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

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TESTIMONY OF ROBERT GREENSTEIN
EXECUTIVE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES
before the
HOUSE COMMITTEE ON THE BUDGET
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Mr. Chairman, Congressman Ryan, and members of the Committee, I appreciate the opportunity to appear here today to explain why I think pay-as-you-go discipline is important, why enactment of a statutory pay-as-you-go rule to reinforce Congressional rules can be beneficial, and why enactment of a statutory pay-as-you-go rule is not itself sufficient to achieve fiscal sustainability.

To explain my view of the benefits and limits of a pay-as-you-go rule, I would like to make three points:

- The United States faces a serious long-term fiscal problem that must be addressed. The current high deficits levels are unfortunate, although it would not be sensible to try to reduce them while the economy remains weak. Deficits are then expected to decline over the next few years as the economy improves. But without changes in current policies, we face the prospect of rapidly growing federal deficits and debt over time that will pose a significant threat to the U.S. economy, to the standard of living of all Americans, and to the ability of the government to meet the needs of its citizens.

- A well-designed pay-as-you-go rule can make a real contribution to the fiscal discipline needed to address the long-term fiscal problem, if there is a real commitment to abiding by the principle that any new tax cuts or mandatory program increases must be paid for. Putting the pay-as-you-go rule in statute does not guarantee that Congress and the President will comply with the rule. Just as is the case with House and Senate rules, a statutory PAYGO rule can be waived if there is sufficient support in the Congress for tax cuts or entitlement increases that are not paid for and the President does not veto legislation that violates the rule. But a statutory pay-as-you-go rule can increase the likelihood the pay-as-you-go principle will be followed. Some lawmakers may be more hesitant to support a waiver of a statutory rule they have supported. In addition, it would be harder for a future Congress to simply eliminate a rule that has been written into statute. Finally, the process of enacting such a rule may help create and demonstrate commitment to the principle behind the rule.

  As noted, the statutory rule will have little effect if there is no real commitment to living by it. That is why we think criticism of the President's proposal to exempt the cost of

extending specified current policies that are scheduled to expire under current law is misguided. To be sure, the Center on Budget and Policy Priorities believes that in light of the long-term fiscal problem we face, it would be highly desirable to pay for any extensions of expiring current policies. But, it has become absolutely clear that there is no chance that tax cuts enacted in 2001 and 2003 that benefit the middle class, provisions enacted in 2001 that limit the scope of the estate tax, relief to prevent the alternative minimum tax from hitting tens of millions of middle-class families, and the deferral of the requirement to cut Medicare physician reimbursement payments by 21 percent starting next January (which could cause a major exodus of physicians from the Medicare program) will either be allowed to expire or be paid for. It makes no sense to put in place a pay-as-you-go rule that says these extensions must be paid for when everyone knows they will not be. Rather than making a phony promise that will lead inevitably to a series of waivers of the pay-as-you-go statute — waivers that will undermine support for the rule itself and open the door to waivers for other costly policies — it is appropriate to acknowledge up front that these specified extensions of current policy will not be subject to the rule and to insist that the rule be strictly applied to any other legislation that is not paid for. I should note that this is exactly the approach followed in this year's budget resolution with respect to House enforcement of its pay-as-you-go rule.

- Abiding by the pay-as-you-go principle will not itself be sufficient to deal with the long-term fiscal problem. To put the budget on a sustainable basis it will be necessary to increase revenues above the level produced under current policies (and under President Obama's budget proposals) and to reduce the growth of spending — especially health care spending — below what is currently anticipated.

Before exploring these points in more detail, I would like to make a plea. While budget rules, such as the pay-as-you-go rule, can be important, actual policy decisions that will be made in the next few months will be far more important in demonstrating a real commitment to begin dealing with the long-term fiscal problem. In particular, the decisions that are made about health reform will be crucial. Whether a statutory pay-as-you-go rule is enacted or not, it is essential for the Congress and the President to demonstrate a commitment to the pay-as-you-go principle by fully paying for the cost of health care reform over the next 10 years. That will require some painful steps, such as adopting politically unpopular changes both in tax laws and in payments to health care providers. But if Congress and the President do not demonstrate that they are willing to take such steps to keep from making an already unsustainable fiscal situation worse, the enactment of a statutory pay-as-you-go rule will ring hollow and will not persuade anyone (including financial markets) that policymakers are willing to deal in a real way with the problems we face. In addition, it is absolutely crucial that the health reform that is enacted produces changes in our health system that begin taking the steps necessary to slow the growth of health care costs systemwide (i.e., in both the public and private sectors). We will never be able to ensure sustainability of the federal budget — or the health of the economy — unless we bring down the growth rate of those costs.

Long-term Fiscal Problem

Projecting federal spending and revenues for coming years, much less for coming decades, is an inexact science and subject to great uncertainty. Nevertheless, there is virtual consensus among

budget analysts that current fiscal policies are not sustainable. (Economists generally define a sustainable fiscal path as one in which debt held by the public does not steadily increase as a share of the nation's gross domestic product.) While the precise estimates have differed according to the specific assumptions made, the Congressional Budget Office, the Government Accountability Office, the Office of Management and Budget in both Republican and Democratic administrations, and the Center on Budget and Policy Priorities have all conducted analyses which find that, unless current policies are changed, federal deficits and the debt held by the public will grow steadily in coming decades, relative to the size of the economy, and reach levels far in excess of those previously experienced in the United States or that are safe for the economy.[1]

For example, in the Center's most recent study of the long-term fiscal problem, published last December, we projected that if current policies remain unchanged — assuming for example, that the middle-class tax cuts enacted in 2001 and 2003 are extended beyond 2010 and AMT relief is continued — deficits will grow to levels far in excess of this year's unusually large deficit (likely to total 13 percent of GDP), which is swollen by the deepest recession since World War II. We project that by 2050, the deficit will total 21 percent of GDP with the economy operating at full capacity. Moreover, by that year, the federal debt held by the public would total 280 percent of GDP, far in excess of the record-high 109 percent of GDP reached at the end of World War II.[2] The increase in deficits relative to the size of the economy under current policies is driven by a decline in revenues as a share of GDP (to 17.2 percent of GDP by 2050) and a big increase in the cost of Medicare, Medicaid, and Social Security (from 8.5 percent of GDP last year to 18.9 percent in 2050). (It's worth noting that other programs do *not* contribute to the growth in deficits as a share of GDP. All mandatory programs other than Social Security, Medicare, and Medicaid are projected to *shrink* relative to GDP both over the next 10 years and in the decades that follow. In addition, both defense and non-defense discretionary spending have generally fallen as a share of GDP over the last 25 years and are projected to continue to do so.)

The increase in the cost of the "big three" programs — Medicare, Medicaid, and Social Security — is partly due to demographic changes; with the aging of the baby-boom population, an increasing share of the population will be elderly. But the growth of Medicare and Medicaid is much greater than the growth of Social Security, and the primary reason for the growth in those two programs is the growing cost of providing health care per person. (CBO has estimated that more than three-quarters of the projected growth of Medicare and Medicaid through 2050 is due to rising per person health care costs.) It is important to note that the anticipated rising per-person cost of providing health care through Medicare and Medicaid reflects the anticipated cost of providing care system

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[1] See "The Long-Term Fiscal Outlook is Bleak: Restoring Fiscal Sustainability Will Require Major Changes to Programs, Revenues, and Nation's Health Care System," Richard Kogan, Kris Cox, and James Horney, Center on Budget and Policy Priorities, December 16, 2008; "The Long-Term Budget Outlook," Congressional Budget Office, December 2007; "The Nation's Long-Term Fiscal Outlook: March 2009 Update," United States Government Accountability Office, March 2009; "Part III — The Long-Run Budget Outlook," in Chapter 13 of the "Analytical Perspectives" volume of the *Budget of the U.S. Government: Fiscal Year 2010* and the *Budget of the U.S. Government: Fiscal Year 2009.*

[2] Because these projections were made last December, they do not take into account the full effects of the economic downturn that are apparent now or the cost of the American Recovery and Reinvestment Act (ARRA) enacted this year to help stimulate the economy. Because these effects are temporary, however, they have a much smaller effect on the long-term fiscal problem than many people assume. For instance, the Center on Budget has estimated that roughly $800 billion in stimulus costs would increase the size of the long-term problem by only 3 percent. See, "Economic Recovery Bill Would Add Little to Long-Run Fiscal Problem," Kris Cox and Paul N. Van de Water, Center on Budget and Policy Priorities, January 16, 2009.

wide. Medicare and Medicaid costs per person have essentially followed the path of system-wide costs — private as well as public — for more than 30 years and are expected to do so in the future under current policies.

It also may be noted that since entitlements other than the "big three" are actually declining as a share of GDP and are projected to continue doing so for as far as the eye can see, we do not face a *general* entitlement problem. The causes of our long-term fiscal problem are, essentially, rapidly-rising health care costs systemwide, an aging population, and an inadequate revenue base.

Other projections differ somewhat from ours — some have higher deficits and debt, some have lower. But virtually all agree that deficits and debt will grow to levels that will pose a real threat to the economic health of the United States and the well-being of its citizens. It is clear that this long-term problem must be addressed.

Pay-as-you-go in the 1990s

A pay-as-you-go rule was first established in the Budget Enforcement Act (BEA), which was part of the 1990 deficit reduction agreement negotiated by President George H.W. Bush and Congressional Democrats and Republicans. It is important to remember that the enforcement procedures were a secondary part of that deal — the most important part of the deal was a package of specific changes in law that increased revenues and cut mandatory program spending. Those legislative changes, along with an enforceable agreement to limit future discretionary appropriations, reduced deficits by an estimated $500 billion below the levels projected under then-current policies over five years.

The pay-as-you-go rule was intended to lock in the savings achieved through the tax increases and mandatory cuts by requiring that any subsequent legislation that undid any of those tax or spending provisions, or otherwise cut taxes or increased mandatory spending, had to be paid for with offsetting tax increases or budget cuts. (The BEA also established statutory caps on discretionary appropriations to enforce the agreement to limit that spending.) Specifically, the pay-as-you-go rule required the Office of Management and Budget to determine at the end of a session of Congress whether all of the tax and mandatory spending legislation (other than legislation designated as emergency legislation) enacted during that session had the net effect of increasing the deficit in the current fiscal year (and the fiscal year most recently ended if the legislation had any effect in that year). If OMB estimated that the deficit had been increased, the BEA required implementation of automatic cuts — called sequestration — in spending for mandatory programs that were not specifically exempt (generally, exempt programs were programs meeting the needs of low-income Americans, Social Security, and programs in which the government has a contractual requirement to make payments, such as interest on the federal debt). The Senate also adopted a pay-as-you-go rule aimed at prohibiting consideration of tax and entitlement legislation that would increase the deficit.

The pay-as-you-go approach proved very successful in the 1990s (an experience that demonstrates the vacuity of claims that pay-as-you-go is a gimmick with no real effect). Congress and the President paid for any increases in mandatory programs and any tax cuts, including the extension of expiring measures such as "tax extenders."[3] Along with the effects of the deficit reduction packages

[3] During the 1990s, every mandatory increase and tax cut was paid for except for one emergency spending measure. In the face of lingering high unemployment 1993, a final six-month extension of extended unemployment benefits enacted

enacted in 1990 and 1993 and a vibrant economy (which was likely helped by the federal government's commitment to fiscal discipline), the pay-as-you-go rule helped achieve the first federal budget surpluses in 30 years. At the end of that decade, however, the broad consensus on the importance of abiding by the pay-as-you-go rule broke down in the face of federal budget surpluses, and Congress and the President began enacting waivers that allowed spending increases and tax cuts without offsets. In 2001, in particular, large tax cuts were enacted that were not paid for. The statutory pay-as-you-go rule then was allowed to expire at the end of 2002. A Senate pay-as-you-go rule remained in effect, but was modified in a way that allowed consideration of legislation that increased the deficit so long as the deficit increase had been assumed in the budget resolution, which made the rule rather ineffectual.

Pay-as-you-go Now

At the beginning of the 110th Congress, the House adopted a new pay-as-you-go rule to limit House consideration of tax and entitlement legislation that would increase the deficit, and the Senate reinstated a version of the pay-as-you-go rule that had been in effect in the Senate in the 1990s. These rules have had significant effect in deterring enactment of new tax and entitlement policies that would increase the deficit.[4] Those who doubt this deterrent effect have not been involved in the numerous difficult discussions that have occurred with lawmakers and their staffs over how to pay for proposed increases in entitlement benefits or tax cuts and have not seriously considered what would have happened in the absence of the rules.

There have been exceptions to the rule, however. The House and Senate enacted substantial tax cuts and entitlement increases as part of legislation aimed at stimulating the sagging economy and shoring up the nation's financial system without offsetting the costs of those provisions. This was entirely appropriate. The original statutory pay-as-you-go rule, the current House and Senate rules, and the President's proposed statutory rule all provide exceptions for emergency legislation. Legislation needed to deal with a near meltdown of the financial system and the worst economic downturn since the Great Depression certainly qualifies as emergency legislation. Not only would abiding by a requirement to find offsets for these efforts have greatly complicated and delayed enactment of this crucial legislation, placing the economy and financial markets at risk, but it also would have undermined the goal of stimulating the economy during a recession. With severely lagging consumer purchases, business cutbacks in employment and investment, state and local government reductions in employment and purchases of goods and services, and short-term interest rates near zero, a deficit-financed increase in federal spending (for direct purchases of goods and services, transfers to individuals who would increase their purchases, and relief for state and local governments to reduce the cutbacks they are making) and a reduction in federal taxes were the best, if not only, hope of boosting aggregate demand, braking the spiral of cutbacks and layoffs, and keeping an already dire situation from reaching tragic proportions. If the stimulus legislation had raised other taxes or cut other spending to offset the cost of the tax cuts and increased spending provided in the legislation, there would have been no net increase in the aggregate demand for

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in the 1990-1991 recession was declared an emergency by both the Congress and the President and for that reason was not subject to the pay-as-you-go statute.

[4] See "The House Has Complied This Year with Its New 'Pay-as-you-go' Rule: But Greater Challenges Lie Ahead," Richard Kogan and James Horney, Center on Budget and Policy Priorities, November 7, 2007.

goods and services and no boost to the economy. Any sensible pay-as-you-go rule should allow for an emergency exception for circumstances such as those we have recently faced.

The other notable exceptions cannot be defended on such policy grounds, but they illustrate the political reality that any statutory pay-as-you-go rule needs to take into account. Congress — particularly the Senate — has demonstrated an unwillingness to offset the cost of extending several current policies such as relief from the alternative minimum tax and the deferral of the large reductions in Medicare physician reimbursements required under the so-call sustainable growth rate (SGR) rules. The budget resolution adopted this year also makes clear that the cost of extending the expiring reductions in middle-class taxes and the estate tax enacted in 2001 and 2003 will not be offset. Given the long-term fiscal problem the nation is facing, and the inevitable need for higher revenues and slower spending in coming decades, I believe it is unwise to extend any expiring tax cuts or relief from required reductions in spending without offsetting the cost of those extensions, and I wish that enactment of a pay-as-you-go rule would ensure that they would be paid for. But, it is clear that the majority of lawmakers do not believe these extensions should be paid for and that, regardless of whether a statutory pay-as-you-go rule is enacted that applies to those extensions, Congress will not let those provisions expire or offset the cost of extending them.

Given that basic political reality, it is appropriate that the pay-as-you go rule make an exception for the cost of extending the specified policies. That is what the President's proposal would do, and what the language in this year's budget resolution that governs application of the House pay-as-you-go rule did.

I believe these exceptions *strengthen* the rule. If there are no such exceptions, there is no doubt that Congress will vote to waive the application of pay-as-you-go when legislation extending those policies is considered. I fear that those waivers will undercut support for the pay-as-you-go rule itself — that having voted to waive the rule a number of times for these extensions, Congress is more likely to vote to waive the rule for other tax cuts or entitlement increases. For example, it is absolutely clear that Congress will not let the estate tax exemption level and tax rates revert to the levels set in law prior to 2001. It also is clear that Congress will not pay for the cost of extending the estate-tax exemption and tax rate at the levels currently in effect and, unfortunately, that there is considerable support in the Senate for further increasing the exemption level and further reducing the tax rate without paying for the billions of dollars of additional revenue losses that would generate. If the pay-as-you-go rule is designed so that it applies even to the cost of extending the current estate-tax parameters, then the rule will unquestionably be waived. And if the Senate Finance Committee already must secure a waiver just to bring legislation to the Senate floor that simply extends current estate-tax policies, no additional waiver will be needed for a Finance Committee bill that goes considerably beyond that and further increases the exemption amount and reduces the tax rate without offsetting the cost.

To be sure, it is not certain that it will be possible to hold the line at extension of the current estate-tax policies in any case (or to pay for any costs of further weakening the estate tax). But there will be a much greater chance of doing so if the line in the sand is clearly drawn at extending current policies. The principle should be clear — if Congress extends current policies there will be no need to waive pay-as-you-go, but any attempt to go beyond extension of current policies without offsetting the cost — i.e., to engage in new deficit financing — will require a vote to waive the PAYGO rule that lawmakers have pledged to support.

A number of critics of the President's proposal to except the cost of extensions of current policies from the pay-as-you-go rule have made their point by analogy, comparing the proposal, for instance, to a promise to abide by a diet that excludes chocolate cake or other highly caloric desserts from dietary restrictions. Such analogies are clever, but inaccurate; they miss the mark. A more apt analogy is with a promise to limit caloric intake in order to lose weight. If a person promises to eat nothing for 30 days, the promise is meaningless and clearly will not help achieve the desired outcome. The person will violate the promise every day, and after the person takes the first bite each day there is no useful yardstick to encourage the dieter to stop eating before he or she is satiated. If, however, the person sets a daily caloric intake at a reasonable level, the pledge might actually help the dieter stop overeating. It is true that the promised diet would be meaningless if the caloric intake is set at such a high level that the dieter can eat virtually anything he or she would like without exceeding the limit. But anyone who thinks the Congressional appetite for tax cuts and entitlement increases would be satisfied once Congress extends the expiring policies has not been paying attention. Drawing a line at extending current policies thus should help significantly in promoting fiscal responsibility.

It is important to be clear that simply putting the pay-as-you-go rule in statutory form and enforcing it with an automatic sequestration does not by itself substantially increase the effectiveness of the rule beyond what the House and Senate rules have already accomplished. The House rule can be waived if the Rules Committee recommends such a waiver and a majority of the House then votes for the resolution (or "rule") the Rules Committee has reported. The Senate rule can be waived with a 3/5 vote of the Senate. It is true that in order to waive a statutory pay-as-you-go requirement, Congress would have to include a specific waiver in legislation and that the President could veto the legislation containing the waiver if he objects to the violation of the pay-as-you-go rule. But the President already can veto any legislation that violates the pay-as-you-go principle if he objects to the violation.

Nonetheless, I believe that enacting a statutory pay-as-you-go rule to reinforce the current House and Senate rules would be useful. It seems likely that at least some lawmakers would be more reluctant to support an effort to override a statutory pay-as-you-go requirement than to vote for a waiver of House and Senate rules. It also would be more difficult for a new Congress to simply eliminate a statutory rule. Finally, the very process of enacting a statutory pay-as-you-go rule could help build support for and commitment to the pay-as-you-go principle. And that commitment is the key to success of any pay-as-you-go rule. Just as no diet will succeed in getting a person to eat less if he or she is not committed to losing weight, no budget process rule can force Congress and the President to forgo deficit-increasing legislation if they are not committed to bringing deficits under control. And, just as a sensible and realistic diet can help a committed individual lose weight, so can a sensible and realistic pay-as-you-go rule help Congress and President adhere to a commitment to stop digging the deficit hole deeper.

Pay-as-you-go Is Not Sufficient

Abiding by the pay-as-you-go principle and avoiding making the long-term fiscal problem worse than it is under current policies is not enough to put the federal budget on a sustainable path. This is not to underestimate the importance of this first step, both in symbolic and substantive terms. As a symbol, it is particularly important because it will demonstrate a clear break with the approach

taken in the first years of this decade when Congress and the President enacted large tax cuts and new entitlement benefits (particularly a new Medicare prescription drug benefit) without offsets and substantially increased both short- and long-term deficits. In substantive terms, it is important because major changes in policies, such as health care reform, that are not paid for would add significantly to the long-term problem.

Of course, merely avoiding making the fiscal problem worse will not avoid the inevitable day of reckoning for the federal budget. As I noted earlier, without changes in current policies, deficits are projected to rise to and remain at unsustainable levels.

Congress and the President will have to take further steps to increase revenues above the level produced under current policies or under the policies proposed by President Obama and, similarly, to reduce spending below the levels produced under current policies or those the President has proposed. Such steps will not be easy, but they are necessary. Ideally, there will be a time in the near future when it is possible for the President and Democratic and Republican Congressional leaders to work together to develop a broad and balanced package of revenue increases and spending reductions that will significantly shrink projected deficits, as occurred in 1990 when President George H.W. Bush negotiated a deficit reduction package with the Congress. In the meantime, it is critical to abide by the pay-as-you-go principle — and to do so in designing a health reform package that is both paid for and contains elements that will facilitate the long-term reduction in the growth of health-care costs.

A failure to deal with the long-term fiscal problem would have very deleterious consequences. Eventually, the run-up in debt would seriously harm the U.S. economy and the standard of living of Americans. It is also possible that even before the debt rises to such levels, the failure to address the problem would lead credit markets around the world to decide that continuing to lend large amounts to the United States to finance its deficits is not desirable, pushing up interest rates and potentially triggering a world-wide financial crisis. It is also clear that spiraling deficits, and any effort to deal with them in a crisis atmosphere, could threaten crucial federal programs that provide assistance to the nation's most vulnerable citizens as well as to veterans, students seeking a college education, and many others. Rather than being addressed, vital unmet needs would grow. Virtually no one in this country will go unharmed if we do not begin to address the long-term fiscal problem in a thoughtful, responsible manner.