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## **STATEMENT ON PAYGO**

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There has been much debate this week about the President's proposed three-year spending freeze on non-security programs and a fiscal commission to tackle the long-term structural deficit. These are good ideas that may or may not pan out as the year progresses. But there is one thing the House of Representatives can do today that would help put an end to new deficit financing. It can pass the pay-as-you-go (PAYGO) law attached to the debt limit increase approved by the Senate.

PAYGO first appeared in the Budget Enforcement Act of 1990 (BEA), negotiated between Republican President George H. W. Bush and the Democratic leaders of Congress. In its original form, PAYGO was a statutory requirement providing that any legislation to lower revenues or expand entitlement spending be offset with corresponding revenue increases or entitlement spending cuts. Violations were to be enforced through cuts in non-exempt programs. The law was renewed with bipartisan support in 1997 but was allowed to expire in 2002. Currently, the House and Senate have PAYGO rules in place but they lack the force of law and have no mechanism for penalizing violations through automatic spending cuts.

Reinstating statutory PAYGO would not prevent Congress from passing tax cuts and entitlement spending increases. Rather, it would simply require that if Congress wants to do these things it must do so in a deficit-neutral way. Given the dire fiscal outlook over the next 10 years and beyond, this should not strike anyone as an unreasonable burden. Indeed, it seems a minimum requirement. Few contest the fact that current fiscal policies are unsustainable. It is thus a matter of common sense to require those who want to enact new tax cuts or entitlement expansions -- which would enlarge the structural deficit -- to put forward spending cuts or tax increases necessary to pay for them. In short, PAYGO requires anyone proposing tax cuts or entitlement expansions to answer the question: "How would you pay for it?" Going through this process would force an explicit trade-off between spending, taxes and debt, which is exactly the priority setting exercise that the budget process should facilitate.

Some have argued that PAYGO should only apply to spending increases and not tax cuts. This would be a mistake. Fiscal discipline is a commitment that must apply to the budget as a whole in order to be effective. Any legislation that would increase the deficit should be part of the enforcement mechanisms. Since spending and tax decisions both affect the bottom line, there is no compelling reason to exempt either from enforcement rules. Moreover, exempting tax cuts from PAYGO would encourage an expansion of so-called "tax expenditures" where benefits are

funneled through the tax code rather than by direct spending. Finally, exempting tax cuts from PAYGO would encourage the false notion that debt is a painless alternative to taxes.

Other PAYGO critics point out that it does not prevent spending from going up. That is true, but irrelevant to PAYGO's essential purpose. PAYGO has never applied to discretionary spending. Nor does PAYGO apply to automatic increases in current entitlement programs and tax expenditures. That is why PAYGO should not be considered a cure-all for what ails the budget. Additional tools are needed.

In Concord's view, budget enforcement rules should apply to all parts of the budget — taxes, entitlements and discretionary appropriations. Excluding any part of the budget from discipline, including automatic growth in current entitlements and tax expenditures, will inevitably lead to that part of the budget becoming an escape valve from fiscal discipline. That is no reason, however, to reject a rule that would impose discipline where it could do some good. Remedies should be judged by what they are designed to do.

A more legitimate concern is that the new law would exempt the extension of certain existing policies, such as middle-class tax cuts, relief from the Alternative Minimum Tax (AMT) and scheduled cuts in Medicare physician reimbursements. While it is true that these exemptions recognize political reality, it is also true that extending these policies without offsets will leave the budget in far worse shape than if they were paid for.

Regardless of political reality, the economic reality remains the same. Persistent deficits of the size now projected under the President's budget would harm the economy, increase our reliance on foreign borrowing, crowd out domestic investments, and lead to a spike in interest costs. Thus, if statutory PAYGO is adopted in the form currently proposed, policymakers must acknowledge the economic consequences of its exemptions and be prepared to deal with them. The cost of these policies will not go away simply because they are exempted from PAYGO. If not paid for now, they will be paid for later at a higher cost in interest payments and a less robust economy. That is why a fiscal commission with a broad mandate to tackle the structural deficit is a logical complement to PAYGO. Moreover, exempting any existing policies from PAYGO does not enact them into law. Legislation must still pass to extend these policies and those who advocate strict compliance with PAYGO can, and should, uphold this principle by voting against any extensions that are not paid for.

Finding a cure for the nation's dire fiscal outlook will obviously require a lot more than a new budget rule, but enactment of statutory PAYGO would send a very positive signal that the federal government is beginning to take the problem seriously. This is not a distant future concern. It has immediate consequences for economic recovery efforts, which have greatly expanded our borrowing needs. With financial markets increasingly skeptical about the federal government's dedication to restoring fiscal discipline once a recovery is underway, we cannot pretend that our ability to borrow cheaply from the rest of the world to finance our rising debt

will persist regardless of our unwillingness to impose long-term fiscal restraint.

Even before the current economic downturn and spike in U.S. debt, the growing awareness that America is living beyond its means, both publicly and privately, had begun to erode confidence in our long-term economic future—and had prompted warnings from international agencies such as the International Monetary Fund about the “irresponsibility” of U.S. fiscal policy that are usually reserved for developing nations. If the administration and Congress do nothing to restore fiscal trust, world markets may lose faith (exactly when cannot be predicted) that U.S. Treasuries are the safe haven they have traditionally been.

But sending signals is not enough. Policymakers must begin forcing the kind of trade-offs that were not made when large deficit-financed tax cuts and entitlement expansions were enacted in the face of alluring, if illusory, budget surpluses, and after the old PAYGO law expired.

The Concord Coalition supports statutory PAYGO and believes that it must be assessed for what it is, not for what it isn't. PAYGO is not a deficit reduction tool. It is not a spending freeze. It does not apply to discretionary spending or automatic increases in entitlement programs and tax expenditures. Holding PAYGO to a standard that assumes it is intended to do all these things (reduce the deficit, freeze spending, control “pork barrel” appropriations or rein in entitlements) sets up a conclusion that the rule would do no good. That is a false standard. PAYGO's real value comes from its deterrent effect on entitlement expansions and tax cuts that would widen our structural deficit. This is certainly worth doing, even if other things are left to be done.