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Obama's PAYGO Law Would Not Slow Spending or Budget Deficits

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A week after muscling through possibly the most expensive spending bill in America history, President Obama has called on Congress to support fiscal discipline. Specifically, he has proposed a Pay-as-You-Go (PAYGO) statute requiring that tax cuts and entitlement expansions be collectively deficit neutral.

Since 2007, Congress has had a PAYGO rule mandating that each new tax and entitlement bill be deficit neutral. Because it is merely a congressional rule, lawmakers can (and do) waive it easily. By contrast, a PAYGO *statute*—which existed from 1991 until 2002—would operate differently. Instead of requiring that each tax and entitlement bill be deficit neutral, this law would keep a running scorecard of all enacted bills (allowing one bill to offset another). If, at the end of the year, the net effect of all tax and entitlement legislation was to increase the budget deficit over the next decade, an automatic series of entitlement spending cuts ("sequestrations") would be triggered to offset those costs.

PAYGO has proven to be more of a talking point than an actual tool for budget discipline. During the 1991–2002 round of statutory PAYGO, Congress and the President still added more than $700 billion to the budget deficit and simply cancelled every single sequestration.[1] Since the 2007 creation of the PAYGO rule, Congress has waived it numerous times and added $600 billion to the deficit.

Creating a PAYGO law and then blocking its enforcement is inconsistent and hypocritical. And given their recent waiving of PAYGO to pass a $1.1 trillion stimulus bill, there is no reason to believe the current Congress and the President are any more likely to enforce PAYGO than their predecessors were. And even if it were enforced, PAYGO applies to only a small fraction of federal spending (new entitlements). Consequently, PAYGO is merely a distraction from real budget reforms that could rein in runaway spending and budget deficits.

Six Problems with PAYGO:

1. *PAYGO Would Not Decrease the Growth of Federal Spending.* PAYGO is not designed to reduce federal spending. It is not even designed to slow the growth rate of spending. It *only* limits the creation of *new* entitlement benefits above the spending growth baseline. In fact, entitlement spending grew *faster* after statutory PAYGO took effect in 1991.[2]
2. *PAYGO Exempts Discretionary Spending.* Discretionary spending programs—which comprise nearly 40 percent of the federal budget—are totally exempt from PAYGO rules. In other words, Congress could provide unlimited budget increases to most defense, education, health

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research, justice, international, environmental, veterans' health, homeland security, and housing programs without triggering PAYGO. This loophole is a major flaw that substantially weakens PAYGO.

3. *PAYGO Exempts Current Entitlement Benefits.* Under PAYGO, current entitlement programs can continue to grow on autopilot. Only newly created entitlement benefits must be offset. In short, PAYGO would not prevent:
   - Social Security from growing 6 percent annually;
   - Medicare and Medicaid from growing 7 percent annually; and
   - Nominal entitlement spending from nearly doubling over the next decade.

   PAYGO could theoretically slow down the creation of any new entitlements. Yet the nation's main budgetary challenges stem from the $44 trillion unfunded obligation from Social Security and Medicare, as well as the growing costs of current entitlements like Medicaid. PAYGO would do nothing to reduce the growth rate of these programs.

4. *PAYGO Employs a Double Standard That Raises Taxes*. Every few years, Congress must review and renew most entitlement programs and many tax cuts. PAYGO sensibly says that renewing an existing entitlement program is not "new" spending and therefore does not need to be offset. However, PAYGO applies a different standard to tax cuts. It classifies tax cut extensions as "new" tax cuts that violate PAYGO and must be offset.

   This makes no sense. PAYGO was intended to block the creation of *new* policies that increase the deficit. Simply keeping current tax policies in place should not be treated as "new" tax cuts. Additionally, the blatant double standard of allowing entitlement spending policies but not tax policies to be extended constitutes a major bias towards higher taxes and spending. For instance, PAYGO allows the extension of expiring SCHIP and farm subsidy laws, but it does not allow the extension of the 2001 and 2003 tax cuts or the Alternative Minimum Tax (AMT) to be patched without offsets. Even President Obama has criticized this double standard, and Congress should eliminate this baseline disparity from any PAYGO statute.[3]

5. *Previous PAYGO Statutes Were Never Enforced—Even Once.* Congress already had a PAYGO statute from 1991 to 2002. But this law was never enforced. Over the statute's 12 years, Congress enacted more than $700 billion in new entitlement spending and tax cuts—and then enacted legislation cancelling every single sequestration. Even if Congress had allowed sequestration, they had already enacted legislation exempting 97 percent of all entitlement spending—all but $31 billion—from being part of any sequestration.[4] The law was practically designed to fail. Entitlement spending actually grew *faster* during the 12 years of PAYGO (1991–2002) than in the 12 previous years (1980–1991).[5]

   The budget did temporarily achieve balance during that period. Yet PAYGO had very little to do with it. The budget was balanced by the combination of the dot com bubble revenue boom, defense savings after the Cold War ended, and declining net interest costs.

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1. Douglas Holtz-Eakin, Director of the Congressional Budget Office "Reforming the Federal Budget Process," testimony before Rules Committee, U.S. House of Representatives, March 23, 2004, at *http://www.cbo.gov/doc.cfm?index=5220&type=0* (February 26, 2009).
2. Calculated from Office of Management and Budget, *Historical Tables: Budget of the United States Government, Fiscal Year 2009*, Table 8.2, page 135. Annual mandatory spending (excluding net interest) grew by 40 percent between 1980 and 1991 (before PAYGO) and by 49 percent between 1991 and 2002 (during PAYGO).
3. J. D. Foster, "Obama to CBO Revenue Baseline: Nuts—and He's Right!" Heritage Foundation *WebMemo* No. 2019, August 11, 2008, at *http://www.heritage.org/Research/Budget/wm2019.cfm.*
4. Bud Newman, "House Passes Bill to Avoid PAY-GO Sequestration But Daschle Says Senate May Not Take It Up," *BNA Daily Report for Executives*, November 18, 2002.
5. See footnote 2 above.

6. *Current PAYGO Rules Are Not Enforced.* Congress has operated under a PAYGO rule since 2007. In that short period of time, Congress has already bypassed PAYGO to:
   - Enact a stimulus bill that costs $479 billion in new entitlements and tax cuts;
   - Enact a veterans' education entitlement bill costing $63 billion;
   - Enact a student loan expansion costing $15 billion;
   - Twice patch the AMT; and
   - Enact SCHIP and farm bills that used blatant gimmicks to hide tens of billions of dollars in new entitlement benefits.[6]

Congress has bypassed PAYGO every time it has proved even slightly inconvenient to its spending agenda. There is no reason to believe another PAYGO statute would be any more successful.

Suggested Improvements. Even if PAYGO were miraculously enforced, baseline entitlement cost increases would still push the size of the federal government to nearly 50 percent of by 2050. PAYGO would also promote the expiration of all 2001 and 2003 tax cuts and force millions of Americans to pay the AMT. As a result, tax revenues would rise from the historical average of 18.3 percent of GDP to a record 23.5 percent by 2050.[7] The slow-growth economies of Western Europe show that such levels of spending and taxation cause serious long-term economic damage.[8]

If a statutory PAYGO law is to be enacted, President Obama and Congress should address some of the problems by:

- Making sure PAYGO treats tax and entitlement programs equally. If the renewal of expiring entitlement programs does not trigger PAYGO, neither should the renewal of expiring tax cuts.
- Pledging to block any legislation cancelling a PAYGO sequestration. Otherwise, Congress will continue to expand entitlements without paying for them.
- Avoiding the past practice of exempting 97 percent of entitlement spending from sequestration, which would otherwise render the law ineffective.
- Enacting statutory discretionary spending caps to close the loophole exempting non-entitlement spending.
- Enacting tougher entitlement controls by setting multi-year spending targets for entitlement programs covered by PAYGO. If OMB projects that spending will exceed these targets, the President would be required to submit reform proposals to reduce spending as part of the annual budget request, and Congress would have to act on those proposals.

Worse Than Doing Nothing. It is easy to suggest that even an ineffective PAYGO would be no worse than the status quo. This ignores PAYGO's bias for painful tax increases. Also, by providing a false sense of security, PAYGO would slow the momentum for vital budget process reforms that could actually rein in spending and the deficits. At the very least, the President should reduce Congress's ability to game the system by adding the improvements noted above to his PAYGO proposal.

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6. Brian M. Riedl, "The Democratic Congress's 2008 Budget: A Tax and Spending Spree," Heritage Foundation *Backgrounder* No. 2081, October 30, 2007, at *http://www.heritage.org/Research/Budget/bg2081.cfm.*
7. Congressional Budget Office, "The Long-Term Budget Outlook," December 2007, at *http://www.cbo.gov/ftpdocs/88xx/doc8877/12-13-LTBO.pdf* (February 26, 2009).
8. See Daniel J. Mitchell, "Fiscal Policy Lessons from Europe," Heritage Foundation *Backgrounder* No. 1979, October 25, 2006, at *www.heritage.org/Research/Budget/bg1979.cfm.*