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Chairman Spratt, Ranking Member Ryan, and Members of the Committee, thank you for giving me the opportunity to discuss the Statutory Pay-As-You-Go ("PAYGO") Act of 2009.

The PAYGO Act would hold us to a simple but important principle: we should pay for new tax or entitlement legislation. Creating a new non-emergency tax cut or entitlement expansion would require offsetting revenue increases or spending reductions. In the 1990s, statutory PAYGO encouraged the tough choices that helped move the Government from large deficits to surpluses, and I believe it can do the same today. Both houses of Congress have already taken an important step toward righting our fiscal course by adopting congressional rules incorporating the PAYGO principle. But we can strengthen enforcement and redouble our commitment by enacting the PAYGO Act into law.

Both the President's Budget and the Budget Resolution approved by the Congress would cut the deficit in half by the end of the Administration's first term, while laying a new foundation for sustained and widely shared economic growth through key investments in health, education, and clean energy. Even though more will ultimately be needed to restore fiscal responsibility, enacting statutory PAYGO would complement the efforts already initiated and represent an important step toward strengthening our budget process.

The PAYGO Principle

The Hippocratic Oath famously reminds doctors to, first, do no harm. Similarly, but more colloquially, Charlie Stenholm, the long-time Texas congressman and a founder of the Blue Dogs, often repeated what he called the "rule of holes": If you find yourself in a hole, stop digging. With respect to taxes and entitlements, the PAYGO Act is the statutory embodiment of these time-tested principles. It tells Congress and the Administration that their minimum duty is not to make the existing multiyear structural deficit any worse than it already is.

This may seem like a relatively easy rule to follow, but history suggests it is not. One way to see this is by looking at three relatively recent pieces of legislation that violated the PAYGO principle: the 2001 and 2003 income tax reductions, or EGTRRA and JGTRRA, and the Medicare Modernization Act of 2003, which created the Medicare Part D prescription drug benefit. None of these three pieces of tax and entitlement legislation was paid for in PAYGO terms. Each was permanent or intended to be permanent. And those three bills together increased the 75-year fiscal gap—the difference between sustainable and unsustainable budgets—by roughly 3 percent of GDP.[1] Since estimates of the long-term fiscal gap prepared by GAO, CBO, and other independent analysts place it at around 7 percent of GDP, those three violations of the PAYGO principle by themselves nearly doubled the long-term fiscal gap. The

[1] The estimate that the 2001 and 2003 tax cuts increased the fiscal gap by 2% of GDP includes as part of its cost the degree to which those tax cuts expanded the size of AMT relief, but does not include cost of AMT relief that would be part of current policy even if those two tax cuts had not been enacted.

difference, then, between adhering to and violating PAYGO is not a question of few billion dollars around the edges—but rather can go to the heart of the nation's fiscal path.

How PAYGO Works

PAYGO Ledger

Under the PAYGO Act, the Office of Management and Budget (OMB) would maintain a PAYGO ledger recording the average ten-year budgetary effects of all legislation enacted through 2013 that affects governmental receipts or mandatory outlays relative to the baseline ("PAYGO legislation"). After recording the average ten-year budgetary effect for each piece of PAYGO legislation enacted in a given year, OMB would then sum the budgetary effect of all PAYGO legislation having effects in that year (including the effects of legislation enacted in prior years but after the enactment of this proposal) and would record a net cost (or debit) for that year if the sum is negative.

Spelling out a few of these features in greater detail:

- **Sunset.** The PAYGO Act would expire after five years, on December 31, 2013.

- **PAYGO window.** The PAYGO Act would measure the cost or savings of PAYGO legislation in the current year and over the next ten years.

- **Averaging.** For the budget year and any remaining years on the PAYGO ledger, the PAYGO Act would require OMB to enter the *average* ten-year budgetary effect—rather than the budgetary effect in each individual year—associated with any piece of PAYGO legislation. This means that the PAYGO ledger is designed to require budget neutrality across a time period rather than year-by-year.

- **Scorecard neutrality.** The PAYGO Act would not require that each piece of enacted PAYGO legislation be budget neutral by itself, but rather only that the averaged budgetary effects in a given year of all PAYGO legislation enacted since the proposal becomes effective be budget neutral.

- **Look back.** To take into account any budgetary effects of PAYGO legislation in the current year (i.e., the year that PAYGO legislation is enacted), the PAYGO Act includes a "look back" rule, which provides that any budgetary effects in the current year (i.e., the year of enactment) would be treated on the PAYGO ledger as if they were budgetary effects in the budget year (which is the year subsequent to the current year).

- **Timing shifts.** The PAYGO Act would not give any credit for savings created or costs avoided through a shift between year 10, which is inside the PAYGO window, and year 11, which is outside the window. This restriction would prevent any gaming of the PAYGO Act that would occur by hiding the budgetary costs of PAYGO legislation just outside the PAYGO window.

- **Basis of estimates.** The PAYGO Act stipulates that OMB would estimate the average ten-year budgetary effects of all PAYGO legislation on the basis of the economic and technical assumptions underlying the latest President's Budget and in conformance with the scorekeeping guidelines determined by OMB after consultation with the House and Senate Budget Committees and CBO.

Sequestration

The PAYGO Act enforces its budget constraint through the threat of sequestration. PAYGO forces policymakers to make the hard decisions necessary to pay for any new mandatory spending or tax reductions by triggering sequestration—automatic cuts in non-exempt mandatory programs—if they do not.

Specifically, if there is a net cost on the PAYGO ledger for the upcoming year when Congress adjourns at the end of a session, the President is required to issue an order temporarily sequestering resources—sufficient to fully pay off the PAYGO debit—from non-exempt mandatory programs in the budget year. With the exceptions of Medicare and three additional, small health care accounts[2], non-exempt mandatory programs would be cut by a uniform percent; Medicare could be cut by at most 4 percent. If a cut larger than 4 percent is needed to offset the debit on the PAYGO ledger, the uniform percentage cut to the other non-exempt mandatory programs would be increased so that the sequester of Medicare and the other non-exempt programs would together produce sufficient savings to offset the budget-year debit.

Following in the footsteps of statutory PAYGO from the 1990s, the proposed legislation would exempt most mandatory programs from sequester—programs such as Social Security, veterans' disability and related benefits, and major low-income entitlements such as Supplemental Security Income and Medicaid. The remaining sequestration base totals approximately $540 billion in fiscal year 2010 and includes programs such as Medicare, farm price supports, and a number of grants to states.

Set up in this way, sequestration strongly encourages policymakers never to violate the PAYGO budget constraint and trigger sequestration—in other words, sequestration is in practice a threat, not a remedy. The sequestration base is broad enough to produce significant savings in the event sequestration were triggered, but it is narrow enough that any such cuts would be painful to important constituencies. In the 1990s, this careful balance resulted in Congress never triggering sequestration and, instead, making the hard choices that PAYGO requires.

It's also important to recognize that being exempt from sequestration does not mean a program is exempt from the PAYGO budget constraint. The only mandatory or tax legislation that is outside the scope of the PAYGO Act is legislation dealing with the two programs that are off-budget by law: Social Security and the Postal Service Fund. Otherwise, new mandatory spending or tax reductions—irrespective of whether they relate to programs that are exempt from sequester—would have to be paid for in order to avoid triggering painful automatic cuts to the programs in the sequestration base.

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[2] The three additional health care accounts excepted from a uniform percentage cut are community health centers, Indian health facilities, and Indian health services; each is capped at a maximum 2 percent cut.

Adjusting for Current Policy

As I have said, the proposed legislation would require that new mandatory or tax policy be paid for—essentially enforcing a "do no harm" fiscal principle. A key word here is "new."

To focus the PAYGO Act on applying a strict budget constraint only to new policy, the proposed legislation includes adjustments in four policy areas where current policy deviates substantially from current law: the Medicare sustainable growth rate formula (SGR), the estate tax, the Alternative Minimum Tax (AMT), and the 2001 and 2003 income tax reductions. In each of these areas, the policies currently in place are set to expire or substantially change in coming years in ways that unrealistically reduce costs or increase revenues—for instance, payments to doctors under Medicare are scheduled to be cut by about 21 percent next year under the SGR, and virtually all of the 2001 and the 2003 tax cuts are scheduled to expire at the end of 2010. For these four areas, where the law on the books does not reflect the realities of current policy, the PAYGO Act would not require a continuation of those policies to be paid for.

Some have criticized the Administration for designing the PAYGO Act to reflect current policy rather than current law in these areas. These critics, however, have provided no indication of how they would offset the costs of continuing current policy in these areas, and I have seen no credible proposals for such offsets. The most plausible result of applying the PAYGO Act to a continuation of these current policies would therefore be waivers of the statute in these cases. Such waivers would establish a harmful precedent that could undermine the statutory PAYGO regime and lead to waivers for new policy, allowing policymakers to avoid the PAYGO budget constraint.[3] The Administration therefore believes it is better to design statutory PAYGO in a credible way to minimize the potential for waivers, and that is what our proposal does.

The PAYGO Act would give a time-limited window for continuing current policy without paying for it. At the end of 2010, the adjustment for current policy would expire, unless the President determines that legislation sufficiently consistent with current policy has not been enacted in any one or more of the relevant four areas—in which case the President can choose to continue the adjustment for one more year, until the end of 2011. Once the adjustment is no longer allowed, continuing current policy would have to be paid-for, like any other tax or mandatory policy.

Complement to Existing Congressional PAYGO Rules

Both the House and Senate adopted PAYGO rules in 2007. Congress should be commended for having done so, and this was a substantial improvement over the immediately prior years when no such rules existed. Nonetheless, the House and Senate rules lack the sequestration mechanism that would give teeth to the PAYGO Act. As a result, the Administration believes

[3] Note also that the PAYGO Act would not alter the existing congressional PAYGO rules. The Senate PAYGO rule would still apply to legislation that extended current policies; the House PAYGO rule, as provided in the Budget Resolution, would recognize limited exceptions for the continuation of current policy if statutory PAYGO were enacted.

that, while the congressional rules are an important bulwark for fiscal discipline, putting PAYGO back into law will complement and strengthen the rules and help to bring us back to a more sustainable budget. In other words, to borrow an old cliché, we believe in a "belt-and-suspenders" approach to PAYGO budgeting, with the PAYGO Act and the House and Senate rules working alongside one another to achieve fiscal discipline in a mutually reinforcing way.

Moreover, the joint presence of PAYGO rules and a PAYGO law would essentially replicate the situation in the 1990s, when a Senate PAYGO rule coexisted with statutory PAYGO. Notably, during this period from 1990 to 1999, Congress did not just meet the PAYGO requirement of budget neutrality, but managed to exceed it with the enactment of tax and entitlement legislation that in fact reduced deficits. (Congress accomplished this feat even before counting the effects of the deficit-reduction packages enacted in 1990, 1993, and 1997, which were deliberately excluded from the PAYGO scorecard.) It is quite possible that Congress was able to reach this result of net budgetary savings during the 1990s because it had to meet the requirement of both congressional rules and statutory PAYGO.

Conclusion

The current debate over health care reform illustrates the importance of enacting the PAYGO Act and abiding by the "do no harm" fiscal principle, even as we seek to invest in areas that have too long been ignored.

Some advocates may support health reform even if it expands the deficit; the Administration does not share that perspective. Instead, the President is insistent that health reform be deficit neutral through scoreable offsets, and has put forward roughly $950 billion in Medicare and Medicaid savings and additional revenue for that purpose. Beyond the need to make deficits no worse in the medium term, it is also crucial that we enact game-changing proposals that will move the health system toward one in which best practices are more universal across the nation, rather than isolated in certain areas and hospitals within the United States. These game changers may not score immediately, but they hold the key to containing health care cost growth in the long term and should be included in the legislation for this purpose.

We should not waiver from the fiscal principle of "do no harm"—in health care reform or elsewhere in the budget. Enacting statutory PAYGO is another important step in holding us to this goal.