BUDGET BULLETIN

A WEEKLY BULLETIN PRODUCED WHEN THE SENATE IS IN SESSION.

COMMITTEE ON THE BUDGET Republican Staff

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202/224-0642 http://budget.senate.gov/republican

110th Congress, 2nd Session: No. 5

April 16, 2008

INFORMED BUDGETEER

Table 1: U.S.-Peru Trade Promotion Agreement (H.R. 3688, P.L. 110-138)
(fiscal years, $ millions)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2007-2012	2007-2017
Changes in Revenues[1]												
Free Trade Agreement	-20	-35	-37	-39	-41	-44	-47	-50	-53	-56	-173	-423
Payment of corporate estimated tax	-	-	-	-	465	-465	-	-	-	-	465	0
Changes in Direct Spending[2]												
Free Trade Agreement	4	5	6	6	6	7	7	1	-	-	27	42
Customs user fees extension	-	-	-	-	-	-	-	-485	-	-	0	-485
Deficit Impact[2]	**24**	**40**	**43**	**45**	**-418**	**516**	**54**	**-434**	**53**	**56**	**-265**	**-20**

1. Negative number means a decrease in revenues (and corresponding increase in deficit); positive number means an increase in revenues (and corresponding decrease in the deficit).
2. Positive number indicates an increase in outlays/deficit; negative number indicates decrease in outlays/deficit. NOTE: There is no 2007 impact from this bill.

NEW ADVENTURES OF OLD PAY-GO (PART 3)

- As explained in the first *Budget Bulletin* of this year (and more seamlessly in the Congressional Record of March 14, 2008, which combines elements of previous *Bulletins* with information in this *Bulletin*), the current pay-go points of order that apply in the Senate and House are definitely not the "old-fashioned, traditional" pay-go that Democrats had been publicly hankering for since 2002 and had campaigned on in 2006.

- By throwing away the discipline of a first-year test that had characterized all previous versions of pay-go from 1991-2006, the Democrats' current pay-go is now Wimpy's pay-go: "I'll gladly pay you Tuesday for a hamburger today." (What's a first-year test? -- any spending increase or revenue reduction in the **first year** of a budget period had to be deficit neutral and therefore matched **in that same year** with an offsetting spending cut or revenue increase.) But instead of a hamburger, Congress wants more spending today. And instead of next Tuesday, Congress has decided to wait at least five or six years before starting to pay for the new spending today.

- That previous *Bulletin* explained (through some simplified, generic examples) the significant leeway afforded by no longer having a first-year test. This *Bulletin* examines the record of the first session of the 110th Congress to evaluate the actual experience with pay-go. Consider one of the enacted bills to see how it "complied" with pay-go (see Table 1 below).

- **The U.S.-Peru Trade Promotion Agreement**. This bill was signed into law on December 14, 2007. Over the next five years, the free-trade-agreement section of the legislation increases outlays (via exempting certain goods from customs merchandise processing fees) by $27 million and reduces revenues (via tariff phase-outs) by $173 million, for a total five-year deficit increase of $200 million (see 2007-2012 column in Table 1 above).

- How was the deficit increase paid for? It wasn't paid for in 2008 or 2009 or 2010 or even 2011. In 2012, the bill requires the payment of $465 million of corporate taxes otherwise due in 2013. Is it paid for yet? Well, the test for deficit neutrality in the first six years (2007-2012, though the bill had no 2007 impact) was satisfied, but the shift of corporate taxes created a hole in the second five years. How was this hole filled? Of course, by our old friend – customs user fees.

- Under the law that existed at the beginning of the 110th Congress, customs user fees were set to expire on September 30, 2014. So far this Congress, five bills have been enacted that have extended these fees: two for one week each, two for two weeks each, and one for two months. The U.S.-Peru Free Trade Agreement, which increased the fees for two months through December 13, 2014, resulted in $485 million of additional fee collections in fiscal year 2015.

- Table 1 demonstrates that the only real offset in this bill -- for the new spending and revenue reduction that happens in years 2008 through 2017 -- is the customs user fee extension in 2015.

- **First Session, 110th Congress**. Next, consider in Table 2 all of the bills enacted during the first session of the 110th Congress that had pay-go effects (not including the AMT bill). The first line summarizes the pay-go effects of the six enacted bills that used the corporate tax timing shift. You can see that bills with the shift increased the deficit in each and every year until 2012. In 2012, the six bills reduced the deficit on net by $8.7 billion, then increased the deficit by $5.3 billion in 2013.

- The second line of Table 2 summarizes the budgetary effects of all the other pay-go bills (except the AMT patch) enacted during the first session. These bills increased the deficit in 2007, 2008, and 2009, and only begin to reduce the deficit in 2010. You can see by looking at the bottom line of Table 2 that these bills altogether increased the deficit by a total of $10.7 billion over the four years 2007-2010.

- Yet, the Senate Budget Committee chairman likes to point to the bottom line of Table 2 to illustrate how well pay-go has worked because there was a pay-go scorecard surplus of $1.988 billion for 2007-2012 and $1.311 billion for 2007-2017 prior to enactment of the AMT patch last December.

Table 2: Snapshot of Cumulative Pay-Go Impact of Enacted Legislation as of Dec. 18, 2007
(by FY, $ millions)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2007-2012	2007-2017
Net deficit impact of all bills with the corporate estimated tax shift[1]	190	573	802	3,918	2,362	-8,682	5,296	-1,267	-1,792	-897	-688	-838	-192
Net deficit impact of all other enacted bills with pay-go effects	3	4,320	2,478	-1,572	-3,561	-2,817	2,524	882	-921	-1,350	-1,107	-1,150	-1,119
Total pay-go scorecard balance	193	4,893	3,280	2,346	-1,199	-11,499	7,820	-385	-2,713	-2,247	-1,795	-1,988	-1,311

NOTE: Positive numbers indicate increase in deficit; negative numbers indicate decrease in deficit. Details may not add due to rounding
1. P.L. 110-42, P.L. 110-52, P.L. 110-138, P.L. 110-142, P.L. 110-28.

- The "surplus" was there because of the big, bumpy deficit reduction that takes place in 2012, thanks mostly to the corporate tax payment shifts. But what the scorecard omits is a cost of spending now and paying later that the Treasury does not have the luxury of ignoring (even though the Congress does).

- **Real Interest Costs Ignored By Pay-Go**. Everything else being equal under our current federal budget deficits, new spending now needs to be financed now. Where does the Treasury go to get the money to pay for the new spending? To the credit markets, of course! Treasury has to go out and borrow the money to pay for the new spending or tax cuts today for as long as it takes for the offsets to kick in.

- The Treasury has no choice but to go out to the credit markets and borrow $10.7 billion (the deficit increase over the period 2007-2010 for all the bills in Table 2). The Treasury will have to pay $2.8 billion in interest costs over the next ten years until all the offsets in these bills finally come in and allow the Treasury to pay off that borrowing. Not only does the unrecognized $2.8 billion interest cost get added permanently to the debt, but it is also so large that it more than wipes out the ephemeral surplus that was on the pay-go scorecard on December 18, 2007. If the interest impacts of "spend now, pay later" had been taken into account, there would have been only a very small surplus on the scorecard in the first six years, and a **deficit of $1.5 billion** over 11 years.

- But the Budget Chairman's "surplus" didn't last long enough to be overtaken by interest costs. Another bill wiped out the surplus on the pay-go scorecard first. The enacted AMT patch increased the deficit by $50.6 billion in 2008. It was not offset, so it created a huge deficit hole in the pay-go scorecard.

- Some House members virtuously cite their version of the AMT bill last November that "paid for" the AMT patch. That AMT bill (which passed the House but not the Senate) would have increased the deficit by $37.4 billion over the 4-year period 2008-2011, and satisfied the 2008-2012 deficit-neutrality test for pay-go only by using a corporate estimated tax shift of $32 billion from 2013 into 2012. This "paid for" AMT bill would have cost an additional $10.5 billion in interest on new borrowing to finance the up-front deficit increase over the first five years and **$17.7 billion** in interest costs on new borrowing over ten years.

- **Pay-Go Time Period Glitch for 2nd Session, 110th Congress**. More "spend now, pay later – but we satisfy pay-go!" legislation is on the way. Press reports indicate that the Farm Bill, which covers 2008-2013 and will cost about $10 billion more than the current baseline over ten years, may be "paid for" in large part by extending customs user fees starting *in 2015*.

- But as we have seen from this *Bulletin* so far, extending customs user fees starting eight years from now can only work as a pay-go offset for near-term deficit increases by combining it with the timing shift in corporate estimated taxes. In the first session of the 110th Congress, the House and Senate had the same time periods for enforcing paygo: 2007-2012 and 2007-2017 (but no first-year test).

- With the start of the second session of the 110th Congress, the House and Senate have different time periods for enforcing pay-go, so it will be interesting to see how they figure out how to shift corporate revenues to satisfy both of the deficit-neutrality tests for the different "first six years."

- What are the "first six years" currently? In the Senate, the pay-go enforcement periods are the same as they were before: 2007-2012 and 2007-2017. The Senate pay-go enforcement periods will remain the same until Congress adopts a conference report on a budget resolution to replace the 2008 budget resolution currently in effect.

- However, in the House, as of January 1, 2008, bills must now be deficit neutral over the six years 2008-2013 and over the 11 years 2008-2018. How will Farm Bill conferees digest this difference between the House and Senate? Perhaps the Farm Bill will require corporations to shift some of their estimated taxes from 2014 into 2013 to satisfy the House pay-go rule and to shift more estimated taxes from 2014 to 2012 to satisfy the Senate pay-go rule. If so, corporations would have to shift twice the amount of estimated taxes than before and would have to shift half of that by about 15 months forward instead of just three months forward.

- **Defending Pay-Go By Pointing at CBO**. Because this Congress abandoned the first-year deficit neutrality test for pay-go that many of its members campaigned on, and because the corporate estimated tax shift (which doesn't pay for anything) has been used to satisfy the pay-go test for the first six years, the current pay-go system in reality only requires offsets over 11 years, and in only the second half of those 11 years. It remains to be see how much in additional interest expense will be incurred from upcoming legislation that is deemed "paid for."

- Still, the current pay-go system has its staunch defenders. The chairman of the Senate Budget Committee is fond of saying that "Pay-go is not full of holes . . .[but] don't take my word for it. We can look to the nonpartisan Congressional Budget Office" (Senate floor debate on the Food and Energy Security Act of 2007, November 16, 2007). Can we really?

- First, savvy budgeteers know that CBO's job is straightforward: it prepares estimates of the budgetary effects of legislation and displays them in each year for a 10-year period. A CBO cost estimate has never evaluated whether a House or Senate point of order applies against legislation or determined whether a piece of legislation complies with the budget resolution. That is the job of the chairmen of the House and Senate Budget Committees, most often using CBO estimates to inform those determinations, but sometimes using alternate estimates.

- For example, last year, the House Budget Committee chairman overrode a scorekeeping rule and directed CBO to score savings for a particular provision in the House Farm Bill. Without this directed scoring, the House Farm Bill would have violated paygo. It was the House Budget chairman who decided whether the House pay-go point of order applied against the House Farm Bill. CBO did not decide.

- Second, CBO does not evaluate the merits of "policy" in its cost estimates. CBO estimates the budgetary incidence of early sunsets and payment shifts exactly as written in legislation, gimmicks though they are. The budget chairmen then say "CBO estimates this bill reduces the deficit" and excuse Congress from responsibility for the gimmicks.

Farewell to a Most Informed Budgeteer. The *Bulletin* bids farewell to a frequent contributor and Senate Budget Committee Chief Numbers Guru David Pappone. Dave left SBC on April 9th for Golden Gopher Country. He is now Director of Finance for the University of Minnesota's Institute of Technology.
Congrats, Dave!