Memo to: New Congressional Leadership

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Memo to Representative Pelosi: How to Make PAYGO Discipline the Federal Budget

Alison Acosta Fraser and Brian M. Riedl

Democrats are committed to ending years of irresponsible budget policies that have produced historic deficits. Instead of piling trillions of dollars of debt onto our children and grandchildren, we will restore "Pay As You Go" budget discipline.

—Representative Nancy Pelosi (D–CA), Incoming House Speaker[1]

No new deficit spending, no new bridges to nowhere, heaping mountains of debt on our children.

—Representative Nancy Pelosi[2]

If you want to have a new program, figure out a way to pay for it without raising taxes.

—Senator Harry Reid (D–NV), Incoming Senate Majority Leader[3]

Representative Pelosi,

Americans sent a strong message to Washington in November: Continued runaway spending is unacceptable. You have stated clearly that you intend to put tough budget controls in place, including a return to "Pay As You Go," or PAYGO, budgeting. PAYGO requires that new or expanded entitlement spending be fully paid for by reductions in other mandatory spending or with tax increases. You have also pledged to stop increases in the deficit from other spending.

To be sure, PAYGO is not a comprehensive solution to the budget problem. If done right, however, it is an important tool. Because it is the one that you have chosen to take the first decisive step towards budget discipline, you should make implementing it your first legislative initiative in the new Congress. You should enact a form of PAYGO that fixes previous versions' weaknesses so it is not a phony budget tool and a veil for new deficit spending. If you do not bolt the budget door shut with a potent form of PAYGO before your colleagues start spending again, the American people will know that your pledge to get the budget under control was not serious.

Americans want Congress to bring discipline to the budget process for good reason. Federal spending has grown by over 42 percent since 2001. Last year alone, spending increased over 7 percent, and over half of this increase was due to entitlement programs such as Social Security and Medicare. These "mandatory" programs are not appropriated in the annual budget but grow on autopilot accord-

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Washington, DC 20002–4999
(202) 546-4400 • heritage.org

ing to provisions of their governing laws. Without reform, these programs are projected to push long-term spending from 20 percent of the economy today to nearly 50 percent by 2050.[4] The only way to get the budget under control is to put in place strong controls on spending.

How to Make PAYGO Meaningful

Because PAYGO is the budget restraint tool you have proposed, you must ensure that it will be meaningful, properly instituted, and not a sham. Any lawmaker seriously concerned about spending control, therefore, must insist on five key features for PAYGO:

1. **PAYGO must be enforceable.** The Senate's current PAYGO rule is weak because it is not self-enforcing. While any one senator can offer a point of order against any offending spending, this often does not happen. If a point of order is offered, it can be waived with 60 votes, in which case there is no additional enforcement such as sequestration (which imposes automatic across-the-board entitlement cuts to pay for any new entitlement spending or tax cuts that Congress does not offset.)

   A PAYGO statute, rather than a porous rule, would require lawmakers to vote to offset new spending. If PAYGO is breached, the statute should require the Office of Management and Budget (OMB) to sequester all excess entitlement spending. The most effective form of PAYGO would include both a statute, enforceable by sequestration, and a Senate point of order rule to keep the 60-vote threshold.
2. **PAYGO should apply to all new policies.** Previous versions of PAYGO applied to all tax and entitlement changes that altered projected budget deficits relative to the Congressional Budget Office's baseline. However, the current Senate PAYGO rule actually exempts all tax and entitlement changes written into Congress's annual budget resolution. This massive loophole made possible the huge 2003 Medicare drug entitlement and would allow Congress to enact an unlimited number of entitlement expansions and tax changes each year without any PAYGO enforcement, simply by writing them into the budget resolution. If you are serious about PAYGO, you must eliminate this loophole.
3. **PAYGO should apply to "emergency" spending.** Another large PAYGO loophole is the exemption of any new spending that is called "emergency." Congress has frequently reclassified regular mandatory and discretionary spending to be "emergency" spending in order to bypass PAYGO and budget limits. Lawmakers should create a separate emergency fund and require a supermajority vote for any additional, non-offset emergency spending. True emergency spending will be able to secure supermajority support.
4. **Congress should not stymie PAYGO enforcement.** Not a single sequestration took place during PAYGO's 12 years as law. Instead, lawmakers repeatedly passed legislation that forbade OMB from enforcing PAYGO at all. Creating a budget control and then refusing to enforce it undermines the rule of law and faith in government. If you and the new Congress believe that PAYGO is the proper way to discipline the budget, then you and your colleagues should pledge to enforce it.
5. **PAYGO sequestration should apply to all mandatory spending.** The PAYGO law that existed from 1990 through 2002 exempted from sequestration Social Security, net interest on the debt, nearly all Medicare spending, and several other entitlement programs. Overall,

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1. House Democrats, "A New Direction for America," December 12, 2006, at *http://democrats.house.gov/newdirection*.
2. Representative Nancy Pelosi, Interview with Brian Williams, MSNBC, November 8, 2006, at *http://www.msnbc.msn.com/id/15627215*.
3. Senator Harry Reid, Interview with Bob Schieffer, CBS News, November 12, 2006, at *http://www.cbsnews.com/htdocs/pdf/face_111206.pdf*.
4. Brian M. Riedl, "Entitlement-Driven Long-Term Budget Substantially Worse Than Previously Projected," Heritage Foundation *Backgrounder* No. 1897, November 30, 2005, at *http://www.heritage.org/Research/Budget/bg1897.cfm*.

97 percent of all mandatory spending—all but $31 billion—had been statutorily exempted from any PAYGO sequestration, according to 2002 OMB figures.[5] This loophole capped sequestration at this small amount and unfairly imposed all the pain of sequestration on a few small programs. Creating a PAYGO law and then blocking its enforcement is inconsistent and hypocritical.

Creating an Effective PAYGO Statute

While a tough PAYGO law would be an important tool to constrain undisciplined budgets, it is only one tool, and others are needed. For instance, PAYGO applies only to new or expanded entitlement spending and does not limit either discretionary or total spending. Moreover, because PAYGO exempts the growing cost of current entitlement programs, it does nothing to deal with the tsunami of already scheduled and largely unfunded entitlement benefits that will accompany the retirement of the Baby Boom generation. Under the current budget rules, Congress does not even have to consider the trillions of dollars in unfunded obligations already enacted.

One small, urgently needed step is to include a measure of the unfunded obligations of the federal government in the annual budget process. At the very least, a highly visible indication of how a proposal would affect these obligations could be a political brake on undisciplined budgeting.[6]

To address the steep growth of current entitlement programs, however, analysts at the Government Accountability Office (GAO) and elsewhere have suggested supplementing PAYGO with a trigger for current entitlement programs.[7] Congress would set multi-year spending targets for entitlement programs covered by PAYGO. If OMB projects that spending will exceed these targets, the president would have to submit reform proposals as part of the annual budget request, and Congress would have to act on those proposals. A similar trigger for Medicare spending was included in the 2003 Medicare prescription drug legislation, and expanding the concept could help Congress address current entitlement spending growth.

PAYGO also focuses on only the budget deficit, rather than the size of government. A strong PAYGO would ensure that new or expanded programs are balanced with other spending cuts or tax increases, but it would not prevent the government from taking a steadily larger share of citizens' paychecks. PAYGO would allow escalating entitlement program costs to push the size of the federal government to nearly 50 percent of GDP by 2050. PAYGO would also promote the expiration of all Bush tax cuts and force millions of Americans to pay the Alternative Minimum Tax. As a result, tax revenues would rise from the historical average of 18.3 percent of GDP to a record 23.7 percent by 2050.[8] The slow-growth economies of Western Europe show that such levels of spending and taxation cause serious long-term economic damage.[9] Therefore, PAYGO must be supplemented with serious caps on the growth of spending and taxes.

5. 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.
6. Alison Acosta Fraser, "Federal Budget Should Include Long-Term Obligations from Entitlement Programs", Heritage Foundation *Executive Memorandum* No. 1004, June 22, 2006, at *http://www.heritage.org/Research/Budget/em1004.cfm*. See Representative Jim Cooper (D–TN), Financial Report of the United States (Nashville: Nelson Current, 2006), pp. ix-xxvii.
7. Susan Irving, "Budget Process: Extending Budget Controls," Testimony before the House Budget Committee, April 25, 2002, at *http://www.gao.gov/new.items/d02682t.pdf*.
8. Daniel J. Mitchell, Ph.D., and Stuart M. Butler, Ph.D., "What Is Really Happening to Government Revenues: Long-Run Forecasts Show Sharp Rise in Tax Burden," Heritage Foundation Backgrounder No. 1957, July 28, 2006, at *http://www.heritage.org/Research/Taxes/bg1957.cfm*. This is based on data from Congressional Budget Office, "The Long-Term Budget Outlook," December 2005, at *http://www.cbo.gov/ftpdocs/69xx/doc6982/12-15-LongTermOutlook.pdf*.
9. See Daniel J. Mitchell, "Fiscal Policy Lessons from Europe," Heritage Foundation *Backgrounder* No. 1979, October 25, 2006, at *http://www.heritage.org/Research/Budget/bg1979.cfm*.

Conclusion

If PAYGO is your preferred tool to end irresponsible budget policy, then you must pass a statutory PAYGO that covers all mandatory spending and is seriously enforced. Making this your first legislative accomplishment will show the nation that you are serious about reining in the budget. You should then take steps to strengthen controls on total spending and address the tsunami of future entitlement costs.

Sincerely,

Alison Acosta Fraser, Director, Thomas A. Roe Institute for Economic Policy Studies

Brian M. Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs