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THE NEED TO RESTORE PAY-AS-YOU-GO BUDGET ENFORCEMENT FOR TAX CUTS AND ENTITLEMENTS

by Richard Kogan

Growing concerns that large chronic budget deficits once again threaten our economic future are leading Members of Congress to consider whether to reinstate the Pay-As-You-Go rule (PAYGO). When the Senate budget resolution reaches the Senate floor the week of March 14, an amendment will be offered to restore the original PAYGO rule. The amendment would apply PAYGO to entitlements and tax cuts alike; both increases in entitlement programs and reductions in taxes would have to be paid for. The PAYGO rule could be bypassed only in instances in which 60 Senators voted to waive the rule.

In April 2004, four budget watchdog groups — the Concord Coalition, the Committee for Economic Development, the Committee for a Responsible Federal Budget and the Center on Budget and Policy Priorities — issued a joint statement urging Congress to reinstate the original PAYGO rule. The four groups stated: "Our organizations strongly believe that PAYGO should be renewed in its original and successful form — applying it without exception to both entitlement expansions and tax cuts. This budget-wide constraint was an effective part of past bipartisan efforts to bring deficits under control. Renewing it would be the best first step to countering the current trend of digging an ever-deeper fiscal hole. In contrast, failure to renew PAYGO, or doing so in a weak form, would send an alarming signal that Washington policymakers are not yet taking our nation's deteriorating fiscal outlook seriously."[1]

In recent weeks, Federal Reserve Chairman Alan Greenspan also reiterated his view that the Pay-As-You-Go rule should be reinstated in its original form. Chairman Greenspan made clear that despite his support for tax cuts, he favors adherence to a PAYGO rule that would cover both tax cuts and entitlement increases.

Background

The pay-as-you-go rule was originally designed during the last period of chronically high deficits to prevent policy changes that would make the situation worse. It did not guarantee deficit reduction or freeze in place all tax and entitlement laws. It did, however, require anyone proposing new tax cuts or entitlement expansions to come up either with a way of paying for them without enlarging the deficit or with 60 votes in the Senate to bypass the rule. Requiring this simple trade-off had a powerful effect. As the Congressional Budget Office has noted, "Between 1991 and 1997, most new revenue and mandatory spending laws that were enacted

[1] "Joint Statement in Support of Restoring Pay-As-You-Go Budget Enforcement for Tax Cuts and Entitlements," April 20, 2004.

were consistent with the PAYGO requirement to be deficit neutral."[2] This deficit neutrality combined with spending restraint on discretionary programs and a strong economy to produce a budget surplus by 1998.

Congressional adherence to PAYGO began to decline once the goal of a balanced budget was achieved. But the main departure from PAYGO — before it was allowed to expire in 2002 — occurred because of the enactment of tax cuts. Indeed, CBO notes that of the more than $700 billion in PAYGO violations that Congress simply wiped off the official scorecard, "most of that amount stemmed from the estimated drop in revenues attributed to the Economic Growth and Tax Relief Reconciliation Act of 2001."[3] This refutes assertions made by some opposed to renewing the original PAYGO rule that lack of fiscal discipline exists only or primarily on the spending side of the budget.

While it is true that PAYGO was not as effective in protecting the surplus as it was in controlling the deficit, protecting surpluses will not be our problem for many decades to come. The task at hand is to bring the deficit back under control. And the track record for PAYGO in times of big deficits is one of major success.

Not All Forms of PAYGO Are Equal

Last year, the House Budget Committee approved legislation that would fundamentally alter PAYGO by applying it only to increases in mandatory programs. Under that approach, tax cuts would not have to be offset, regardless of their size, economic justification, or impact on the deficit. That proposal was not aimed at controlling deficits. Rather, it was more narrowly designed to control spending by requiring that entitlement expansions be offset with cuts in other entitlement programs. Since tax cuts would be exempt from fiscal scrutiny under such a proposal, deficits could rise substantially even if the spending restraint in the proposal proved effective.

Exempting tax cuts from PAYGO also would be dangerous for another reason — doing so would erect an incentive to create additional "tax entitlements," with benefits that otherwise would be provided through an entitlement program being funneled through tax breaks instead. That would complicate the tax code while growing the deficit just as inexorably as new entitlement spending would.

There is no good reason to exempt tax cuts from budget enforcement rules. In the absence of a compelling case to provide short-term economic stimulus, if Congress wants to pass particular tax cuts, it should either reduce mandatory programs or raise other revenues to offset the cost of the tax-reduction measures, not simply give itself a free pass to enact tax cuts without financing them. Doing otherwise merely provides an open invitation to keep our existing government services without fully paying for them and then send the bill to our children.

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[2] CBO, *The Budget and Economic Outlook: Fiscal Years 2004-2013*, Appendix A, The Expiration of Budget Enforcement Procedures: Issues and Options, p.114.

[3] Id. at 116.

Existing Senate PAYGO Rule Is Not Meaningful

A weak and largely meaningless version of the PAYGO requirement currently exists in Senate rules. It was enacted two years ago as part of the 2004 Congressional budget resolution and remains in effect until its scheduled expiration on September 30, 2008.

Under this existing rule, the Senate is permitted to consider tax cuts and entitlement increases without paying for them to the extent that the most recent Congressional budget resolution accommodates such measures. In other words, so long as tax cuts or entitlement increases are assumed in the budget resolution, no offsets are required. Offsets are necessary *only* for tax cuts and entitlement increases beyond those assumed in the budget resolution.

This existing rule is not true PAYGO in any real sense, since the Senate can accommodate tax cuts or entitlement increases of any size in the budget resolution. Nor does this tepid version of PAYGO add to other budget enforcement mechanisms. The Congressional Budget Act already provides a 60-vote hurdle against any entitlement increase or tax cut that would violate the most recent congressional budget resolution.

In short, the existing, weak PAYGO rule provides essentially no extra impediment to tax and entitlement legislation beyond the constraints of the Congressional Budget Act. It does not require that all new tax or entitlement costs be offset or "paid for." It cannot be regarded as a meaningful "Pay-As-You-Go" requirement.

Budget Outlook Warrants a Return to Traditional PAYGO

In September 2003, the Concord Coalition, the Committee for Economic Development, and the Center on Budget and Policy Priorities issued a joint statement warning that "a fiscal crisis is developing in the United States, and the risks of inaction are high." The three organizations further noted that concern over the near-term budget outlook is compounded by the fact that "the fiscal situation will deteriorate markedly in the decades that follow, as the cost of the baby boomers' health care and retirement needs consumes a rising share of the economy and the budget. Deficits over the next generation will dwarf the already large deficits the nation faces in the decade immediately ahead."[4]

Nothing has altered that assessment. The mid-term outlook is essentially unchanged and the long-term outlook is, because of the cost of the Medicare prescription drug benefit, actually somewhat worse than we earlier assumed. Without a change in current policies, the federal government can expect to run a cumulative deficit of approximately $4.5 trillion over the next 10 years. Running consistent deficits of this size would absorb national savings and crowd out productive investment. It would reduce the fiscal flexibility to deal with unexpected developments, raise the cost of servicing the national debt, and likely put upward pressure on long-term interest rates. There is wide room for debate on how best to address the fiscal challenge the nation faces. But adding to that challenge by running up the national debt over the next decade is not among the responsible options.

[4] "The Developing Fiscal Crisis – Deficits Matter," September 29, 2003, p.1.

On our current path, we are in danger of ever-expanding deficits and declining growth in our national output and living standards. To be clear, budget process alone cannot reverse these trends. No matter how tightly budget rules are drawn, they will not work without the political will to make hard choices. However, budget rules such as PAYGO establish hurdles that make it more difficult to enact fiscally irresponsible policies. Returning to a meaningful version of PAYGO would, at a minimum, force policymakers to consider the consequences of proposals that would dig the fiscal hole deeper.

Conclusion

The return of budget deficits for as far as the eye can see and the daunting long-term challenge that awaits beyond the 10-year budget window warrant a prompt return to strict budget discipline — including the responsible notion that we must pay as we go. We strongly urge Congress to reinstate the PAYGO rule in its original and successful form, applying it to both tax cuts and entitlements as the proposed Senate amendment would do. Watered down versions of PAYGO provide a fig leaf rather than the needed fiscal restraint