to deal with it.

Potential Outcomes: What's On the Table

- Absent any agreement on appropriation bills or a Continuing Resolution (CR), the federal government will shut down nonessential operations on October 1 due to lack of funding.
- Under current law, appropriation levels are set by sequester. The sequester cuts for FY2014 will cause discretionary spending levels to be \$91 billion below what was previously agreed to for FY2014, or \$967 billion. This is equal to \$20 billion below the sequestered FY2013 level with most of the additional cuts in defense.
- The Senate has been marking up their funding bills at pre-sequester levels that are \$91 million more than what current law allows.
- The House originally attempted to pass appropriation bills that would have placed sequester cuts onto non-defense programs.

Potential Outcomes: What's On the Table

(Cont'd)

- On September 11, the House Appropriations Chairman introduced a CR (H.J.Res. 59) that would continue government spending through December 15 and provide funding at annualized rate of \$986.3 billion – slightly below current FY2013 levels (including sequestration). Some flexibility is given for certain programs (Customs and Border Protection, Forest Service, Veterans Benefits, Administration, weather warnings and forecast, chemical or biological attacks, etc.).
- Process is now tied up with other issues (Syria, funding of Affordable Health Care Act, etc.).
- Prospects: ? ? ? Also, ? ? ? about debt ceiling in mid-October

So What If Sequestration Continues in FY2014

- Appropriators would be required to appropriate no more than \$967 billion in new discretionary funds, about \$20 billion less than what was appropriated (after sequestration) for FY2013.
- Cuts would hit defense hardest. No service branch is planning unpaid furloughs for FY2014; instead, there would be “reductions in force” or RIF’s.
- Prior predictions of consequences of sequestration have been overstated on a number of fronts. (See attached Washington Post Tracking article)
- Nonetheless, there are real risks.
- Department of Defense (DOD) says it may have to shed 6,272 civilian employees if sequester cuts continue in FY2014. Also, it would result in:
 - 10% less in equipment than budget request (\$475 billion vs. \$426.6 billion)
 - 16% reduction in Pentagon procurement and research spending, and
 - 12% cut in operations, maintenance and military construction.

So What If Sequestration Continues in FY2014 (Cont'd)

- The Army indicates it would lose more than 2,100 workers out of 263,900 person civilian workforce,
 - The Navy estimates it would cut up to 2,672 of 214,000 people,
 - The Air Force will require targeted reductions to its 185,400 person civilian workforce but no number, as of yet, has been given,
 - Department-wide agencies would RIF 1,500 people from an estimated workforce of 137,000, with most from the Defense Control Management Agency.
- In Virginia, a planned overhaul to the USS George Washington aircraft carrier would be delayed. Last overhaul, in 2005, lasted about 6 months, and involved more than 10,000 separate job requirements.

The Uncertainty Has Consequences

- The Secretary of the Army and the Army Chief of Staff have ordered a report as to where the service can make 25% cuts in funding and manning levels at all Army headquarters elements at the 2-star level and above.
- Contractor specializing in providing services to the federal government have been one of the early casualties, according to the Center for Strategic and International Studies (CSIS).
 - Contract spending related to information and communications technology peaked in 2011, and then fell
 - For FY2012, federal services contract obligations declined by 13.5% (\$358 billion to \$308 billion) since 2009.
- Some of the larger weapons manufacturers have been able to weather the storm by shedding jobs and reprioritizing work.

The Uncertainty Has Consequences (Cont'd)

- Contractors who focus on services appear to be having a more difficult time. For example:
 - At a major McLean based contractor, profits for the three month period ended August 2 fell \$42 million (12 cent a share) or a nearly 62% decline from the same quarter a year ago. Revenue fell 12.5% over the same period.
 - A Herndon-based company has reported falling profits which Standard and Poors has indicated breached a requirement on some of their financing.
- No doubt, the uncertainty and potential for sequestration cuts are having a dampening effect on the Virginia economy and revenue collections. The only issue is how much.

The Slowdown in Withholding Was Attributable to Weakness in Federal Contractors and Small Businesses

Withholding Tax Collections Fiscal Years 2011 - 2013 Millions of Dollars

Top 10 and Small Payers Industry (Percent of Total Amount)	# of Firms in FY13	\$ Millions			Annual Growth	
		FY11	FY12	FY13	FY12	FY13
Public Sector (18%)	92	\$1,783.6	\$1,831.5	\$1,874.9	2.7%	2.4%
Education and Health Services (7%)	240	\$759.5	\$750.4	\$757.4	-1.2%	0.9%
Federal Contractors (5%)	189	\$504.3	\$495.6	\$482.8	-1.7%	-2.6%
Finance (3%)	134	\$252.6	\$270.3	\$294.7	7.0%	9.0%
Professional and Business Services (3%)	526	\$240.9	\$260.5	\$285.5	8.1%	9.6%
Investment (2%)	147	\$130.8	\$134.8	\$159.6	3.1%	18.4%
Manufacturing (1%)	167	\$126.7	\$135.8	\$141.0	7.2%	3.8%
Transportation (1%)	41	\$102.7	\$103.1	\$108.9	0.4%	5.7%
Energy (1%)	47	\$98.9	\$96.2	\$84.4	-2.8%	-12.3%
Other (5%)	704	\$476.8	\$468.0	\$468.8	-1.8%	0.2%
Total Large Payers (45%)	1,757	\$4,476.7	\$4,546.1	\$4,658.0	1.6%	2.5%
Total Small Payers (55%)	228,388	\$5,158.4	\$5,493.5	\$5,593.3	6.5%	1.8%
Total All	230,145	\$9,635.1	\$10,039.7	\$10,251.3	4.2%	2.1%

- The employment sectors tied to financial markets showed the largest gains in fiscal year 2013.

Withholding Collections Were Markedly Weaker in the Fourth Quarter of Fiscal Year 2013 Due to the Effects of Federal Sequestration

Withholding Tax Collections Fiscal Year Fourth Quarter Only Millions of Dollars

Top 10 and Small Payers Industry (Percent of FY13 Total Amount)	# of Firms in FY13	\$ Millions			Annual Growth	
		FY11	FY12	FY13	FY12	FY13
Public Sector (18%)	92	\$461.6	\$481.3	\$494.3	4.3%	2.7%
Education and Health Services (7%)	240	\$194.4	\$186.8	\$190.3	-3.9%	1.9%
Federal Contractors (5%)	189	\$123.9	\$120.2	\$117.2	-3.0%	-2.4%
Finance (3%)	134	\$56.1	\$60.9	\$63.2	8.5%	3.8%
Professional and Business Services (3%)	526	\$58.3	\$65.6	\$59.8	12.4%	-8.8%
Manufacturing (2%)	167	\$34.4	\$36.9	\$39.1	7.2%	6.0%
Investment (1%)	147	\$28.8	\$30.6	\$37.6	6.0%	22.9%
Transportation (1%)	41	\$25.6	\$25.3	\$25.9	-0.9%	2.4%
Housing (1%)	174	\$15.9	\$18.5	\$17.6	16.4%	-4.7%
Other (5%)	577	\$109.4	\$110.6	\$103.3	1.1%	-6.6%
Total Large Payers (45%)	1,757	\$1,108.4	\$1,136.7	\$1,148.4	2.5%	1.0%
Total Small Payers (55%)	228,388	\$1,309.2	\$1,443.4	\$1,443.4	10.3%	0.0%
Total All	230,145	\$2,417.6	\$2,580.1	\$2,591.8	6.7%	0.5%

- The key Professional and Business Services employment sector, which is sensitive to changes in federal expenditures, experienced the largest decline of the top ten large withholding payers' categories.

Withholding and Sales Tax Collections Since the Implementation of Sequestration

\$ in Thousands

<u>Month</u>	<u>Withholding</u>			<u>Sales Tax</u>		
	<u>2012</u>	<u>2013</u>	<u>%Δ</u>	<u>2012</u>	<u>2013</u>	<u>%Δ</u>
April	\$ 830,023	\$ 888,133	7.0%	\$ 271,780	\$ 271,668	0.0%
May	871,292	855,916	-1.8%	259,133	266,081	2.7%
June	878,713	847,802	-3.5%	430,130	433,244	0.7%
July	694,037	830,108	19.6%	168,908	159,549	-5.5%
August	<u>847,015</u>	<u>800,278</u>	<u>-5.5%</u>	<u>257,334</u>	<u>242,930</u>	<u>-5.6%</u>
Total	\$ 4,121,080	\$ 4,222,237	2.5%	\$ 1,387,285	\$ 1,373,472	-1.0%

What is the Federal Funds Impact on States

- There has been little noticed pain thus far for states.
- Two reasons for this:
 - Sequestration was delayed from January to March, almost out of most states' FY2013, which ended on June 30, 2013.
 - Some flow through money is from prior authorizations which take time to spend out.
- Federal Funds Information for States (FFIS) also estimates that about 82 percent of federal funding that is most important to the states (including Medicaid and Children's Health Insurance Program) is actually exempt for the automatic cuts.

What is the Federal Funds Impact on States (Cont'd)

- FFIS also estimates that a second round of sequestration cuts would reduce domestic federal spending by about \$4.2 billion.
- States would face additional cuts in public housing assistance, money for schools with low-income students, food inspection, scientific research grants, and environmental protection programs in addition to the \$4.6 billion sequestration cuts that states experienced in FY2013.
- Although the total amount of FY2014 cuts would be less than what states experienced in FY2013, they would be on top of the earlier cuts and, therefore, more painful.
- Also, because states have already enacted their FY2014 budgets, they would probably have to amend their FY2014 budgets in the midst of much uncertainty.

Programs to Watch

<u>Program</u>	<u>VA Impact \$ Millions</u>
Special Education	- 21.5
Basic Elementary and Secondary Education Including Title 1	- \$17.6
Head Start	- 8.8
Social Services Block Grant	- 3.2
Substance Abuse Block Grant	- 3.2
Unemployment Insurance State Administration	- 3.8
Clean Water State Revolving Fund (EPA)	- 2.2
Various Housing Programs (Section 8, etc.)	Local
Indirect Costs for State Administration	?

Note: Impact is measured from amounts in FY2013 Continuing Resolution.

Source: Federal Funds Information for States

Washington Post Sequestration Tracking Article