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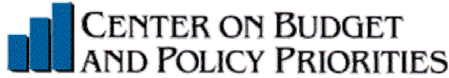

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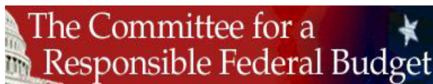

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JOINT STATEMENT IN SUPPORT OF RESTORING PAY-AS-YOU-GO BUDGET ENFORCEMENT FOR TAX CUTS AND ENTITLEMENTS

Growing concerns that large chronic budget deficits once again threaten our economic future have led Members of Congress to consider whether to reinstate the pay-as-you-go rule (PAYGO) and, if so, whether to include an exemption for tax cuts. Our organizations strongly believe that PAYGO should be renewed in its original and successful form — applying it without exceptions 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.

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 with either a way of paying for them without enlarging the deficit or 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 were consistent with the PAYGO requirement to be deficit neutral."[1] This deficit neutrality combined with spending restraint on discretionary programs, including defense, and a strong economy to produce a budget surplus by 1998.

The effectiveness of PAYGO began to decline once the goal of a balanced budget was achieved. But the main deviation from PAYGO before it was allowed to expire in 2002 occurred during 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."[2]

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[1] CBO, The Budget and Economic Outlook: Fiscal Years 2004-2013, Appendix A, The Expiration of Budget Enforcement Procedures: Issues and Options, p.114.
[2] Id. at 116.

This refutes recent assertions from some who oppose renewing the original PAYGO rule that lack of fiscal discipline exists only 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 years 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 success.

Not All Forms of PAYGO Are Equal

PAYGO requirements are now the main point of contention between House and Senate negotiators who are attempting to reach agreement on a congressional budget resolution for fiscal year 2005. The Senate budget resolution includes a 5-year renewal of PAYGO that would apply to both tax cuts and entitlements — in other words, the original PAYGO. The House budget resolution contains no PAYGO provision. Instead, the House Budget Committee has approved separate legislation that would redefine PAYGO by limiting its application to spending increases in mandatory programs. Under this approach, tax cuts would not have to be offset regardless of their size, economic justification, or impact on the deficit. The Bush Administration has sent a similar legislative proposal to Congress.

The House bill and the Administration's proposal are not specifically aimed at controlling deficits. Instead, they are more narrowly designed to control spending by requiring that entitlement expansions be offset with cuts in other entitlement programs. But since tax cuts would be exempt from fiscal scrutiny under these proposals, deficits could rise substantially, even if the spending restraint in this proposal proved effective.

A further danger of exempting tax cuts from PAYGO is the incentive it would provide to create additional "tax entitlements," where benefits are funneled through tax breaks. This subterfuge complicates the tax code while growing the deficit just as inexorably as new entitlement spending.

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 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 provide ourselves with more government services than we are willing to pay for and then send the bill to our children.

The Budget Outlook Warrants a Return to Traditional PAYGO

In September of 2003, we warned that "a fiscal crisis is developing in the United States, and the risks of inaction are high." We 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' retirement and health care 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."[3]

Nothing has altered our assessment of the situation. The mid-term outlook is essentially unchanged and the long-term outlook is actually somewhat worse than we earlier assumed. Without a change in current policies, the federal government can expect to run a cumulative deficit of $4.6 trillion over the next 10 years, averaging 3 percent of the economy. (This is $400 billion less than our September estimate primarily because the Administration and Congress seem willing at the present time to let the bonus depreciation provision of last year's tax bill expire on schedule at the end of this year. If this tax cut were ultimately extended, our cumulative 10-year estimate would again be a deficit of slightly more than $5 trillion.)

Running consistent deficits of this size would absorb our national savings and crowd out productive investment. It would put upward pressure on long-term interest rates, reduce the fiscal flexibility to deal with unexpected developments, and raise the cost of servicing the national debt. Moreover, these negative effects would come at a particularly bad time. We are an aging society, and as we age, the declining share of the population that is made up of workers will have to support the retirement and health needs of the growing wave of baby-boom seniors. This demographic shift, along with rising health care costs, will place unprecedented strains on the budget. We project that by the time today's newborns reach 40 years of age, the cost of Medicare, Medicaid, and Social Security will more than double as a percentage of the economy — from 8.4 percent of GDP to over 18 percent.[4] As a nation we have yet to confront the difficult trade-offs this will require. Certainly, there is wide room for debate on how best to ease the fiscal challenge that future generations will face. But adding to that challenge by running up the national debt over the next decade is not among the responsible options.

On our current path, we are in danger of ever-expanding deficits and declining growth in our national output and living standards. Our unwillingness to address these deficits may make the next generation of Americans poorer than their predecessors for the first time in our country's history. To be clear, budget process alone cannot reverse these trends. No matter how tightly budget laws 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 Congress to consider the consequences of proposals that would dig the fiscal hole deeper.

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

[4] By comparison, CBO projects that all federal government spending this year will equal 20 percent of GDP and that revenue will equal 15.8 percent.

The Danger of Watering Down PAYGO

Various alternative PAYGO ideas have been proposed. As noted, the House and the Bush Administration would fundamentally redefine PAYGO by exempting all tax cuts. For reasons stated above, we believe that this approach would not control the deficit and should be rejected. A tax cut that is not paid for can be every bit as fiscally irresponsible as a spending increase that is not paid for.

We are also concerned, however, about reported "compromise" proposals that would subject tax cuts to PAYGO in theory while in effect imposing little if any meaningful restraint. For example, some proposals would apply PAYGO for just one year or would exempt tax cuts given "reconciliation" protection in the budget resolution, or tax cuts that are contained in a House-Senate conference report. All such proposals allow lawmakers to duck the hard choices that PAYGO is supposed to make them confront.

Exemptions Based on the Budget Resolution

Last year the Senate adopted a sham PAYGO rule that exempts all policies (tax cuts or entitlements) assumed in the budget resolution. Any such blanket exemption is obviously meaningless because it essentially allows Congress to enact fiscally irresponsible policies by simply assuming them into the budget resolution.

A variation of this proposal is to exempt tax cuts that are assumed in the budget resolution reconciliation instructions. At first, this may appear to be a narrower exemption, particularly if one assumes that it would only apply to the three "middle-class" tax cuts that expire this year and have strong support. However, upon closer inspection there is little reason to believe that this exemption would provide any more fiscal restraint than ignoring PAYGO altogether.

For example, the proposal might exempt revenue losses associated with the extension of three middle class tax cuts (the expanded child credit, marriage penalty provisions, and the new 10 percent income tax bracket) that are scheduled to expire this year. However, those extensions are likely to happen with or without PAYGO because they are sufficiently popular to attract the 60 votes needed to waive the rule. For the same reason, they would also survive any attempted filibuster and do not, therefore, need reconciliation protection. And since the budget resolution includes reconciliation protection for a specific dollar amount of tax cuts — not the specific policies to be enacted — congressional leaders would be allowed to substitute less popular tax cuts in a reconciliation bill and avoid PAYGO on those tax while letting the more popular proposals move forward without reconciliation.

Moreover, this type of PAYGO "compromise" would be subject to additional forms of gaming. Nothing would prevent a reconciliation bill from extending the three popular middle class tax cuts for just one or two years and using the "savings" to throw the cloak of reconciliation protection — and hence exemption from pay-as-you-go discipline — around additional tax cuts. Finally, such an exemption would apply not only to tax cuts in this year's reconciliation bill but to tax cuts in reconciliation bills in coming years as well.

Another reported compromise would apply PAYGO to tax cuts in the Senate when first voted upon but not when they came back in the form of a House-Senate conference report. This would do more to promote legislative gamesmanship than to promote fiscal discipline. Any tax cut inserted into a conference report would be exempt from PAYGO.

Compromises based on timing

Another "compromise" would limit the PAYGO requirement to one year. It is difficult to see what this would accomplish. Since Congressional action this year on tax cuts that aren't offset is likely to be limited to extending the three broad tax-cut provisions scheduled to expire, along with Alternative Minimum Tax relief — and since legislation to extend these measures will likely secure at least 60 votes in the Senate anyway — imposing a pay-as-you-go rule for the coming year only is likely to make the rule meaningless.

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. Redefining the concept of PAYGO by exempting tax cuts would neither control spending nor shrink the deficit. It would accomplish nothing other than to weaken substantially a proven tool for promoting fiscal responsibility. Further, policymakers should not adopt a deceptive "compromise" proposal that honors PAYGO in name while substantially or entirely gutting it in fact. We strongly urge Congress to reinstate the PAYGO rule in its original and successful form — applying to both tax cuts and entitlements — as the Senate-passed provision does. Watered down versions of PAYGO provide a fig leaf rather than the needed fiscal restraint.