



CHAIRMEN

BILL FRENZEL
TIM PENNY
CHARLIE STENHOLM

The Statutory Pay-as-You-Go Act of 2009
July 22, 2009

PRESIDENT

MAYA MACGUINEAS

DIRECTORS

BARRY ANDERSON
ROY ASH
CHARLES BOWSHER
STEVE COLL
DAN CRIPPEN
VIC FAZIO
WILLIS GRADISON
WILLIAM GRAY, III
WILLIAM HOAGLAND
DOUGLAS HOLTZ-EAKIN
JIM JONES
LOU KERR
JIM KOLBE
JAMES LYNN
JAMES MCINTYRE, JR.
DAVID MINGE
JIM NUSSLE
MARNE OBERNAUER, JR.
JUNE O'NEILL
RUDOLPH PENNER
PETER PETERSON
ROBERT REISCHAUER
ALICE RIVLIN
MARTIN SABO
GENE STEUERLE
DAVID STOCKMAN
PAUL VOLCKER
CAROL COX WAIT
DAVID M. WALKER
JOSEPH WRIGHT, JR.

SENIOR ADVISORS

HENRY BELLMON
ELMER STAATS
ROBERT STRAUSS

Today, the House passed legislation to re-instate statutory pay-as-you-go (PAYGO), based on a proposal by the Administration. The bill requires new mandatory spending and tax cuts to be offset under the threat of automatic spending cuts, or sequestration. However, it exempts certain policies not scheduled under current law from its requirements, including: the renewal of the 2001/2003 income tax cuts; the extension of current estate tax rules; continued patches of the Alternative Minimum Tax; and continued updates of Medicare physician payments.

The Committee for a Responsible Federal Budget strongly supports statutory PAYGO, along with tough but realistic discretionary spending caps, as a means to keep the budget situation from further deteriorating. We are, however, extremely concerned by the bill's exemptions, which could add trillions of dollars to the deficit over the coming decade.

Summary of the Administration's PAYGO Proposal

The PAYGO proposal, as introduced, adds a statutory sequestration mechanism that cannot be provided through the current House or Senate PAYGO rules. The sequestration would mandate cuts in budgetary resources for mandatory programs if the Office of Management and Budget (OMB) determines that the Congress had not, by the end of a session, fully offset the budget year costs of new laws affecting mandatory spending or receipts.

The threat of sequestration would apply for five fiscal years (FY 2010-2014) for legislation enacted through the end of calendar year 2013. The bill establishes a "PAYGO ledger," in which the net ten-year costs and savings from legislation subject to PAYGO are averaged and recorded for each year. At the end of each calendar year, if the PAYGO ledger for the then-current fiscal year sums to a net cost, a sequestration – an automatic cut in certain mandatory spending programs – would be required. OMB, rather than the Congressional Budget Office (CBO), would be both the official estimator and holder of the ledger, although CBO would provide estimates for informational purposes.

In general, OMB will measure the budgetary effects of any new legislation against a current-law baseline, which essentially assumes laws remain as they are on the books. However, the proposal would exempt the effects of four major policies:

- **Income tax provisions from the 2001/2003 tax cuts.** Assumes tax rates and refundable tax credits do not sunset at the end of 2010.
- **Estate and Gift Taxes.** Assumes estate tax exemption and rates would remain at 2009 levels of \$3.5 million per person and 45 percent, respectively.
- **The Alternative Minimum Tax (AMT).** Assumes continuation of the 2009 exemption amounts and related parameters and is indexed for inflation in the future.
- **Medicare payments for physician services.** Assumes cuts in physician payments will not occur as under current law, and instead 2009 payment rates and parameters will remain in place.

Any legislation enacted before the end of 2011 on any of these preceding policies and their effects would not be included on the PAYGO ledger – as either a cost or a savings – unless the legislation produced additional savings relative to the *current law* baseline, or additional costs beyond the above assumptions. The bill also exempts from PAYGO legislation which converts discretionary programs into mandatory programs or vice-versa, without changing the amount spent.

As under the previous statutory PAYGO, changes to off-budget programs such as Social Security and debt service effects are not included on the PAYGO ledger. Further, the budgetary effect of any provisions designated by both the Congress and President as an emergency requirement would not be recorded on the PAYGO ledger.

If, according to these rules, the PAYGO ledger showed a net cost in the budget year, “the President shall issue an order sequestering budgetary resources from mandatory programs by enough to fully offset that debit.” Generally, the sequestration would be a uniform percentage cut to the baseline of mandatory programs. However, many mandatory programs would be exempted, including Social Security, veterans benefits, payments to retirement funds, Medicaid, Supplemental Nutrition Assistance Program, Temporary Assistance to Needy Families, Supplemental Security Income, all refundable tax credits, the Children’s Health Insurance Fund, Pell Grants, the Academic Competitiveness/Smart Grant Program, the Universal Service Fund, health benefits for retired federal employees, and all economic recovery programs. In addition, the maximum percentage cut to Medicare could be no more than four percent.

The legislation would also make a number of changes to the budget baseline. Among them, it would make is so that all mandatory programs with outlays in excess of \$50 million be assumed to continue to operate beyond their scheduled expiration date. This is different from current practices, in which only some mandatory

spending is projected to continue beyond expiration; and CBO estimates this change will increase the ten years baseline deficit by at least \$25 billion.

Summary of the Substitute Amendment

The House, in a substitute amendment by House Majority Leader Steny Hoyer, altered the administration's PAYGO proposal. Among the major changes, include:

- PAYGO, as enforced through sequestration, would become a permanent feature of the budget process, rather than expiring after 2013.
- The PAYGO ledger would be replaced by two PAYGO scorecards – one with five-year average costs or savings and another with the ten-year average costs or savings. If there are net PAYGO costs on both scorecards, the sequestration would have to address the larger difference.
- The cost of legislation for the PAYGO scorecards would generally be based on CBO estimates, rather than OMB estimates, although OMB would continue to maintain the scorecards.
- The renewal of the 2001/2003 income tax cuts for individuals making over \$200,000 and couples making over \$250,000 would no longer be exempt from PAYGO, although the exemptions for the remaining tax cuts would remain.
- The policies exempted from PAYGO would be excluded permanently, not just through 2011.
- The conversion of discretionary programs to mandatory programs would not be protected from normal PAYGO rules.
- The baseline would no longer be altered to assume all mandatory programs larger than \$50 million continue indefinitely.

Analysis of the PAYGO Proposals

We are strong supporters of PAYGO, but there are weaknesses in both the Administration's proposal and substitute.

- Statutory PAYGO would be a positive step in dissuading new, non-offset tax cuts or mandatory spending programs. PAYGO, which has been effective in the past, can help to force trade-offs in creating or expanding entitlement programs or tax cuts. Though PAYGO can always be gamed, waived, or ignored, as it has been all too often, it has more strength when it is codified into law. The substitute would make statutory PAYGO permanent.

- The decision not to add new mandatory spending into the baseline is a wise one. When policy makers address expiring programs, it is important they carefully weigh the costs and benefits of renewal. This should be true on both the tax and spending side.
- Unfortunately, too many policy provisions are exempt from PAYGO. According to CBO, making exceptions for the 2001/2003 tax cuts, AMT patches, and physician payments reforms “would allow the Congress to enact legislation that would increase deficits by an amount in the vicinity of \$3 trillion over the 2010-2019 period without triggering a sequestration.” Although the House substitute would reduce the size of the exemptions, those exemptions still result in unaffordable costs.
- Too many programs are excluded from sequestration. While some programs may be legally, technically, or politically difficult to sequester, the number of programs forced to “share the pain” should be as numerous as possible. If all programs are punished for the bad behavior of Congress, lawmakers will be more fearful of sequestration and more likely to remain responsible.

We understand the argument that, since Congress may be unwilling to pay for certain policies anyway, subjecting them to PAYGO could result in a waiver which could in turn weaken PAYGO. Nonetheless, we believe the fiscal problems facing the country are dire. By exempting such costly policies, this PAYGO legislation keeps us on an unsustainable fiscal path. A discussion of how to deal with expiring tax cuts, the AMT and Medicare should be part of a broad negotiation on a larger budget deal in which we develop a “fiscal recovery plan.”

As the Committee has described previously (http://www.crfb.org/documents/FRM_RecoveryPlan_000.pdf), such a plan should include measures for reducing the medium and long-term deficits, have strong enforcement mechanisms such as statutory PAYGO and discretionary spending caps, and most importantly, contain a real political commitment from members of Congress and the President to restoring our fiscal health.