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# Tax Legislation and the Specter of Sequestration

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A recent analysis by the Congressional Budget Office (CBO) has raised concerns about the potential impact the Congressional tax bills could have on farm programs and the farm bill (CBO, Nov. 14, 2017). In short, the concern raised is that if the tax bills increase the deficit by $1.5 trillion over 10 years, existing statutory requirements for sequestration and Pay-as-you-go (PAYGO) would require automatic reductions to offset the deficit increases. The following reviews the issue from the perspective of the potential implications for farm programs, crop insurance, conservation and the upcoming farm bill debate.

**Background on Sequestration**

There are basically two types of spending by Congress, mandatory and discretionary. Mandatory spending generally occurs through entitlement programs such as commodity programs and the Supplemental Nutrition Assistance Program (SNAP). Congress designs how benefits are provided and funds continue until revoked; spending does not depend on annual appropriations. By comparison, discretionary spending occurs through annual appropriations bills. The modern Congressional budget process began in 1974 with reform legislation to institute budget discipline for appropriations. Over time Congress has made further attempts at managing budget deficits. In 1981, Congress proactively used budget procedures to force reductions in mandatory programs over multiple years (Miller and Range, 1983).

Congress next created sequestration in the Balanced Budget and Emergency Deficit Control Act (BBEDCA) of 1985. In its initial form, sequestration was a budget enforcement mechanism that triggered automatic, mostly across-the-board reductions in spending on both appropriated and mandatory programs. Sequestration is generally triggered under PAYGO requirements. If a bill or joint resolution increases spending above the budget baseline, OMB is required to use sequestration to cancel enough spending to offset the legislated increase (2 U.S.C. §931 et seq.). In effect, PAYGO-triggered sequestration is an automatic cancellation of enacted increases in spending above the baseline so as to achieve deficit neutrality (Lynch, 2015).

Use of sequestration was altered materially with the Budget Control Act (BCA) of 2011. The 2011 BCA required sequestration to reduce the federal deficit by $1.2 trillion (over 10 years) when Congress was unable to agree on specific reductions to achieve that goal. The 2011 BCA sequester agreement split the cuts equally between defense spending and non-defense spending. The Office of Management and Budget (OMB) must calculate the necessary amounts each year to meet the required annual reductions of $109 billion, or $54.667 billion each for defense and non-defense spending (OMB, 2017). Congress has, however, exempted many non-defense programs from sequestration. In the context of the farm bill, exempted programs include Supplemental Nutrition Assistance Program (SNAP) and prior obligations of the Federal Crop Insurance Corporation Fund (2 U.S.C. §906). Exempting programs increases the required sequestration for non-exempt programs; a category that includes commodity and conservation programs but with some restrictions for existing contractual obligations.

**Sequestration and the Farm Bill**

Sequestration is triggered automatically. OMB's role is to calculate and implement it, as well as to issue reports to Congress. Recent sequestration reports under the 2011 BCA provide examples but not the full scope of the potential concern for the farm bill.

For the current Federal Fiscal Year (FY) of 2018, OMB calculated a 6.6% sequestration. It was applied to $13.602 billion in Commodity Credit Corporation (CCC) budget authority, contributing $904 million to the $54.667 billion sequestration requirement (OMB, 2017). OMB also calculated sequestration in the amount of $4 million from the Federal Crop Insurance Corporation Fund for administrative expenses (6.6% of $56 million in budget authority). While it is unclear from the documents, the administrative expenses subjected to sequestration are presumed to be from the Administrative and Operating (A&O) assistance USDA provides to crop insurance companies because expenses for Federal employees are not subject to sequestration. An additional $259 million was sequestered from conservation program spending (6.6% of $3.928 billion in budget authority) to bring the farm bill contribution to sequestration to $1.167 billion for FY 2018. For FY2017, farm programs contributed $1.239 billion (6.9%) to sequestration, while Crop Insurance A&O contributed $4 million (6.9%) and conservation contributed $287 million (6.9%) (OMB, 2016). For FY 2016, farm program sequestration was $1.389 billion (6.8%), along with $231 million for conservation (6.8%) and another $3 million in crop insurance administrative costs (OMB, 2015).

Without revising the 2011 BCA, the sequestration reductions would continue through FY 2021. In addition, if Congress agrees to final tax legislation that increases the deficit by $1.5 trillion or $150 billion each of the ten years in the budget window, it would trigger sequestration from PAYGO. Accordingly, OMB would have to sequester an amount sufficient to offset the $150 billion annual increase in the Federal deficit from the tax legislation (CBO, Nov. 14, 2017). A substantial level of sequestration that is further complicated because the law also limits reductions in Medicare spending to 4% maximum, shifting significant requirements from other spending accounts. CBO acknowledges that there is likely not enough in the remaining accounts to cover the entire sequestration that would result from a tax bill similar to current legislation being considered. Others estimate that the full $150 billion could be found but would require almost $70 billion from other, unspecified programs (CRFB, Oct. 18, 2017). The only certainty is that no one knows how OMB would implement sequestration if it goes into effect.

The concern for the farm bill is fairly clear, however. All indications are that if sequestration is implemented it would effectively eliminate all spending on farm programs. It would also eliminate all conservation program spending other than existing (prior obligated) Conservation Reserve Program contracts. Finally, it would presumably impact A&O funding for crop insurance but appears unlikely to impact the funds for premium discount or subsidy, the bulk of crop insurance outlays. If sequestration were to be implemented, it would be expected to zero out spending on these programs. The next farm bill will be written using the 10-year baseline estimated by CBO in 2018. Therefore, the concern is that sequestration would eliminate the entire baseline for commodity programs, as well as a substantial portion of the baseline for conservation programs.

In its June 2017 Baseline, CBO indicated $10.224 billion in FY 2018 on CCC programs, including some conservation programs, as well as an additional $3.479 billion for conservation program spending in the

Natural Resources Conservation Service (NRCS) account. It also estimates $8.268 billion from the CCC account and $3.866 billion for the NRCS account in FY 2019 (CBO, June 2017). Keep in mind that for farm programs, payments for the 2016 crop were made in October 2017, which is FY2018 and payments for the 2017 crop will be made in October of 2018, which is FY2019. These timing shifts do not protect farm program payments because the statute is clear that CCC payments can be subject to sequestration in the following fiscal year and credited as outlay reductions in the fiscal year of sequestration (2 U.S.C. §906(c)(C)(ii)).

While cause for concern in farm bill circles, it must also be made clear that the above discussion is not a foregone conclusion. For one, Congress would have to pass tax legislation that increases the deficit. As indicated, it is also unclear if OMB could implement sequestration given that there may be insufficient outlays to cover the deficit increases. Finally, sequestration may also be prevented by Congress. To avoid it, Congress could offset the deficit increases that the final tax bill would create or waive its impact on PAYGO rules (CBO, Nov. 14, 2017). Congress could also eliminate the PAYGO requirements. These would, however, require further acts by Congress and could collide with other pending fiscal matters. In the rush to move tax legislation, significant uncertainties abound.

**Concluding Thoughts**

The potential for sequestration problems from the tax legislation adds further questions and uncertainty to the expedited effort to pass the bill while adhering to budget reconciliation requirements. The sheer absurdity of triggering sequestration in this situation, however, makes it highly unlikely to ever take place. But that does not end the matter entirely and presents cause for further concern. The situation raises similarities with 1981 that are rather striking; echoes from history that may well be warning sirens for the forthcoming farm bill. In 1981, Republicans in Congress made unprecedented use of budget reconciliation to push through President Reagan’s agenda (Miller and Range, 1983). Doing so greatly complicated writing a farm bill that year (*farmdoc daily*, March 16, 2017). If the current tax bill requires offsets in spending it could add substantial complications that would make writing the next farm bill difficult.

If Congress passes tax legislation, fixing the sequestration problem would not resolve the expected increases to the deficit and debt. When the bill for the tax cuts comes due -- whether it is $1.5 trillion or something less -- the conversation will most likely focus on spending reductions. Further complicating matters, Congress also has to continue funding the Federal government through the remainder of FY2018 and raise the debt ceiling. Key lawmakers are already indicating a shifting focus towards entitlement and welfare spending (Rappeport, Nov. 15, 2017). Although farm bill spending is a small share of total Federal outlays, it rarely fares well under such a conversation. The previous farm bill process faced numerous problems trying to satisfy demands for reduced spending, especially from farm programs and the Supplemental Nutrition Assistance Program (SNAP). Supporters of the bill would be well-advised to be prepared.

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