RSC Republican Study Committee

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--***Could Lead to Tax Increases.*** Specifically, H.R. 2920 makes it harder to maintain some tax cuts that exist under current law (of note the capital gains/dividend tax cuts and the lower 35% income tax rate). It is also possible that the threat of sequestration could be used by proponents of tax increases to try and force through higher taxes.

--***Discretionary Spending Loophole.*** The legislation does not impose any limits (even for spending increases above those assumed in CBO's baseline) for the 40% of the federal budget that consists of discretionary spending.

--***Lack of Enforcement.*** Congress can simply designate any spending it wants as "emergency" spending to avoid the constraints of the legislation. In addition, the bill's sole enforcement mechanism is the same sequestration process from the 1990 Budget Enforcement Act, which was never actually used (for a PAYGO violation) and, in any event, exempts the vast majority of the federal budget. The legislation actually expands the number of programs that would be exempt from any theoretical sequestration.

--***Does Nothing to Put Budget on Sustainable Course.*** Under current budget policies, as outlined in the President's budget, the public debt will double in five years and triple in ten years. All of this increase in the debt—an amount that exceeds what has been racked up by every prior Administration in U.S. history—is permissible under this bill without triggering a PAYGO violation.

--***PAYGO Does Not Work.*** Since the current PAYGO rule was adopted, the deficit has increased from $162 billion (the last budget process under Republican control) to a projected $1.84 trillion. All of this ***$1.678 trillion***, or ***1,035.8%***, increase to the federal deficit occurred with a PAYGO rule in effect.

For more details, see below.

H.R. 2920—Statutory Pay-As-You-Go *(Spratt, D-SC)*

<u>Order of Business</u>: The House is scheduled to consider H.R. 2920, the Statutory Pay-As-You Go Act, on Wednesday, July 22, 2009 under a structured rule (H.Res. 665). The rule waives all points of order against consideration of the bill, except for Clause 9 (earmark disclosure) and 10 (PAYGO) of Rule XXI, and provides one hour of debate. The legislation makes in order one Republican Amendment in the Nature of a Substitute (that will be summarized in a separate RSC document), and self-enacts the Hoyer Amendment in the Nature of A Substitute (as amended by a self-enacting amendment). The analysis of the underlying bill is based off of this substitute.

<u>Summary</u>: The legislation is, in general, intended to enact a statutory PAYGO requirement to some spending legislation, and to most tax legislation. Highlights of the legislation are as follows:

PAYGO Scorecard: The legislation applies a PAYGO requirement to the *53%* of the federal budget that consists of entitlement spending and to *most* changes to tax law (with some exceptions, as detailed below). Violations of PAYGO would not be judged on a per-bill basis (as under the current House PAYGO rule), but instead would be judged at the end of each year by two separate standards: the average annual impact on the deficit over five years, and the average annual impact over ten years. To the extent that this scoring system shows bills passed by Congress (again, counting only the types of budget decisions that H.R. 2920 subjects to the PAYGO requirement) led to a *net* deficit impact over either period, OMB would be required to issue a sequester order to get rid of the violation. CBO scoring would be used to measure the "cost" of legislation, except where a CBO score is unavailable (in which case OMB could supply the score). *<u>Note</u>*: OMB is a <u>partisan</u> entity, while CBO is non-partisan.

PAYGO and "Policy Adjustments": The legislation creates a new baseline to measure compliance with PAYGO that differs with the current House PAYGO rule (which uses CBO's baseline). Specifically, H.R. 2920 builds into the baseline:

- The cost of extending higher physician payment rates;
- The "cost" of maintaining the death and gift tax at 2009 levels (which is actually a substantial tax increase compared to the scheduled repeal of the death tax in 2010).
- "AMT Patch": Potential legislation that prevents the number of individuals who pay the Alternative Minimum Tax (AMT) AMT (compared to 2008) from growing.
- Legislation that extends the expiration date of the:
    1. 10% marginal tax rate;
    2. the $1,000 tax child credit;
    3. the marriage penalty tax relief;
    4. the $10,000 adoption tax credit;
    5. the child care tax credit;
    6. the dependent care tax credit;
    7. the education tax benefits provided in the Economic Growth and Tax Relief Reconciliation Act of 2001;
    8. the lower 25% and 28% marginal tax rates; and

9. The 33% marginal tax rate (as it applies to individuals earning less than $200,000 and joint filers earning less than $250,000).

Of note, this list does *__not__* include many other expiring tax cuts, such as the lower 35% tax rate, and the lower 15% capital gains/dividend tax rates.

Emergency Designation: The bill allows Congress to get around all of the constraints of the legislation by simply applying an emergency designation. In practice, this means that the legislation is very unlikely to exert much pressure against legislative changes that increase the deficit. There is *no* limit on how often, or for what, this emergency designation could be used.

Sequestration: The legislation generally uses the same sequestration process as the 1990 Budget Enforcement Act. As CBO notes, the vast majority of the federal budget is exempt from sequestration under that process. The bill further increases the portion of the federal budget that is exempt from sequestration to include TARP and SCHIP, among other things.

Discretionary Spending and PAYGO: H.R. 2920 does not impose any limit on how much discretionary spending through the appropriations process can increase (not even on spending above what is assumed in the baseline).

__What PAYGO Does Not Do__: Under H.R. 2920, PAYGO would ***__NOT__***:

- apply to authorized discretionary spending;
- apply to the 40% of the federal budget that consists of discretionary spending;
- limit unsustainable entitlement spending growth that will occur under current law;
- impose any limit at all on federal budget deficits;
- place any obstacle to legislation that increases the federal debt limit—Congress has increased the debt limit 4 times since the House PAYGO rule was adopted two and a half years ago;
- impose any limit at all on how much the federal debt can grow;
- impose any limit at all on the federal government's unfunded obligations;
- allow for the extension of many expiring tax provisions, unless offsets are included;
- require any reforms that would put the federal budget on a sustainable course—CBO, GAO, and many other objective analysts have concluded that the longer-term federal budget outlook is unsustainable if the federal budget is simply left on auto-pilot (the maximum constraint PAYGO ever imposes); or
- have any effect at all if Congress decides that the legislation constitutes an "emergency."

__Additional Background__: At the beginning of the 110th Congress, the new Majority adopted a PAYGO rule that applies to legislative provisions *"affecting **direct spending** and **revenues** have the net effect of increasing the deficit or reducing the surplus…"* Two things are of note on the House version of the PAYGO rule. First, PAYGO is applied unevenly to revenue and spending budget choices. While PAYGO applies to 100% of federal tax collections it only applies to the 53% of federal spending that consists of direct spending. Second, the PAYGO rule judges whether a direct spending/revenue provision worsens the budget deficit in comparison to the CBO baseline. For the spending side of the ledger, this means that PAYGO imposes no limit on entitlement spending increases that occur under current law. For the revenue side of the budget, this means that extensions of current tax law (if scheduled to expire at a future date—such as with the AMT patch, the 2001 and 2003 tax cuts, and the "tax extenders") must be offset.

In the 110th Congress, under the House PAYGO rule, Congress enacted $420 billion worth of PAYGO violations (see this document by House Budget Committee Republicans on PAYGO compliance in the last Congress). The deficit has increased by ***$1.678 trillion***, or ***1,035.8%***, in the little more than two years since the Democrats adopted the PAYGO rule at the beginning of the 110th Congress.

H.R. 2920 proposes a weaker version of PAYGO compared to the current House rule in at least two respects. First, it eliminates the theoretical (and often ignored) requirement that *every* bill comply with the PAYGO requirement. Instead, H.R. 2920 creates a running tally of all bills enacted over the Congress (that count per the legislation), and requires that the overall balance come out even (on an average over five years and ten years). Second, H.R. 2920, allows some expiring tax cuts to be maintained without counting against PAYGO, as well as the cost of extending higher physician reimbursement rates.

H.R. 2920 is theoretically stronger than the current House PAYGO rule in that it would be enforced with potential sequestrations of federal spending. However, from 1990-2002 no sequestration ever actually occurred because of a PAYGO violation, and the vast majority of federal spending is exempt from potential sequestrations (H.R. 2920 increases the number of programs exempt from sequestrations).

Democrat Inconsistency Alert!

Spending Increases and PAYGO: This week the House will consider the FY 2010 Labor-HHS bill that increases spending by 7.3% compared to last year, and the FY 2010 Transportation-Housing Urban Development bill that increases spending by 25.2%. These spending increases will not have to be paid for under H.R. 2920.

Potential Conservative Concerns: Many conservatives have expressed concerns about H.R. 2920. Some of these concerns are as follows:

No Effect on Discretionary Spending. The legislation, while applying to almost all federal tax collections, only applies to 53% of federal spending. Discretionary spending is completely exempt from the legislation, even increases above what is assumed in CBO's baseline.

Could Lead to Tax Increases. The bill requires tax increases to "pay for" merely extending current tax policy in some cases. This includes the lower 35% top income tax rate (scheduled to increase to 39.6% in 2011), and the lower 15% top tax rate applied to capital gains and dividend income.

Lack of Enforcement. The bill relies on the same sequestration process as the 1990 Budget Enforcement Act. That sequestration process exempts the vast majority of federal spending. Under the old PAYGO rule, CBO notes that a sequestration never actually took place.

Does Nothing to Put Budget on Sustainable Course. Under current budget outlook, the public debt will double in five years and triple in ten years. The legislation does nothing to improve this already unsustainable budget outlook—the most it can claim to intend to do is prevent the budget outlook from getting even worse.

PAYGO Does Not Work. The deficit has increased by ***$1.678 trillion***, or ***1,035.8%***, in the little more than two years since the Democrats adopted the PAYGO rule at the beginning of the 110th Congress. It has gone from **$162 billion** in FY 2007 (the last budget process without any PAYGO rule) to a projected **$1.84 trillion** in FY 2009.

Committee Action: The legislation was introduced on June 17, 2009 and referred to the House Budget Committee, which took no official action.

Administration Position: The Statement of Administration Policy (SAP) expresses the Administration's "strong support" for the legislation.

Cost to Taxpayers: The legislation proposes significant changes to the federal budget process. However, the bill does not itself include any spending or changes to tax laws.

Does the Bill Expand the Size and Scope of the Federal Government?: Yes. The bill makes it harder to maintain some tax cuts that exist under current law. It is also possible that the threat of sequestration could be used by proponents of tax increases to try and force through higher taxes.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: No CBO score containing any potential such mandates is available.

Does the Bill Comply with House Rules Regarding Earmarks/Limited Tax Benefits/Limited Tariff Benefits?: No committee reporting citing compliance with the House earmark rule is available, but the legislation does not appear to contain any earmarks.

Constitutional Authority: No committee report citing constitutional authority is available.

Outside Groups Opposed to Legislation: Americans for Tax Reform (ATR).

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