"Statutory PAYGO: An Important First Step Toward Fiscal Responsibility"

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Chairman Spratt and members of the Committee:

I am happy to be back before this Committee to support the enactment of statutory PAYGO. Enshrining in law the PAYGO rules which Congress adopted in 2007 would highlight their importance and make them easier to enforce. Statutory PAYGO is a small, but important step toward restoring fiscal discipline to the federal budget. Along with President Obama, the Blue Dog Coalition, and many other proponents of responsible federal budgeting, I urge you to take this step without delay.

The long term budget outlook: impending catastrophe

No one needs to remind this Committee that the outlook for the federal budget is worrisome—indeed, scary. Long before the financial crisis and the current deep recession, this Committee was anxiously pointing out that current federal spending and revenue policies are on a risky, unsustainable course. Promises made under the major entitlement programs (especially Medicare and Medicaid) will increase federal spending rapidly over the next couple of decades, as the population ages and medical spending continues to rise faster than other spending. Federal expenditures are projected to grow substantially faster than revenues, opening widening deficit gaps that cannot not be financed.

The financial crisis and the recession, combined with the measures the government has taken to mitigate both, have worsened the budget outlook dramatically. The federal deficit will probably reach 13 percent of the GDP this year and will likely remain at worrisome levels even as the economy recovers. Federal debt held by the public, including our foreign creditors, is projected to double as a percent of GDP over the next decade. The recent rise in long term Treasury rates is a timely reminder that our creditors, foreign and domestic, may lose faith in America's willingness to take the difficult steps necessary to move the budget toward balance. This loss of faith—reversing the widespread perception that U.S. Treasuries are the safest securities in the World—could lead to rapidly rising interest rates, killer debt service costs for the federal government and others, a plunging dollar, and an aborted recovery.

As I testified before this Committee on January 27, 2009, I strongly believe that most of the emergency actions that authorities have taken to stimulate the economy and rescue the financial sector were the right policies in these dire circumstances. An escalating deficit and huge amounts of debt were necessary to avoid a much deeper and longer recession and a total meltdown of the financial system. However, these actions have made it absolutely necessary for Congress and the Administration to work together aggressively to bring future deficits under control. Unpopular actions to restrain future spending and augment future revenues must be taken now, even before recovery has been achieved. Putting Social Security on a sound fiscal base, credibly reducing the rate of growth of federal health spending, and raising future energy-related and other revenues are all actions that could be taken now to reduce future deficits.

Immediate actions to reduce long-term deficits—such as fixing Social Security this year--will enhance the prospects for recovery by restoring confidence in government and reducing long-term interest rates. These actions to reduce future deficits will require political courage. Stronger budgetary rules, such as statutory PAYGO, can bolster political courage.

Statutory PAYGO: one tool for fiscal discipline

PAYGO is budget speak for "do no harm" or "don't make future deficits worse." PAYGO rules are designed to discourage Congress and the Administration from enacting legislation that would add new mandatory benefits or reduce revenues without taking other actions that would have equal and opposite effects on the deficit over a ten year period. Statutory PAYGO affecting both mandatory spending and taxes was in effect from 1991 through 2002, when the legislation lapsed and was not reenacted. Currently PAYGO is part of the House and Senate rules, but does not have the force of law.

I believe that statutory PAYGO proved a highly effective deterrent to deficit- increasing legislation in the 1990's—at least until the surplus was achieved in 1998. The effects of PAYGO were not visible to the public or the press because they involved spending and taxing proposals that never saw the light of day. At the Office of Management (OMB) in President Clinton's first term my uncomfortable job was to tell the President and rest of the Administration that many of their most cherished ideas could not even be proposed because we could not find a way to off-set them under the PAYGO rules. Similar conversations took place in Congressional committees. Detractors of PAYGO, who point out that a serious sequestration has never been enforced, miss the point that sequestration is a deterrent, not a policy. It would be a more powerful deterrent if it could be waived only by enacting a law subject to veto. I believe sequestration would be an even more effective as a deterrent if there were fewer exceptions to its automatic cuts.

The difficult problem of defining the baseline

The most difficult decision in designing a strong PAYGO rule is answering the question, "Don't make deficits worse compared to what?" Should the baseline be strictly current law or a more realistic appraisal of what is likely to happen? In general, it is best to stick with current law, because it is the easiest rule to understand and explain. However, occasionally extending currently law is clearly not what most people expect to happen.

President Obama's statutory PAYGO proposal recognizes that four specific provisions of existing law are so unrealistic that incorporating them in a current law baseline would make the PAYGO rule unworkable. The proposal recognizes that Medicare payments to physicians under Part B will not automatically be cut by 21 percent as the law requires; the estate and gift tax will not expire in 2010 and return to pre-2001 levels in 2011; that the current AMT patch will not be allowed to expire without replacement; and that all of the 2001 and 2003 tax provisions will not all expire at the end of 2010. Critics of the Administration's proposal point out that allowing these adjustments to a current law baseline amounts to accepting the damage already done to future budgets that these bizarre legislative provisions were designed to hide. They argue that in making these exceptions Congress would be ducking the responsibility to face the consequences of its past lack of budgetary courage. I agree that these are four examples of legislative sleight of hand covering up future bad news. But the bad news must be dealt with head-on in a comprehensive policy process. Keeping these four legislative anomalies in the current law baseline for PAYGO purposes, would only guarantee that PAYGO would be immediately waived and its future usefulness seriously impaired.

Moving beyond statutory PAYGO

While I support the Administration's proposal for Statutory PAYGO, I regard it as a small first step on the arduous path that will move the budget to long run sustainability. We also need firm caps on discretionary spending. But the biggest threat to future budget solvency is not new legislation; it is the budgetary consequences of legislative decisions already made—both with respect to mandatory spending and the tax code.

While the current annual budget process involves Herculean efforts to scrutinize discretionary spending, it leaves entitlement programs and revenues on automatic pilot outside the budget process. Fiscal responsibility requires that all long-term spending commitments be subject to periodic review along with taxes and tax expenditures. There is no compelling logic for applying caps and intense annual scrutiny to discretionary spending, while leaving huge spending commitments, such as Medicare or the home mortgage deduction entirely outside the budget process and not subject to review on a regular basis. Nor is there any good reason for subjecting new mandatory spending and revenue legislation to an elaborate PAYGO procedure while ignoring the budget implications of past legislation.

I am a member of a bipartisan group called the Fiscal Seminar (sponsored by The Brookings Institution and the Heritage Foundation) that addressed this problem in a controversial paper entitled, Taking back our Fiscal Future, in 2008. We proposed that Congress enact long run budgets for the three biggest entitlement programs. These budgets would be reviewed every five years. Spending overruns would trigger automatic spending cuts or revenue increases that would take effect unless Congress acted. We recognized that we had proposed only a partial solution—the tax side of the budget should be included--and others may have better ideas. However, we clearly identified a glaring defect in the budget process that stands in the way of getting the federal budget on a sustainable long run track. We believe it is imperative for Congress to adopt a new budget process that includes ALL spending and revenue and subjects the budget impacts of long-term commitments to serious periodic review.

Thank you, Mr. Chairman and members of the Committee.