OFFICE OF MANAGEMENT AND BUDGET

# THE STATUTORY PAY-AS-YOU-GO ACT OF 2010: A DESCRIPTION

The Statutory Pay-As-You-Go Act of 2010 (PAYGO, or "the Act") is part of Public Law 111-139, enacted on February 12, 2010. Briefly, the Act requires that all new legislation changing taxes, fees, or mandatory expenditures, taken together, must not increase projected deficits. This requirement is enforced by the threat of automatic across-the-board cuts in selected mandatory programs in the event that legislation taken as a whole does not meet the PAYGO standard established by the law. PAYGO also established special scorecards and scorekeeping rules.

**A. Principle.** The principle underlying PAYGO is a rule of budget neutrality – that is, the government must not enact any new laws that would increase projected deficits.

Adherence to PAYGO does not by itself reduce projected deficits, but during the 1990s, when the first statutory PAYGO law was in effect, adherence to the principle reinforced – and effectively locked into place – the substantive deficit-reduction measures enacted in 1990 and 1993, helping to lead to surpluses in the last four years of the Clinton Administration.

**B. Applicability.** PAYGO applies to laws enacted after February 12, 2010, that would alter revenues or mandatory spending or collections. (Mandatory spending encompasses any spending except that controlled by the annual appropriations process.[1]) For simplicity, this description calls such laws "PAYGO bills."

PAYGO requires that bills reducing revenues must be fully offset by cuts in mandatory programs or by revenue increases. It also requires that any bills increasing mandatory expenditures must be fully offset by revenue increases or cuts in mandatory programs. For purposes of PAYGO, there is no fundamental distinction between mandatory and tax legislation. Although it is simplest to describe the PAYGO principle as barring legislation that would increase projected deficits, the Act, which is permanent, would continue to apply even if the budget were in surplus.

**C. Enforcement.** If Congress enacts PAYGO bills cutting taxes or increasing mandatory expenditures without fully offsetting the costs, the Act specifies a penalty, called "sequestration." If Congress adjourns at the end of a session with net costs – that is, more costs than savings – on the scorecard, the Office of Management and Budget (OMB) is required to calculate, and the President is required to issue a sequestration order implementing, across-the-board cuts to a select group of mandatory programs in an amount sufficient to offset the net costs on the PAYGO scorecard.

PAYGO subjects mandatory spending to sequestration, with specified exemptions. Exemptions from sequestration include Social Security; most unemployment benefits; veterans' benefits; interest on the debt; federal retirement; and the low-income entitlements such as Medicaid, SNAP (food stamps), and Supplemental Security Income. [2] The major remaining mandatory programs, which are subject to sequestration, include most Medicare payments, farm price supports, vocational rehabilitation basic state grants, mineral leasing payments to states, the Social Services block grant, and many smaller programs.

If a sequestration is ordered, each non-exempt mandatory program is reduced for one year by the same percentage, with one exception: Medicare payments subject to sequestration cannot be reduced more than 4 percent.[3] Consequently, if an overall 4 percent sequestration would not suffice to offset net costs on the PAYGO scorecard, sequestrable Medicare payments would be cut 4 percent and all other non-exempt programs would be cut by a higher uniform percentage. In effect, if a large sequestration is needed, the bar to cutting sequestrable Medicare payments by more than 4 percent means that other non-exempt programs must make up the difference.

Even though sequestration is calculated to fully offset any net costs on the PAYGO scorecard, it historically has acted as a successful deterrent, and so has not been needed as a remedy. During the 1990s, under the first statutory PAYGO law, the sequestration rules and exemptions were almost identical to those in the current Act. Congress complied with PAYGO throughout that decade, although it eventually set aside the statute shortly before its legal expiration. As a result, no PAYGO sequestration ever occurred.

**D. The PAYGO scorecards.** Under PAYGO, OMB must maintain both a five-year and a 10-year scorecard. One scorecard displays the costs or savings produced by legislation averaged over the first five years, and a second scorecard with the costs or savings averaged over the first 10 years. The costs or savings of every PAYGO bill enacted from February 12, 2010, onwards will be recorded on the scorecards. At the end of each session of Congress, OMB will add all the (averaged) costs and savings for the fiscal year that has just started, to determine whether a sequestration is necessary.

More specifically, the scorecards on this website will display the cost or savings of every PAYGO bill after it is enacted. The five-year scorecard displays columns for the budget year and each of the next four years, while the 10-year scorecard displays columns for the budget year and each of the next nine years. The costs and savings produced by a PAYGO bill are averaged over five and 10 years, respectively, before being entered on the scorecards.[4]

The following example shows how the estimated costs (+) or savings (-) of a hypothetical PAYGO bill enacted in calendar year 2010 would be entered on each of the two scorecards. In this example, the hypothetical PAYGO bill is estimated to cost a total of $20 billion through 2015. That total is divided by five to produce an average cost of $4 billion per year, so $4 billion is entered in each column 2011-2015 of the five-year scorecard. The same PAYGO bill is estimated to cost $10 billion through 2020 because the costs in the earlier years turn to savings by 2017. That total is divided by 10 to produce an average of $1 billion per year, which is entered into each column 2011-2020 of the 10-year scorecard.

**Estimated budgetary effects of a hypothetical PAYGO bill: five- and ten-year scorecards**

| Fiscal year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *Estimated effects* | *+2* | *+4* | *+5* | *+4* | *+3* | *+2* | *+1* | *-2* | *-3* | *-3* | *-3* |
| **5-year scorecard** | | **+4** | **+4** | **+4** | **+4** | **+4** | | | | | |
| **10-year scorecard** | | **+1** | **+1** | **+1** | **+1** | **+1** | **+1** | **+1** | **+1** | **+1** | **+1** |

In this case, the five-year scorecard reflects higher costs than the 10-year scorecard because the costs occur primarily in the earlier years.

The two PAYGO scorecards each show running totals by year of all the entries, with one entry on each scorecard for each PAYGO bill. The example above shows a single PAYGO bill with net costs. When Congress adjourns, OMB is required to sum the entries on each scorecard for all such PAYGO bills. (The scorecards will actually display a running total of the entries for all bills at all times.) The key question for purposes of the sequestration trigger is whether the sum for the budget year (in the example above, 2011) on the five-year scorecard or on the 10-year scorecard is positive – that is, costs exceed savings – when Congress adjourns at the end of a session. If either sum is positive, the sequestration described in Part C above will go into effect automatically to offset the net 2011 costs. If both the five- and 10-year scorecards show net costs in the 2011 column, the sequestration must offset the higher amount.

As noted, when statutory PAYGO was in place in the 1990s, sequestration was never triggered. Consistent with this experience, the expectation is that under the Act, if Congress were to enact the hypothetical PAYGO bill with nets costs shown above, it would enact offsetting savings before adjournment, thereby avoiding a sequestration. If not, the example shows sequestration as a remedy. Specifically, the example shows a PAYGO bill enacted in 2010 that produces net costs of $20 billion through 2015; $4 billion per year is entered onto the five-year scorecard. If no further legislation is enacted, there would be a sequestration of $4 billion when Congress adjourns late in 2010, offsetting the $4 billion entry in the 2011 column of the five-year scorecard. That sequestration would last for only one year – fiscal year 2011 – but at the end of the following session of Congress, if further legislation did not alter the scorecard, there would be another one-year sequestration of $4 billion, and so on through 2015. In total, $20 billion of costs would be removed through sequestration, offsetting the $20 billion of costs through 2015 that had been entered on the five-year scorecard.[5]

When Congress starts a new session, the budget year will shift forward by one year and the two scorecards will each extend one year into the future. The net sum of all prior entries – the PAYGO balances from prior sessions of Congress – will remain on the scorecard and be part of the calculations. Suppose, for example, that the hypothetical PAYGO bill shown above were the only one enacted in the current session, leading to a $4 billion sequestration at the end of the session. At the beginning of the next session, the budget year rolls over to become fiscal year 2012. If a second hypothetical PAYGO bill were enacted – in this case, a new savings bill enacted in 2011 – the five-year scorecard might look as follows.

**The five-year scorecard, rolled over to a new year, and showing another hypothetical bill**

| Fiscal year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *Estimated effects* | *-1* | *-1* | *-1* | *0* | *-1* | *-1* | *-1* | *-2* | *-2* | *-2* | *-2* |
| **Prior balances** | | **+4** | **+4** | **+4** | **+4** | | | | | | |
| **5-yr avg. bill costs** | | **-1** | **-1** | **-1** | **-1** | **-1** | | | | | |
| **Running total** | | **+3** | **+3** | **+3** | **+3** | **-1** | | | | | |

The estimated savings, averaging $1 billion per year through 2016, are insufficient to eliminate the sequestration scheduled to occur at the end of the session (see the 2012 column), but reduce the running total and thus the possible sequestration from $4 billion to $3 billion.

**E. Special rules for certain PAYGO estimates.** The discussion above implies that all estimated costs of PAYGO bills are entered on the PAYGO scorecard. There are a number of special rules, however, that affect the entries.

- Off-budget costs or savings are excluded. The Social Security trust funds and the Postal Service fund are the only two federal programs designated as off-budget by law. If legislation affects Social Security, for example, those effects, though shown in the unified budget, will not be entered on the PAYGO scorecards.
- Emergency costs are excluded. If Congress statutorily designates specified costs as emergency requirements under the Act, the costs are not entered on the PAYGO scorecard but instead are shown separately.
- Certain timing shifts are excluded. Congress cannot use timing shifts to avoid violating PAYGO on the 10-year scorecard. If a PAYGO bill contains provisions that would move costs from year ten of the scorecard to year 11, or would move savings from year 11 onto the last year of the scorecard, the effects of those timing shifts are ignored.
- CLASS Act savings are excluded. The CLASS Act, enacted as part of health care reform, established a voluntary, fully prefunded long-term care benefit, with the value of the benefit linked directly to the value of the advance funding. Because it is fully prefunded, the legislation reduces deficits in the early years but over time breaks even. A special provision of the Act provides that the CLASS Act does not have its budgetary effects entered on the PAYGO scorecard.
- Current-policy scorekeeping adjustments can reduce scored costs. In Part A, we described PAYGO as requiring that legislation should not increase projected deficits, relative to current law (baseline). This raises the question of how existing tax and mandatory laws are projected. In most cases, baseline projections are assumed to reflect scheduled changes built into those existing laws. For example, future benefits under the food stamp program are indexed to inflation under current law, as are tax brackets. This indexing is

assumed to occur on schedule, so a PAYGO law is viewed as changing future deficits only if it changes some aspect of law that is already scheduled to occur.

However, under the Act there are five exceptions to this general rule. Each exception exists because the scheduled future changes in the law are considered so unrealistic that they do not provide a reasonable benchmark for judging the effect of new legislation.

1. Some longstanding programs require periodic reauthorization, such as farm price supports, SNAP (food stamps), the Children's Health Insurance Program (CHIP), and Temporary Assistance to Needy Families (TANF). These programs are treated as though they are ongoing. This has been the baseline rule since baselines were first developed in the 1970s.[6]

2. The temporary increase in the exemption from the Alternative Minimum Tax (AMT) expires at the end of 2010. If further action is not taken, this expiration will cause tens of millions of taxpayers to be subject to the AMT who were not before. In the past, Congress has always granted "temporary" relief from the scheduled AMT charge.

   In this case, the Act does not change the baseline, which continues to reflect scheduled AMT law. Rather, it provides that legislation extending relief from the scheduled AMT hit is not scored as producing PAYGO costs except to the extent that the relief is more generous than the relief currently in effect. AMT relief that is less generous than that currently in effect would not be scored as a PAYGO savings, however; such savings would therefore not be available to cover other PAYGO costs. More precisely, if an AMT provision is enacted, the cost of that provision, relative to scheduled law, is adjusted downward, but not below zero, by an amount equal to the costs of granting relief equivalent to that in effect in 2008 (which is virtually the same as that in effect in 2009). The Act provides for these downward current policy adjustments only for AMT relief through December 31, 2011.

3. Reimbursement rates for Medicare physicians are scheduled to decrease dramatically. In the past, Congress has always granted "temporary" relief from the cuts. The benchmark for the current policy adjustment is the physician reimbursement rates as they were in effect in 2009, and the adjustment in

scoring is done in the same way as that for the AMT. This adjustment only offsets the costs of a fix to this payment system through December 31, 2014. Any fixes in effect after that point are scored relative to current law.

4. The estate tax expired on December 31, 2009, and the treatment of inherited capital gains changed, but both the estate tax and the treatment of inherited gains are scheduled in 2011 to revert to the law as specified in 2000, imposing higher estate taxes than have been in effect for a decade. In this case, the benchmark for the current policy adjustment is the estate and gift tax law as it was in effect for 2009, and the scoring adjustment method is the same as for the AMT. This adjustment only offsets the costs of revisions to estate tax law in place through December 31, 2011.

5. A wide variety of cuts to the individual income tax were enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), and some of those tax cuts have been amended. All of these tax cuts are scheduled to expire on December 31, 2010. In these cases, the benchmark for the current policy adjustment is the relevant provision of the tax code as in effect for 2010, and the scoring adjustment method is the same as for the AMT. Here, the relief from the scheduled expiration of those tax cuts at the end of 2010 is allowed to be permanent. However, this relief does not apply to all the provisions of EGTRRA and JGTRRA – only those referred to as the middle-class tax cuts. If the upper-income tax cuts are to be extended, their extension must be paid for. Under the Statutory PAYGO Act, permanent current policy adjustments are allowed for the following provisions of EGTRRA and JGTRRA:

   - The 10-percent income tax bracket;
   - The child tax credit;
   - Tax benefits for married couples;
   - The adoption tax credit;
   - The dependent care tax credit;
   - The employer-provided child care tax credit;
   - The education tax benefits;
   - The 25-percent and 28-percent tax brackets;

- The 33-percent tax bracket, but only for taxpayers with Adjusted Gross Income (AGI) of $200,000 or less for single filers or $250,000 or less for married filers;
- The tax rates on capital gains and dividends, but only for taxpayers with AGI of $200,000 or less for single filers or $250,000 or less for married filers;
- The phase-out of personal exemptions (PEP) and the limitation on itemized deductions (Pease), but only for taxpayers with AGI of $200,000 or less for single filers or $250,000 or less for married filers; and
- The increased limits on "expensing" small business assets under §179(b) of the internal revenue code.

As described in items two through five above, current policy adjustments allow the enactment without offsets of relief from certain scheduled changes in laws. Whether the relief is allowed through 2011 (AMT, estate tax), through 2014 (Medicare physician reimbursement rates), or permanently (middle-class tax cuts), the legislation providing that relief must be enacted by December 31, 2011, to be eligible for the current policy adjustments.

**F. Responsibility for PAYGO estimates.** The Act provides two mechanisms for providing PAYGO cost estimates. The first uses an estimate included in the Congressional Record by the Chairmen of the Budget Committees. The second relies on OMB to produce the PAYGO estimate.

Under the first mechanism, Congress can determine the costs or savings of PAYGO legislation for purposes of the Act by enacting those estimates into law. Under the Act, Congress would include within the text of a PAYGO bill a cross-reference to an estimate that will have been included in the Congressional Record by the Chairmen of the Budget Committees. That estimate must be submitted to the Record before the House of Representatives or the Senate has voted on final passage of that PAYGO bill but after they have voted on the last amendment (if any) to that bill. Under this mechanism, OMB's role is limited to entering the Congressionally determined year-by-year estimates on the five-year and 10-year PAYGO scorecards, averaging and cumulating the entries, and calculating any sequestration that might be needed.

In the event that Congress does not determine the costs or savings of PAYGO legislation as described above, under the Act, OMB must estimate the budgetary effects for the PAYGO scorecards using the economic and technical assumptions in the President's Budget.

Cost and savings estimates are entered on the scorecard when PAYGO bills are enacted. Entries on the scorecard are not later changed, even if new estimates could be developed.

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[1] Mandatory spending is termed direct spending in the Act. The term mandatory encompasses entitlement programs, e.g., Medicare and Medicaid, and any funding not controlled by annual appropriations bills, such as the automatic availability of immigration examination fees to the Department of Homeland Security.

[2] Though many programs are exempt from sequestration, they are not exempt from PAYGO. A bill to increase veterans' disability benefits or Medicaid benefits must be offset, even though a sequestration, if it is required, will not reduce those benefits.

[3] Medicare payments for services, devices, or insurance plans are subject to sequestration within the limit described above; other payments – such as the low-income subsidy that is part of the prescription drug benefit—are not subject to sequestration.

[4] Costs or savings that occur in the current year are treated as though they were projected to occur in the budget year. The terms budget year and current year are defined with respect to a session of Congress; the budget year means the fiscal year that will start or has started on the October 1 that falls within that session of Congress, and the current year is the fiscal year before the budget year.

[5] In addition, if further legislation did not produce net PAYGO costs or savings, our hypothetical example would lead to sequestrations of $1 billion per year starting with fiscal year 2016 and continuing through 2020 because of the $1 billion yearly costs entered on the ten-year scorecard. Establishing two scorecards and having the larger net cost govern sequestration will produce results that save at least as much as required, and possibly more.

[6] One consequence of this rule is that a five-year reauthorization of the SNAP program that, for example, increases benefits is scored as though it increases benefits permanently, since the underlying program is treated as permanent. Therefore, that increase would be scored as producing costs in all ten columns of the ten-year scorecard, and so would require ten years of offsets.

*Source:*

The Statutory Pay-As-You-Go Act of 2010: A Description
https://obamawhitehouse.archives.gov/omb/paygo_description/