

Revised April 9, 2004

CERTAIN “COMPROMISES” ON PAY-AS-YOU-GO RULE WOULD GUT THE RULE

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When Congress returns from its spring recess, Republican leaders will seek to resolve the differences between the Senate and House positions on the “pay-as-you-go” rule. The Senate budget resolution includes a provision resurrecting for five years the type of pay-as-you-go rule that was in force in the 1990s, under which both tax cuts and entitlement increases have to be paid for. The House budget plan contains no such provision. Separate legislation that the House Budget Committee has approved, and which the House Republican leadership and the White House support, would apply this rule to entitlement increases only. Under that approach, tax cuts would not have to be offset.

This disagreement prevented House and Senate Republicans from producing a conference report on the budget resolution in early April. Unfortunately, there is growing risk that this matter may be resolved by a “compromise” rule that appears on paper to apply the pay-as-you-go discipline to tax cuts but that is artfully designed so the rule is likely to have no actual effect in requiring tax cuts to be paid for.

Press reports in early April (as the House was about to recess) cited unnamed Congressional sources as identifying several pay-as-you-go “compromises” under consideration. One common feature of various of these compromises stands out: while appearing to apply the pay-as-you-go rule to some or all tax cuts, they likely would have little or no effect on tax cuts in reality.

One so-called “compromise” would exempt from the pay-as-you-go rule any tax cuts that are accommodated under a “reconciliation” directive contained in a budget resolution. Since Congress can place many or all tax cuts assumed in a budget resolution under a reconciliation directive — and since tax cuts *not* included in a reconciliation bill already are more difficult to pass, because they can be subject to a filibuster — this “compromise” would exempt from the pay-as-you-go rule most or all of the tax cuts that the framers of a given year’s budget resolution actually intended to pass. 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.

Senate Already Has a Meaningless Pay-As-You-Go Rule That Supposedly Applies to Tax Cuts

The Senate currently operates under an ostensible pay-as-you-go rule. The rule has a giant loophole, however, that makes it essentially a farce. Under the rule, tax cuts and entitlement increases must be paid for, *except that* tax cuts and entitlement increases called for in the most recent Congressional budget resolution are exempt. So, each year, Congress can assume new tax cuts (and entitlement increases) in the budget resolution. Once the budget resolution is passed, all tax cuts and entitlement increases assumed in the resolution are exempt from the pay-as-you-go rule.

Reconciliation bills already have special protection in the Senate; they cannot be filibustered. The combination of reconciliation protection and an exemption from pay-as-you-go discipline would mean that tax cuts contained in reconciliation bills always would need only 51 votes to pass rather than 60, even if they contained massive, unpaid-for tax cuts.

- Another “compromise” would institute a pay-as-you-go rule for just one year, after which it would expire. 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 on December 31 and Alternative Minimum Tax relief — and since legislation to extend these measures will very 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 rather meaningless.

Providing an Exemption for the Middle-Class Tax Cuts Set to Expire December 31

Another suggested compromise is to exempt legislation to extend three “middle-class” tax cuts slated to expire on December 31, 2004 — the 10 percent bracket, child tax credit, and married couple provisions of last year’s tax-cut law — from the pay-as-you-go rule. Providing such an exemption may sound like a simple, straightforward matter, and such an approach may sound like it avoids some of the pitfalls associated with the so-called compromises described above. Unfortunately, this matter is not as simple as it may initially seem. There is serious risk that if an exemption for the three middle-class tax cuts is provided, the exemption will be drafted in a way that allows other tax cuts to be exempted as well.

Suppose the conference agreement on this year’s budget resolution is drafted to include a pay-as-you-go exemption of \$95 billion over five years, the cost of extending the three expiring middle-class tax cuts for five years (\$77 billion in lower revenues and \$18 billion in higher outlays for the refundable portion of the child tax credit). Such an exemption would enable some other tax cuts to be exempted from the pay-as-you-go rule as well. To exempt other tax cuts, the tax-writing committees could extend the three middle-class tax cuts for a period shorter than five years and then use the remaining amounts under the exemption for other tax-cut measures.

As a result, if Senators who favor applying the pay-as-you-go rule to both entitlements and taxes ultimately decide to agree, as a compromise, to an exemption for the extension of the three middle-class tax cuts, they will need to ensure that the pay-as-you-go rule is written so the exemption is explicitly for the extension of those three specific tax cuts, and is not simply an exemption of a specific dollar amount. This could be done by including “reserve fund” language in the budget resolution conference agreement that identifies the three specific tax-cut extensions and provides an exemption from the pay-as-you-go rule for legislation extending these three provisions.

It should be noted that a specific exemption for these three tax-cut extensions is not the same thing as an exemption for tax cuts covered by a reconciliation directive in a budget resolution. First, the reconciliation instructions contained in the budget resolutions that both the Senate and House have recently passed encompass other tax cuts in addition to the three middle-class tax-cut measures. Second, providing an exemption for whatever tax cuts can be placed in this year’s reconciliation bill may, as just explained, lead the tax-writing committees to extend the three middle-class provisions for less than five years to create more room for other tax cuts. Finally, if a general exemption were established for any tax cuts contained in reconciliation bills over the next five years, Congress could bypass the pay-as-you-go rule for an array of hefty tax cuts in the years ahead simply by including reconciliation instructions in future budget resolutions that covered such tax cuts.

- Still another supposed “compromise” would apply the pay-as-you-go rules to tax legislation when such legislation is initially considered on the Senate floor, but *not* to conference reports on the legislation. Such a proposal would essentially exempt tax cuts entirely from pay-as-you-go discipline, since tax cuts could be approved in the House and added in conference without being paid for.

In short, those concerned with fiscal discipline will need to look long and hard at “compromises” advanced in the days ahead on the pay-as-you-go rule. Various “compromises” that may be proposed would be the equivalent of deceptive advertising — appearing to include a pay-as-you-go rule that applies to both tax cuts and entitlements, while substantially or entirely gutting the rule.