The Likely Impact of Sequestration on Higher Education

Recent attention in Washington and throughout the country has focused on the so-called "fiscal cliff." The fiscal cliff was comprised of two major components: the expiration of a number of significant tax incentives, and a massive, across-the-board reduction in federal spending through the budget process known as sequestration. As has been well covered in the media, a last-minute deal to avoid "going over the cliff" was struck after high-stakes negotiations, resulting in the American Taxpayer Relief Act of 2012 (H.R. 8).

The fiscal cliff deal resolved a number of key tax provisions by either making those provisions permanent or extending them for a number of years. On the spending side, it modified the impact of the sequester and delayed its implementation until March 1.

What is less well known is exactly what this deal means for programs of interest to higher education. This paper will review what is happening and the implications for these programs.

First, some brief background on how we got here. Sequestration is simply the name for a scheduled reduction in federal spending by fixed percentages across almost all federal programs (with a number of key exemptions). While the sequestration process has been used by the federal government a number of times in the past, the current spending cuts are the result of a political dispute centered around congressional opposition to raising the federal debt ceiling. In August 2011, that specific dispute was resolved with the passage of the Budget Control Act (or BCA). The BCA established a series of goals the government would need to meet to reduce the federal debt by between $1.2 and $1.5 trillion over 10 years and included the threat of automatic sequestration should those goals not be met.

While a number of goals were met, Congress ultimately failed to produce a comprehensive debt reduction package. As a result, a process combining sequestration in 2013 and restrictions on spending over the subsequent nine years would have been automatically triggered on Jan. 2, 2013. The total debt reduction would have been $1.2 trillion through caps in the discretionary budget levels (fixed annual spending levels known as "spending caps") to reflect total cuts of $600 billion from defense spending and $600 billion from non-defense spending. This works out to reductions of $55 billion from defense and $55 billion from non-defense spending per year (additional savings to be realized from debt service not incurred).

Sequestration was scheduled to occur on Jan. 2, 2013, early in fiscal year (FY) 2013. The process is somewhat complicated, but it works like this. The Office of Management and Budget (OMB) examines the total level of funding needed to meet the mandated amount. OMB then examines the total funding of the programs that will be cut. Finally, OMB determines an overall percentage that each category must be reduced to meet the specified reduction. Prior to the passage of the American Taxpayer Relief Act (also known as "the cliff deal"), OMB determined that discretionary funding (which constitutes the bulk of federal spending that reaches campuses) would have been reduced 8.2 percent. Mandatory spending would need to have been reduced 7.6 percent.

Not all federal programs would be reduced under sequestration. Most notably, almost all of the entitlement programs, which account for the vast majority of all federal spending, would not be cut. In addition, a number of programs have been specifically excluded from the cuts, primarily those serving low-income populations. The exempt program of greatest interest to higher education is the Pell Grant

Program, which provides around $35 billion in need-based grant aid to students annually. The administration has also indicated they will not impose the cuts on current military benefits or veterans' benefits.

As mentioned above, negotiations over the fiscal cliff ultimately produced a compromise bill that dealt with the tax issues while delaying the sequester cuts by two months. It did this by "paying" for the delay, at a cost of $24 billion. This $24 billion reduction was paid for with $12 billion from changes to tax provisions of Roth IRA plans, and the remaining $12 billion was found by changing the spending caps for FY13 and FY14. It reduced the FY13 caps for defense and non-defense spending by $2 billion each, and the FY14 caps for defense and non-defense spending by $4 billion each. The $24 billion reduction means that less money will be cut through sequestration in FY13. Accordingly, the sequester percentage cuts are smaller as well, dropping from 8.2 percent to approximately 5.1 percent for discretionary-funded programs, and 7.6 percent to approximately 5.3 percent for mandatory-funded programs.

How This Impacts Higher Education

For students and institutions, there are two major areas where the impact of sequestration will be felt: research funding and student aid. These two categories are by no means inclusive of all programs with funding implications for higher education, but they do comprise the overwhelming majority of federal funding to campuses. All programs in these areas will be reduced by roughly 5.1 percent under sequestration.

Research Funding

The federal government's support is critical to the pursuit of scientific research and development (R&D) on university campuses. The National Science Foundation (NSF) estimates that in FY11 (the most recent year for which there is data), the federal government provided $40.8 billion to institutions for research and development, which comprises 62.6 percent of all higher education R&D funding. Six federal agencies are responsible for almost all of this support: NSF, the National Institutes of Health, the Department of Defense, the Department of Energy, the Department of Agriculture and the National Aeronautics and Space Administration.

The chart below shows the likely impact of sequestration under H.R. 8 on R&D funding at these agencies. It is important to note that not all of the R&D funding at these agencies goes to campuses, so the cuts do not equal a dollar-for-dollar loss in research support. In addition, it is not entirely clear at this writing how agencies plan to address reduced funding in terms of modifying existing grants or making new grants.

R&D by Agency	FY11 Actual (in millions)	FY12 Estimate (in millions)	Sequester %	Post-HR 8 Level (in millions)	HR 8 Cut (in millions)
Defense (R&D)	$79,112	$74,464	5.1	$70,666	$3,798
S&T (6.1-6.3, incl. medical)	$12,751	$13,530	5.1	$12,840	$690
All Other DOD R&D	$66,361	$60,935	5.1	$57,827	$3,108
Health and Human Services (R&D)	$31,183	$31,143	5.1	$29,555	$1,588
National Institutes of Health	$29,831	$30,046	5.1	$28,514	$1,532
All Other HHS R&D	$1,352	$1,097	5.1	$1,041	$56

Energy (R&D)	$10,673	$11,019	5.1	$10,457	$562
Atomic Energy Defense	$4,081	$4,281	5.1	$4,063	$218
Office of Science	$4,461	$4,463	5.1	$4,235	$228
Energy Programs	$2,131	$2,275	5.1	$2,159	$116
NASA (R&D)	$9,099	$9,399	5.1	$8,920	$479
National Science Foundation (R&D)	$5,494	$5,614	5.1	$5,328	$286
Agriculture (R&D)	$2,135	$2,331	5.1	$2,212	$119
Totals	$137,696	$133,970		$127,138	$6,832

Source: AAAS

Student Aid

Perhaps the most important aspect of sequestration concerns a program that won't be impacted by it. As mentioned above, the Pell Grant Program, which is the largest federal student aid program, is exempt from sequestration. No funding for Pell Grants will be reduced in FY 2013 as a result of sequestration. In addition, recent estimates by the Congressional Budget Office have shown Pell Grants as being fully funded at their maximum award level through FY 2013 as well as the next fiscal year (FY 2014).

For the other student aid programs, the impact is more direct. The chart below demonstrates what the H.R. 8 sequester cuts would mean for program funding. While it is difficult to determine precisely how an individual student will be impacted, the Student Aid Alliance has estimated that for high-need students, sequestration under the terms of H.R. 8 would mean a loss of $765 in academic year 2013-14. In addition, as part of the deal that delayed sequestration until March 1, the FY 2014 spending caps for discretionary funding (the category of funding that covers student aid) were further reduced by $4 billion. This reduction will makes it increasingly difficult for program funding to be increased in future years.

Post-HR 8 Sequester Cuts for Student Aid Programs (in millions)

Program	FY12 Funding	FY13 CR Adjustment	Adjusted Funding Level	HR 8 Seq Cut	Post-HR 8 Level	HR 8 Cut Amt	BCA Seq Cut	Post-BCA Cut Level	BCA Cut	Diff. btw cuts
SEOG	$734	0.612	$738.49	5.1	$701	$38	8.2	$678	$61	$23
FWS	$977	0.612	$982.98	5.1	$933	$50	8.2	$902	$81	$30
TRIO	$840	0.612	$845.14	5.1	$802	$43	8.2	$776	$69	$26
GEAR UP	$302	0.612	$303.85	5.1	$288	$15	8.2	$279	$25	$9
GANN	$31	0.612	$31.19	5.1	$30	$2	8.2	$29	$3	$1
Total						$148			$238	$90

Finally, while interest rates on federally-issued student loans (both PLUS and Stafford) will not be increased under sequestration, and terms of their availability have not changed, student borrowers will see a very modest one-year increase in their loan origination fees. Those changes are detailed below.

Changes in Origination Fees Under Sequester					
Program	**Origination Fee**	**HR 8 Seq %**	**Post HR 8 O-fee**	**BCA Seq. %**	**BCA O-fee**
Stafford Loans	1.00%	5.3	1.053%	7.6	1.076%
PLUS Loans	4.00%	5.3	4.212%	7.6	4.304%

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