BUDGET BULLETIN
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COMMITTEE ON THE BUDGET Republican Staff
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INFORMED BUDGETEER

THE NEW ADVENTURES OF "OLD" PAY-GO (PART 1)

A little more than a year ago, offices were being relocated, staffs were being reorganized, and Capitol Hill was readying itself for the change in majority in the House and Senate. The new majority's Leadership and Budget Committee membership immediately set out to put in place pay-as-you-go rules that would fulfill Democrats' promise to return to "tough, old-fashioned pay-go." To illustrate what "old-fashioned" or "traditional" pay-go means, the *Bulletin* looked at a little history leading up to January 2007.

What Did They Say They Wanted, and Why Did They Say They Wanted It?

- In November 2005, during debate on a reconciliation bill (that became the Deficit Reduction Act of 2005), Senator Conrad offered an amendment to change the Senate's pay-go point of order and stated, *"Our proposal is to go back to what has worked in the past. It is traditional pay-go."* In March 2006, during debate on the FY 2007 Budget Resolution, Senator Conrad again offered an amendment to change the Senate's pay-go point of order and stated, *"This amendment would reestablish the budget discipline that worked so well in previous years, a rule that has been allowed to lapse by our colleagues on the other side of the aisle."*

- These are just two examples. In fact, Democratic Senators (most often Senators Feingold and Conrad) have offered amendments to reinstate in the Senate "tough, old-fashioned pay-go" to every Republican budget resolution debated since 2004. They also proposed pay-go amendments to the 2005 tax reconciliation bill and during the Senate Budget Committee markup of the Stop Over Spending Act of 2006 (SOS Act).

- The Senate pay-go point of order amendments offered by Democrats (when they were in the minority) were remarkable in their consistency.

- Every time Senate Democrats offered a proposal to reinstate the "tough, old-fashioned pay-go" point of order, the proposal required deficit neutrality in the 1st year of the budget, over the sum of years 1-5 and over the sum of years 6-10. (For example, if such a point of order were in place for the 2008 budget resolution, it would require direct spending and revenue legislation to be deficit-neutral in 2008, 2008-2012, and 2013-2017.)

- Every instance of their proposal also included a cumulative pay-as-you-go scorecard, so that any net savings recorded from an enacted piece of legislation could be used to offset the cost of a future piece of legislation.

- Why did Senate Democrats keep returning to the same version of the pay-go point of order? Because the Senate pay-go point of order was based on the original pay-go law, enacted in 1990 in the Budget Enforcement Act. That law put in place a five-year pay-go scorecard that kept track of any accumulated deficit increases from enacted legislation. If, at the end of each year, the net effect of all enacted laws affecting revenues and mandatory spending was to increase the deficit, then the Office of Management and Budget was supposed to issue a sequestration order – an across-the-board cut of certain mandatory spending.

- Statutory pay-go, in effect, was the original "first-year" test, enforced by sequestration. In 1993, Senate Democrats created a five-year pay-go point of order, for the Senate only, that was based on and paralleled the pay-go law (but relied on the sanction of a point of order instead of sequestration to encourage compliance).

- But some members sought to increase spending <u>after</u> the five-year pay-go window so they would not run afoul of the initial five-year pay-go point of order. So in a 1994 revision to this initial point of order, the Senate added a second five-year test (that covered years six through ten of the "budget window") to have the point of order cover a 10-year period instead of just five years. Given all this activity on pay-go in the 1990s, some assert that the pay-go concept (without being specific about whether it was the pay-go law, the pay-go point of order, or both) was responsible for reducing the deficit in the 1990s. (See previous *Bulletin* for more detail: http://budget.senate.gov/republican/analysis/2003/bb12-2003.pdf.)

An Early Head Fake

- No question about it – Democrats are on record in support of traditional pay-go, and that support was carried through as a major theme of many 2006 Democratic candidates' campaigns. The *Bulletin* does not have to remind readers of the refrain: *"If you want to increase spending you have to pay for it. If you want to cut taxes you have to pay for it."* And, when Democrats returned to power in the Senate in 2007, their efforts appeared true to their past pay-go efforts and campaign promises – at first.

- As one of their "top 10" legislative priorities for the 110th Congress, new Majority Leader Reid with Senator Conrad introduced S. 10, the Restoring Fiscal Discipline Act of 2007. S. 10 included a provision to install in the Senate the exact same "old-fashioned" pay-go point of order offered so many times over the previous three years (as summarized in Table 1). S. 10 was referred to the Budget Committee on January 4, 2007, but the Chairman has scheduled no further action.

TABLE 1: PROPOSED PAY-GO AT START OF THE 110TH CONGRESS

	S. 10	*House (H. Res. 6)*
Description	Would create a point of order in the Senate against measures that increase or create an on-budget deficit in the **current year, the budget year (1st year)**, **the first 5 years, or the second 5 years** (would not apply if sufficient on-budget surpluses were projected).	*Makes it out of order to consider legislation that increases the deficit or reduces the surplus for the first 6 years (2007 – 2012) or the first 11 years (2007 – 2017).*
Votes Needed to Waive Point of Order	60 votes	*Simple majority through adoption of a rule that waives the point of order.*
Scorecard	Uses a cumulative scorecard, so that savings in earlier enacted bills could offset deficit increases in later bills.	*House point of order applies on a bill-by-bill basis. No scorecard maintained.*
Sequestration	No sequestration enforcement.	*House point of order is not a law and therefore can not include sequestration.*
Expiration date	September 30, 2012.	*House point of order is effective for the 110th Congress only.*
In effect?	Must be enacted to go into effect. (Pay-go provision in S. 10 could be put into effect if written into a new budget resolution that Congress agrees to).	*House point of order is in effect now.*

- Following the pay-go promise set out in S. 10, the 2008 Senate-passed budget resolution did include the same, "old-fashioned" pay-go point of order requiring deficit neutrality in each of the periods covering year 1, years 1-5 and years 6-10.

- In contrast, the 2008 House-passed budget resolution did not include pay-go budget enforcement, because a House pay-go rule had already been put in place. The House had never before had any kind of pay-go point of order – not until January 5, 2007, when the House agreed to its rules package (H. Res. 6) for the 110th Congress. Title IV of that package included the first-time-ever pay-go point of order that applies in the House.

- The House pay-go rule makes it out of order to consider direct spending or revenue legislation that increases the deficit or reduces the surplus over years 1-6 or over years 1-11 (so in the case of legislation considered during 2007, the relevant periods were 2007-2012 and 2007-2017; for 2008, the relevant periods in the House are now 2008-2013 and 2008-2018). Each measure is considered on a bill-by-bill basis; savings from one bill cannot be "banked" and used to satisfy the pay-go requirement for future legislation.

(For a more detailed discussion of House and Senate proposals on pay-go in early 2007, see previous *Budget Bulletins*: http://budget.senate.gov/republican/analysis/2007/bb01a-2007.pdf http://budget.senate.gov/republican/analysis/2007/bb01b-2007.pdf.)

Do As We Do, Not As We Say

- When it came time to arrive at a conference agreement on the 2008 Budget Resolution, there were two good reasons to think that the agreement would include the Senate pay-go point of order in the exact same form as was included in the Senate-passed budget resolution, which was the old-fashioned pay-go they advocated for years.

- First, the pay-go point of order in the Senate-passed 2008 budget resolution applied only in the Senate. The House-passed budget resolution did not include any pay-go point of order for the Senate or the House (because the House already had adopted one). So there was no reason for the conference agreement to compromise or deviate from the version in the Senate-passed budget resolution.

- Further, Senate supporters of "old-fashioned" pay-go had repeatedly insisted over recent years and throughout the 2006 campaign on the same version of pay-go contained in the Senate-passed 2008 budget resolution and had pledged to return to it if they were in the majority.

- Apparently, 15 years of Senate Democrats' support for "old-fashioned" pay-go was expendable when their conferees on the 2008 budget resolution decided that the new, less-stringent time periods for deficit neutrality in the House rule weren't so bad after all. Currently, in the Senate's enforcement under the conference agreement on the 2008 budget resolution, the relevant time periods for measuring pay-go compliance are 2008-2012 (the first five years) and 2008-2017 (the 10 year-period). (The year 2007 is no longer included in the sum because 2007 is over.)

- But there is no test for the first-year (currently 2008) and no test for just the "second" five-years (2013-2017, aka the five years after the first five years).

- While the Senate Democrats were abandoning their fealty to old pay-go, they also sidestepped some of the tougher features the House had just adopted in the House's new pay-go rule (see Table 2).

TABLE 2: PAY-GO IN EFFECT IN THE 110TH CONGRESS

	Senate (Sec. 201 of S. Con. Res. 21, 2008 Budget Resolution Conference Agreement	***House (H. Res. 6)***
Description	Point of order against direct spending or revenue legislation that increases or creates an on-budget deficit.	*Makes it out of order to consider direct spending or revenue legislation that increases the deficit or reduces the surplus.*
Period covered[a]	Must be deficit-neutral for the first 6 years (2007 – 2012) and the first 11 years (2007 – 2017). **No first-year test and no test for years 6-10.**	*Must be deficit-neutral for the first 6 years (2007 – 2012) and the first 11 years (2007 – 2017).* **No first-year test and no test for years 6-10.**
Application	Would not apply if sufficient on-budget surpluses were projected.	*Applies regardless of whether on-budget surpluses are projected.*
Votes Needed to Waive Point of Order	60 votes	*Simple majority – via adoption of a rule that waives the point of order.*
Scorecard	Uses a cumulative scorecard, so that savings in earlier enacted bills could offset deficit increases in later bills.	*House point of order applies on a bill-by-bill basis. No scorecard maintained.*
Expiration date	September 30, 2017 or until changed by a subsequent resolution.	*House point of order is effective for the 110th Congress only.*
In effect?	Current pay-go point of order became effective on adoption of the conference agreement on S.Con.Res 21 (May 17, 2007).	*House point of order has been in effect since January 5, 2007.*

a. In the House these were the periods covered for the first session of the 110th Congress. With the start of the 2nd session, the House pay-go rule required the enforcement periods to change to 2008-2013 for the first six years and 2008-2018 for the 11 years.

- For example, the pay-go point of order (applying only in the Senate as adopted via the 2008 Budget Resolution conference agreement) measures any deficit effect of each bill against a pay-go scorecard. If the scorecard has a zero or negative balance on it, the legislation would have a pay-go point of order against it, unless the deficit increases are offset in the same measure.

- If the Senate pay-go scorecard has a sufficient positive balance on it (representing a projected on-budget surplus or net decreases in the deficit accumulated from previously enacted legislation), then no pay-go point of order would apply against the measure.

- In the House, there is no pay-go scorecard. Instead, each bill is independently evaluated by whether it increases the deficit, on net, over six and 11 years.

- In addition, the House pay-go rule prohibits legislation that increases the on-budget deficit or reduces the surplus; the Senate rule only prohibits legislation that increases the on-budget deficit.

MAKE SURE TO READ ON TO PART 2 OF THIS TWO-PART BULLETIN IN No. 1B

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PART 2 OF THE NEW ADVENTURES OF "OLD" PAY-GO (CONTINUED)

Thought Experiment

- Despite their rhetoric about returning to good, old-fashioned pay-go enforcement, the Democrats' 2008 budget resolution changed their promised, long-sought Senate pay-go point of order to an easier test that is now in place. Legislation cannot increase the deficit over the sum of five years or over 10 years. But, for the first time since pay-go began back in 1990, legislation no longer has to be deficit neutral in the first year!

- By throwing the first-year test overboard and swapping the old test for years 6-10 for a new 10-year sum, the Democrats' new pay-go point of order has encouraged timing shifts to make legislation look like it is paid for over the near-term, even if it isn't.

- Consider a simple example starting with Table 3A to see how this has worked. Under good, old-fashioned pay-go, let's say you wanted to increase spending (or cut taxes) by $9 billion in 2008 (and nothing thereafter). To avoid an old-fashioned, traditional pay-go point of order, you would have had to come up with a $9 billion offset in 2008 (so that there would be no net increase in the deficit) to satisfy the first-year test and the first-five-years test.

TABLE 3A: TOUGH FIRST-YEAR OFFSET REQUIREMENT UNDER OLD-FASHIONED PAYGO

($ billions)	1st year 2008	2009	1st 5 years 2008-12	2nd 5 years 2013-17
Increase in Spending	9	0	9	0
Needed Offset (tax increase or spending decrease)	-9	0	-9	0
Net Deficit Effect[1]	**0**		**0**	**0**

1. Old Pay-go test would have been satisfied since each of these three periods is zero or less

- But let's face it – under old pay-go, coming up with an immediate reduction in spending of $9 billion this year or increasing taxes by $9 billion this year would be supremely tough. So maybe you defer your spending to 2009 instead. Then you don't need an offset in 2008, and you could come up with an offset that reduces the deficit by $9 billion over the next four years (say by $2.25 billion in each of the years 2009-2012) and still not have a pay-go point of order, as shown in Table 3B.

TABLE 3B: UNDER OLD PAY-GO, OFFSETS EASIER TO ACHIEVE OVER 5 YEARS BY SHIFTING COST PAST FIRST YEAR

($ billions)	1st year 2008	2009	1st 5 years 2008-12	2nd 5 years 2013-17
Increase in Spending	0	9	9	0
Needed Offset (tax increase or spending decrease)	0	-2.25	-9	0
Net Deficit Effect[1]	**0**		**0**	**0**

1. Old Pay-go test would have been satisfied since each of these three periods is zero or less

- But maybe you don't even have an offset that is palatable over the next several years. Maybe the only offset you can come up with is to extend customs user fees past 2015, when they are currently slated to expire. For this example (see Table 3C), let's say that doing so would yield about $3 billion in customs fees in each year 2015-2017, for a total of $9 billion. Customs user fees have been around since 1985 and will likely continue to be extended forever since they are a favorite offset (see: http://budget.senate.gov/republican/analysis/2003/bb16-2003.pdf http://budget.senate.gov/republican/analysis/2004/bb08-2004.pdf).

TABLE 3C: UNDER OLD PAY-GO, OFFSETS IN YEARS 6-10 COULD NOT PAY FOR NEAR-TERM SPENDING

($ billions)	1st year 2008	2009	1st 5 years 2008-12	2nd 5 years 2013-17
Increase in Spending	0	9	9	0
Needed Offset - Customs Fees	0	0	0	-9
Net Deficit Effect (+ =deficit increase/minus=deficit decrease)[1]	**0**		**+9**	**-9**

1. Old Pay-go test would have not been met because deficit increases in 2008-2012

- So under tough old pay-go, customs user fees would not save you from a pay-go point of order because extending them does not provide an offset when you need it – in the first five years. Good thing that Senate Democrats threw out old pay-go for a new version that would allow them to skip a first-year test and use offsets far in the future, like customs user fees, to pay for near-term spending (as in Table 3D). (While this example shows the increase in spending in 2009, note that, because there is no first-year test, this approach would work just as well if you want to do your spending in 2008 instead of 2009.)

TABLE 3D: NEW PAY-GO NEEDS MORE THAN LONG-TERM OFFSET TO PAY FOR SPENDING TODAY

($ billions)	1st year 2008	2009	1st 5 years 2008-12	2nd 5 years 2013-17	all 10 years 2008-17
Increase in Spending	0	9	9	0	9
Needed Offset-Cust. Fees	0	0	0	-9	-9
Net Deficit Effect[1]	0		**9**		**0**

1. New Pay-go test would not be met because deficit increases over 5 years (note that over 10 years this example is budget neutral)

- But the trick of using customs user fees (that won't be collected until seven years from now) to pay for spending today requires one more tweak. While customs user fees will satisfy the 10-year test of deficit neutrality, extending these in 2015 still would not satisfy the first five-years test, as shown in Table 3D.

- So what to do? Do what many bills have already done in the 110th Congress – do a timing shift (shown in table 3E). Specifically, tell corporations with assets of at least $1 billion to increase their corporate estimated tax payment due in the last quarter of FY 2012 by a certain percentage. Also tell corporations that their first payment due in FY 2013 should be decreased by the same percentage.

- This progression of examples demonstrates that new pay-go is in effect only a 10-year test of deficit neutrality. The stricter tests of deficit neutrality in the first year and over the first five years have been dropped or emasculated, respectively. The corporate tax timing shift is the linchpin for meeting new pay-go's significantly weakened tests in the 110th Congress because it makes it possible to satisfy the first five-year test when the only real offsets occur near the end of the 10-year period.

TABLE 3E: NEW PAY-GO, ALONG WITH CORPORATE TAX TIMING SHIFT, ALLOWS SPENDING TODAY WITH OFFSETS FAR IN THE FUTURE

($ billions)	1st year 2008	2009	1st 5 years '08-12	2nd 5 years '13-17	all 10 years '08-17
Increase in Spending	0	9	9	0	9
Needed Offset-Customs Fees	0	0	0	-9	-9
Needed Timing Shift Corporate est. tax payments			-9	9	0
Net Deficit Effect[1]	0		**0**		**0**

1. New Pay-go test is met because deficit does not increase over 5 years or 10 years

Spend it Now, Pay For It Way Later

- Table 4 shows that in the first session of the 110th Congress, six bills were enacted that include the corporate estimated tax shift. The Internal Revenue Code now says that corporations must send in $6.8 billion more to the federal Treasury in 2012. Congress apparently thinks that corporations are OK with that, since corporations will send in $6.8 billion less in 2013.

- In addition, there is $8 billion more in corporate tax shifts still in the wind (depending on the conference outcomes of the farm bill and energy tax provisions). Is there a point at which corporations say "Whoa!"? Perhaps. If the House-passed "paid for" AMT patch for 2007 had become law, corporations may have had a hard time shifting nearly $32 billion in tax payments from 2013 into 2012.

- But wait – isn't pay-go supposed to be about "paying" for something? How does moving money three months forward pay for anything?

TABLE 4: CORPORATE ESTIMATED TAX SHIFT USED IN LEGISLATION IN THE 110TH CONGRESS

	Public Law	($ billions) 2012	2013
Enacted legislation:			
2007 Supplemental (incl. minimum wage increase)	110- 28	+5.0	-5.0
Andean Trade Preference Act extension	110- 42	+0.2	-0.2
Burmese Freedom and Democracy Act	110- 52	+0.2	-0.2
Trade Adjustment Assistance extension	110- 89	+0.2	-0.2
US-Peru Free Trade Agreement	110-138	+0.5	-0.5
Mortgage Forgiveness Debt Relief Act	110-142	+0.9	-0.9
Total enacted tax shift		**+6.8**	**-6.8**
Pending legislation:			
H.R. 2419, Farm Bill, as passed by the Senate (in conference)		+4.2	-4.2
Possible agreement on energy tax provisions (not included in HR 6)		+3.8	-3.8
Total tax shift in pending legislation		**+8.0**	**-8.0**
Tax shift in passed, but not enacted, legislation (HR 4351, House-passed 2007 AMT patch)		+31.7	-31.7

Details do not add to totals due to rounding.
Source: CBO/JCT cost estimates

New Pay-Go Forgets That "The Debt Is The Threat"

- Supporters of the new pay-go who have bragged on its success throughout 2007 neglect to tell you about an important feature of their new, though not improved, rule. As the examples above demonstrate, because it no longer has a first-year test, new pay-go allows Congress to spend new money immediately (or cut taxes immediately), without an immediate offset.

- Everything else being equal under our current federal budget deficits, where does the Treasury go to get the money to pay for the new spending? To the credit markets, of course! Treasury has to go out and borrow the money to pay for the new spending (or tax cuts) today for as long as it takes for the offsets to kick in.

- In the case of the example in Table 3E above, the offsets for the $9 billion in spending in 2008 do not start coming in (in $3 billion annual installments) until 2015-2017. (The corporate tax timing shift only moves corporate payments forward by one month, which does not significantly affect Treasury's borrowing needs over the next 10 years.) The Treasury won't be able to pay off all the principal amount of $9 billion until the end of 2017. By then, however, it will have cost Treasury $4 billion in interest to borrow that $9 billion for 8-10 years.

- Does the new pay-go require that the $4 billion in interest costs be offset to satisfy the point of order? No. Pay-go pretends that the Treasury does not have to borrow money in the near-term. But in fact, Treasury has no choice but to add to the debt, at least for many years, to provide for the new spending (or the tax cuts). If the "debt is the threat," then why is it so virtuous that new pay-go requires the Treasury to borrow the $9 billion and pay $4 billion in interest financing costs? **This adding to the national debt forever the $4 billion in interest costs, which will never be offset under new pay-go**.

TAX GAP UPDATE – 110th Congress, 1st Session

Last year, the majority's 2008 budget resolution claimed that it would result in Congress reducing the tax gap by at least $300 billion over five years. That was the advertising. What happened in reality?

A Meek Step Forward. Congress did enact a few of the tax gap proposals included in the President's 2008 Budget, amounting to $0.2 billion in tax gap closure over five years.

A Sidestep. Congress decided not to enact the other $5.5 billion (over five years) of the total tax-gap-closing policies proposed by the President, meaning that Congress did only 4 percent of the job.

A Misstep. The President proposed, and the 2008 budget resolution agreed, to provide the IRS an additional $406 million in 2008 to increase tax compliance efforts to close the tax gap. While the Senate and House each passed a 2008 appropriation bill that would have provided this additional money, in the end, the Omnibus appropriation bill that Congress sent to the President for signature did not provide the additional $406 million. This means that Congress fell down on an opportunity to aid the IRS in collecting billions in revenue that now the IRS will not have the resources to track down.

Starting to Step Backwards. Last year, the House (but not the Senate) passed legislation (which has not yet been enacted) that, instead of making progress towards closing the tax gap, would actually widen the tax gap by about $1.1 billion over 10 years. The three provisions would result in the following levels of revenue loss by:

- Repealing the IRS' ability to hire private debt collectors ($1.05 billion).
- Delaying for one year the implementation of government withholding ($0.04 billion).
- Limiting to three years the time that IRS has to audit individuals living part of the year in the Virgin Islands ($0.04 billion).

(See previous *Bulletins* for more tax gap information:
http://budget.senate.gov/republican/analysis/2007/bb06-2007.pdf
http://budget.senate.gov/republican/analysis/2007/bb06b-2007.pdf)