October 29, 1997

Honorable Pete V. Domenici
Chairman
Committee on the Budget
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

As requested in your letter of October 16, the Congressional Budget Office (CBO) has examined whether the pay-as-you-go procedures set forth in section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985 (the Deficit Control Act) apply in a year for which the Office of Management and Budget projects a budget surplus. CBO agrees with your conclusion that the pay-as-you-go procedures "apply in every year through 2006, whether there is a total budget surplus or not." We find that the procedures for computing the amount of a pay-as-you-go sequestration are clearly specified in law and in no way depend on the projection of a deficit or surplus. Moreover, the law establishes no mechanism for turning off the sequestration process if a surplus is projected.

The Deficit Control Act is straightforward about how the Office of Management and Budget (OMB) determines whether a pay-as-you-go sequestration is required. OMB is directed simply to add up the cost estimates it has submitted for each direct spending or revenue bill that has been enacted. If the sum of all estimated increases in direct spending and reductions in receipts exceeds the sum of all estimated reductions in direct spending and increases in receipts, a sequestration must take place.

The law calls the sum of the net increase in direct spending and the net reduction in receipts the "net deficit increase." The use of that terminology follows section 3(6) of the Congressional Budget Act, which defines "deficit" as "the amount by which outlays exceed receipts" during a fiscal year. Under that definition, if receipts exceed outlays, the amount of the deficit is negative.

The General Accounting Office's *Glossary of Terms Used in the Federal Budget Process* explicitly recognizes that "sometimes a deficit is a negative surplus." Thus, a net deficit increase may occur even when the budget is in surplus.

Another indication that the pay-as-you-go procedures are intended to remain in effect regardless of the deficit or surplus is that the Deficit Control Act does not specify a process for turning off the procedures if there is a surplus. The law provides specific guidance about how the procedures can be suspended in the event of a war or recession, but it gives no directions for suspending them in the event of a projected surplus. For example, it does not specify when the estimate of the deficit or surplus would be made, when the procedures would cease to be effective, and how and when the procedures would be reinstated.

The absence of such directions is hardly surprising since the pay-as-you-go system was explicitly designed to control the effects of legislation on direct spending and revenues without regard to the projected level of the deficit or surplus. In 1990, the Congress and the President deliberately chose to substitute procedures that are based only on the budgetary effects of new legislation for the original Gramm-Rudman-Hollings procedures, which relied on projections of the deficit and were found to be an unsatisfactory basis for controlling the budget. If the pay-as-you-go procedures did not apply when OMB projected a surplus, the executive branch would have an incentive to make optimistic budget projections, as occurred when the Gramm-Rudman-Hollings procedures were in effect.

In your letter you also asked whether, if OMB interprets section 252 to mean that the pay-as-you-go procedures do not apply in a year for which it projects a surplus, the Social Security surplus should be excluded from that projection. Although CBO does not agree with such an interpretation, the relevant surplus would have to exclude the transactions of the two Social Security trust funds. Section 13301 of the Budget Enforcement Act of 1990 clearly states that "the receipts and disbursements of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund shall not be counted as new budget authority, outlays, receipts, or deficit or surplus for purposes of . . . the Balanced Budget and Emergency Deficit Control Act of

1985." The transactions of the Postal Service are also designated by law as off-budget and are thus also excluded from any calculations under the Deficit Control Act.

I hope that this response to your letter is helpful. As you know, CBO's role under the Deficit Control Act is strictly advisory, as are the views expressed here. OMB has the statutory responsibility for carrying out the law.

Sincerely,

June E. O'Neill
Director

Identical Letters Sent to Honorable Frank R. Lautenberg, Honorable John R. Kasich, Honorable John M. Spratt, Jr.