Insight

Congress Broke PAYGO

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Executive Summary

- Under current law, largely due to the American Rescue Plan Act, there is a $742 billion positive balance on the Statutory Pay-As-You-Go (S-PAYGO) scorecard.
- Under the S-PAYGO Act, new legislation must be paid for, on average, over 5- and 10-year periods.
- Every year, the Office of Management and Budget (OMB) tabulates the budget effects of legislation over these 5- and 10-year periods, and if there is a positive balance, it must offset those balances with spending cuts known as a sequester.
- Yet under the law, there is nowhere near $742 billion in non-exempt funding to sequester, meaning OMB would be unable to comply with the law.

Introduction

Last December, Congress passed legislation that facilitated an increase in the federal debt limit, arguably the most pressing ticking time bomb in U.S. public finance at the time. Along the way, Congress punted some smaller holiday crackers into the following year. Specifically, Congress pushed off not one, but two separate cancellations of federal spending – sequesters – that were scheduled to occur early in the new year. The future, alas for Congress, has a bad habit of becoming the present, and while one of these spending cuts has been allowed to go forward, a far larger spending cut of $742 billion is set to take effect in less than two months.

This sequester is due to a requirement in the Statutory Pay-As-You-Go (S-PAYGO) Act which requires that new legislation must be paid for, on average, over 5- and 10-year periods. Parliamentary rules and a healthy dose of politics prevented congressional Democrats from exempting the American Rescue Plan Act's (ARPA) $2 trillion cost from S-PAYGO, and now the law dictates that its costs are offset through annual sequesters. Though 2021 legislation punted these cuts, it essentially doubled the cut set to take effect early next year. While there could well be a lively and perhaps necessary public debate over the desirability of an automatic spending cut of 3 percent of gross domestic product in 2023, such concerns are merely theoretical: Under current law, the vast majority of federal programs are exempt from sequestration. Accordingly, even if the $742 billion sequester is ordered by the Office of Management and Budget (OMB) in early 2023, OMB only has about $138 billion in funding to reduce – rendering the executive branch unable to comply with the law. Essentially, Congress and the executive branch broke S-PAYGO.

Statutory PAYGO

The Statutory Pay-As-You-Go Act was signed into law, along with a debt-limit increase, by President Obama in February of 2010. Under S-PAYGO, the average annual net revenue and direct spending effects of legislation over the 5- and 10-year periods subsequent to its enactment are estimated, averaged, and recorded by OMB. Over the course of the year, OMB tallies the S-PAYGO effects of legislation, and if there is a positive balance on either the 5- or 10-year scorecard, OMB is required to order a sequestration of non-exempt funding to offset the debit on the S-PAYGO scorecard. If there is a debit on both the 5- and 10-year scorecards, as is currently the case, OMB is required to offset the larger of the two debits. One nuance is that OMB must offset the debit with a reduction in actual spending, or outlays, rather than just funding, or budget authority (BA). Generally, a given dollar in BA yields less than a dollar in outlays. But OMB doesn't directly control outlays, so OMB must estimate how much BA must be reduced to yield the necessary reduction in outlays.

While OMB goes through the estimating motions every year, it has remained a theoretical exercise. Since the enactment of S-PAYGO, debt held by the public has grown by $16.5 trillion. How could this be if there is a law that requires Congress to pay as it goes?

For more mundane legislation, Congress often abides by the spirit of S-PAYGO and offsets the cost of new legislation with pay-fors of varying degrees of seriousness. Yet for prime-time legislation, such as the Tax Cuts and Jobs Act (TCJA), the CARES Act, and pretty much anything with a big price-tag, Congress either exempts the legislation from S-PAYGO or wipes out the recorded costs later. Accordingly, in the 12 years since S-PAYGO's enactment, OMB has never ordered an S-PAYGO sequester.

S-PAYGO in FY2022 and FY2023

At present, the 5-and 10-year Statutory PAYGO scorecards carry large balances – $742 billion and $375 billion, respectively, for fiscal year (FY) 2023. This is almost entirely due to the ARPA, which OMB estimated would cost $2 trillion over the period 2021-2031. Thanks largely to budget gimmicks, the Infrastructure and Investment Act was scored as reducing the deficit and offset by about $173 billion of this 10-year debit. Thus, for FY2022, the PAYGO scorecards had 5-and 10-year annual debits of $371 and $187 billion, respectively, which would have required OMB to order a sequestration.

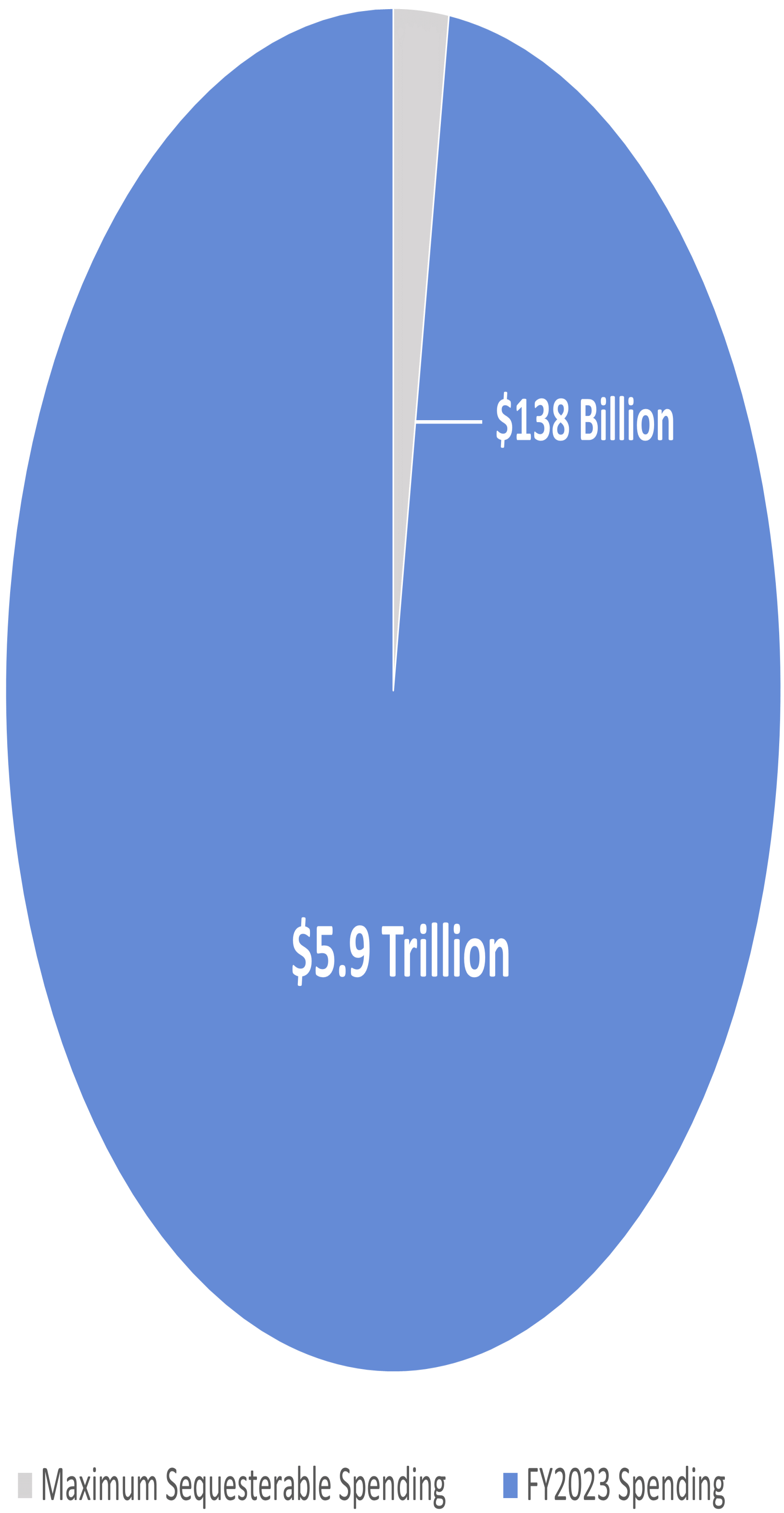
Under the law, 14 days after the end of the 1st session of the 117th Congress, mid-January 2022, OMB would have been required to order a sequestration in BA sufficient to reduce outlays by $371 billion for the year, and all else equal, every year for the following four years.

Yet Congress passed legislation last December that punted these debits to FY2023, effectively doubling the size of the potential sequester. Accordingly, there is a theoretical sequestration order of $742 billion possible for FY2023, subject to OMB's determination 14 days after the conclusion of the Congress (there are some other timing nuances not worth getting into here).

Blood from a Stone

The Congressional Budget Office (CBO) projects that the federal government will spend $5.9 trillion in FY2023. Under statutory PAYGO, however, the vast majority of federal spending (and relating funding) is exempt from potential sequestration. Under PAYGO, OMB is limited to sequester the non-exempt sequestrable base. This is composed of $13 billion in mandatory defense funding, and $88 billion in non-defense direct spending. PAYGO also subjects Medicare and some community health funding to sequestration, but caps any reduction at 4 percent, which amounts to about $38 billion in FY2023. Combined, the total amount of available funding OMB could potentially cancel amounts to about $138 billion – which would yield less than that amount in actual outlay reductions.

Maximum Potential Sequester Is 2 Percent of 2023 Spending



There is no provision in the S-PAYGO Act that clarifies what happens in the event that an S-PAYGO balance exceeds OMB's capacity to sequester it. When queried on this possible outcome, CBO dryly observed that, "…OMB would be unable to fully implement the outlay reductions required by the PAYGO law."

A confounding issue is that there is already a separate sequestration of some of the same pool of resources – largely Medicare – already in effect. Under the Budget Control Act, a sequestration of mandatory spending has been in effect since 2013. This provision capped the sequestration of Medicare spending to 2 percent. While the Budget Control Act largely expired at the end of 2021, this sequester has been extended to 2031 (with a pause and temporary reduction during the pandemic) as it has become a popular bipartisan budgetary offset. The relevant statutes are silent on how this sequester and a potential S-PAYGO should work in tandem.

As noted previously, this dynamic is unsurprisingly animated by politics. Republicans were able to enact legislation with Democratic votes to eliminate any potential positive balance on the S-PAYGO scorecards from TCJA. Democrats were unable to get the votes needed to do the same for the ARPA. The fallback was to punt the problem until after the midterms. While on paper this doubles the size of the problem, in reality OMB couldn't offset the higher amount even if the executive branch wanted to. No doubt there will be a debate in Congress on whether and how to mitigate this potential spending reduction.

Conclusion

Congress is spectacularly duplicitous in its approach to budgeting. For small-ball legislation, Congress will often go to some lengths to offset any costs. But for big-ticket items, often the product of campaign promises, these rules rarely apply. Statutory PAYGO itself is riddled with specific exceptions and exemptions and is so ineffectual it has never been invoked despite serial congressional profligacy. This habit has become so common that the current Congress has racked up an S-PAYGO balance so large that it exceeds any capacity for the executive branch to comply with the law. Congress broke S-PAYGO, and the quick fix that will likely occur at the end of the year probably won't be pretty.