Center on Budget and Policy Priorities

820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

December 20, 2006

REINSTATEMENT OF PAY-AS-YOU-GO IS A WELCOME STEP TOWARD FISCAL RESPONSIBILITY

By James Horney and Richard Kogan

House and Senate Democratic leaders have pledged to reinstate the "Pay-As-You-Go" rule early in the 110th Congress. Such a rule, which was in effect in the 1990s, helps to enforce fiscal discipline by requiring that any tax cut or increase in entitlement spending be offset by an increase in other taxes or reduction in other entitlement spending, rather than being deficit financed.

Reinstating a PAYGO rule that bars consideration of tax cuts or entitlement increases that would increase the deficit will not guarantee that the Congress and the President act in a fiscally responsible manner, but it will indicate that the leaders of the new Congress:

- Recognize that the nation faces a serious deficit problem and that enacting legislation that would make that problem worse is not desirable;

- Reject the notion that tax cuts are different from entitlement increases and should not have to be paid for; and

- Accept the proposition that budgeting requires tradeoffs and that tax cuts or entitlement increases that are worth enacting are worth paying for.

The reinstatement of the PAYGO rule represents a limited, but significant, step toward a more fiscally responsible budget process. Those who recognize that the continuation of current budget policies would lead eventually to economically dangerous levels of debt, and also erode the ability of the government to meet the needs of the American public, should welcome reinstatement of the rule and hope it encourages policymakers to take further steps to deal with the long-term budget problems we face.

Background

The pay-as-you-go rule was originally adopted in 1990, 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 that anyone proposing new tax cuts or entitlement expansions 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.[1]

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."[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 large tax cuts in 2001. CBO has reported that of the more than $700 billion in PAYGO violations that Congress simply wiped off the official scorecard before PAYGO expired in 2002, "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 is not likely to be our problem in the years ahead. 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

A weak and largely meaningless version of the PAYGO requirement currently exists in Senate rules. It was enacted more than three years ago as part of the Congressional budget resolution for 2004 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* so long as 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 magnitude in the budget resolution. Nor does this tepid version of PAYGO add to other budget enforcement mechanisms. The Congressional Budget Act already

---

[1] The PAYGO rule does not apply to funding for discretionary programs provided in annual appropriation bills. That funding is subject to separate limits established in the annual Congressional budget resolution. The original PAYGO rule was statutory, enforced by an automatic sequestration (across-the-board cuts of non-exempt entitlements). Tax cuts or entitlement increases could be exempted from PAYGO only by enacting a new law that contained such an exception. Legislation that provided such an exemption was subject to a 60-vote point of order in the Senate.

[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] Ibid., p.116.

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 in the Senate provides essentially *no* extra impediment to deficit-financed tax and entitlement legislation, beyond the constraints of the Congressional Budget Act. The existing rule 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.

Similarly, a version of the PAYGO rule proposed by the President and endorsed in 2004 by the Republican-controlled House Budget Committee would not be effective in preventing enactment of legislation that would increase the deficit. That proposal 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 still rise substantially.

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 sound reason to exempt tax cuts from budget enforcement rules. 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 provide government services without fully paying for them and then send the bill to our children.

Some may argue that PAYGO should not apply to tax cuts because it would make it difficult to enact temporary tax cuts intended to stimulate the economy during a recession. It is equally true, however, that PAYGO would apply to increases in entitlement spending — such as a temporary increase in unemployment benefits — that are intended to respond to an economic downturn. There is no good reason to exempt tax cuts from PAYGO while covering entitlement costs. Furthermore, it should be possible to waive the PAYGO rule for either tax cuts or entitlement increases that are legitimately aimed at dealing with an economic downturn.

Conclusion

Reinstating a true PAYGO rule that requires all tax cuts and entitlement expansions to be paid for would represent a significant step toward a return of fiscal responsibility. While it would not guarantee that the President and the Congress act responsibly, it would represent a welcome recommitment to important principles: (1) that deficits matter; (2) that tax cuts, as well as spending, should be subject to budget constraints; and, (3) that budgeting requires careful consideration of tradeoffs.