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Pay-As-You-Go Requirement for FY2002: A Procedural Assessment

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Robert Keith
Specialist in American National Government
Government and Finance Division

Pay-As-You-Go Requirement for FY2002: A Procedural Assessment

Summary

The 1985 Balanced Budget Act, as amended, establishes a "pay-as-you-go" (PAYGO) requirement for direct spending and revenue legislation. Under this procedure, legislation proposing new direct spending or decreasing revenues for a fiscal year must not result in a net cost for that year on the "PAYGO scorecard." Any violation of the PAYGO requirement would trigger a sequester after the end of the session, involving automatic, largely across-the-board spending cuts in nonexempt programs. This requirement presently applies to legislation enacted through the end of FY2002 (on September 30, 2002) and covers the effects of such legislation through FY2006. In determining whether a sequester is needed for a fiscal year, the balances on the scorecard for that year and the preceding year are combined.

Direct spending, which is expected to amount to more than $1.2 trillion in FY2002 (excluding net interest), is controlled by the legislative committees of the House and Senate and funds entitlement and other mandatory programs, such as Medicare and federal civilian retirement. Direct spending is distinguished from *discretionary spending*, which is controlled by the House and Senate Appropriations Committees. Social Security is not subject to the PAYGO requirement. *Revenues*, which are expected to amount to more than $2.0 trillion in FY2002, are under the jurisdiction of the House Ways and Means and Senate Finance Committees.

President George W. Bush submitted his FY2002 budget to Congress on April 9, 2001, calling for a 10-year tax cut of $1.6 trillion and significant increases in direct spending for Medicare reform and other initiatives. The budget resolution for FY2002 (H.Con.Res. 83), adopted on May 10, largely accommodated the President's overall requests. Under the budget resolution, revenue reductions amounting to $65.3 billion for FY2002 and $1.369 trillion over 10 years were expected to be achieved, largely through the reconciliation process. Both the President and Congress recognized that their policies regarding PAYGO legislation implied action later in the session on a procedural device to prevent a PAYGO sequester.

In late December, the House and Senate brought their budgetary actions during the 2001 session to a close by enacting the Defense Appropriations Act for FY2002, H.R. 3338. President George W. Bush signed the measure into law on January 10, 2002 (P.L. 107-117). In addition to revising the discretionary spending limits, the act also included a provision to prevent a PAYGO sequester for FY2002. Section 102 in Division C of the act (115 *Stat*. 2342) instructed the OMB director in preparing his final sequestration report to set the PAYGO balances for FY2001 and FY2002 to zero.

According to the OMB director's report, a combined balance of $130.279 billion ($75.271 billion for FY2001 and $55.008 billion for FY2002) was removed from the scorecard pursuant to the scorekeeping directive in P.L. 107-117. The FY2002 effects of any PAYGO legislation enacted during the 2002 session (through September 30) will be added to the balance for FY2003 to determine whether a PAYGO sequester will be needed for that year.

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The Pay-As-You-Go Requirement

The Budget Enforcement Act (BEA) of 1990 established a "pay-as-you-go" (PAYGO) requirement for direct spending and revenue legislation as part of an underlying law, the Balanced Budget and Emergency Deficit Control Act of 1985.[1] Under this procedure, legislation proposing new direct spending or decreasing revenues for a fiscal year must not result in a net cost for that year. The PAYGO requirement is intended to keep the on-budget surplus from being reduced (or the on-budget deficit from being increased). This requirement, which has been revised and extended over the years, presently applies to legislation enacted through the end of FY2002 (on September 30, 2002) and covers the effects of such legislation through FY2006.

Direct spending, which is expected to amount to more than $1.2 trillion in FY2002 (excluding net interest), is controlled by the legislative committees of the House and Senate through substantive law and funds entitlement and other mandatory programs, such as Medicare, federal military and civilian retirement, and unemployment compensation. This amount includes about $450 billion in spending for Social Security, which is not subject to the PAYGO requirement. *Revenues*, which are expected to amount to more than $2.0 trillion in FY2002 (including more than $500 billion for Social Security), are under the jurisdiction of the House Ways and Means and Senate Finance Committees.

Direct spending is distinguished from *discretionary spending*, which is expected to amount to more than $700 billion in FY2002. Discretionary spending falls under the control of the House and Senate Appropriations Committees and is provided in annual appropriations acts. For the most part, discretionary spending funds the routine operations of the federal government, including the "salaries and expenses" accounts of most agencies. (The BEA of 1990 subjects discretionary spending to a different enforcement mechanism, adjustable limits on budget authority and outlays, rather than to the PAYGO process.[2]) Direct spending and discretionary spending together make up total federal spending.

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[1] The BEA of 1990 is Title XIII of P.L. 101-508 (November 5, 1990), the Omnibus Budget Reconciliation Act of 1990; see 104 *Stat*. 1388-573 through 628. The 1985 act is Title II of P.L. 99-177 (December 12, 1985), a measure increasing the public debt limit; see 99 *Stat*. 1037-1101.

[2] For more information on this topic, see: CRS Report RL31193, *Discretionary Spending Limits for FY2002: A Procedural Assessment*, by Robert Keith.

The PAYGO requirement, as originally set forth in the BEA of 1990, covered FY1991-1995. It was extended by the Omnibus Budget Reconciliation Act (OBRA) of 1993, through FY1998, and the Budget Enforcement Act (BEA) of 1997, through FY2002.[3] As mentioned previously, the PAYGO requirement applies to legislation enacted through FY2002, but it covers the effects of such legislation through FY2006.

With regard to direct spending, the PAYGO requirement applies to outlay levels rather than levels of budget authority. *Budget authority* represents the legal authority for agencies to incur obligations; annual appropriations are perhaps the most well known form of budget authority. *Outlays* represent the liquidation of the obligation, usually in the form of an electronic funds transfer or the issuance of a check by the Treasury Department. Outlays, rather than budget authority, are compared to revenue levels to determine the amount of the surplus or deficit.

The PAYGO balances for each fiscal year are maintained on a rolling PAYGO "scorecard" that accumulates the budgetary effects of laws enacted during the session and in prior years (beginning with FY1992).[4] The threshold test for a PAYGO sequester deals with how legislation affects the net cost for a fiscal year on the PAYGO scorecard, not how it changes the surplus or deficit for that fiscal year in the federal budget generally.

As the budget moved from an overall deficit to an overall surplus in recent years, and as an on-budget surplus emerged, there was some confusion regarding whether the PAYGO requirement would continue to apply. The concern arose from the fact that the stated purpose of the PAYGO requirement, in Section 252(a) of the 1985 Balanced Budget Act, refers only to legislation "that increases the deficit." In the report accompanying the FY2000 budget resolution, for example, the House Budget Committee stated:

> The law is somewhat unclear whether PAYGO lapses when there is an on-budget surplus. OMB has hinted that PAYGO would indeed lapse if the budget was in balance without counting excess Social Security receipts.[5]

In response to this concern, Jacob Lew, then director of the Office of Management and Budget (OMB), issued a statement indicating that such a position was not correct, stating "we believe that PAYGO does apply when there is an on-budget surplus."[6] The controlling factor, as stated previously, is how legislation changes the balance on the PAYGO scorecard.

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[3] OBRA of 1993 is P.L. 103-66 (August 10, 1993); see Title XIV at 107 *Stat*. 683-685. The BEA of 1997 is Title X of P.L. 105-33 (August 5, 1997); see 111 *Stat*. 677-712.

[4] On several occasions, PAYGO balances have been reset to zero or otherwise modified pursuant to law, primarily to prevent the sizeable savings from reconciliation legislation from being used as offsets to subsequent direct spending increases.

[5] See the report of the House Budget Committee to accompany H.Con.Res. 68 (H.Rept. 106-73), March 23, 1999, at page 87.

[6] Letter of April 6, 1999, from OMB Director Jacob Lew to the Honorable John Spratt, ranking minority member of the House Budget Committee.

Enforcement by Sequestration

The sequestration process, established by the Balanced Budget and Emergency Deficit Control Act of 1985 (Title II of P.L. 99-177) and used to enforce annual deficit targets, was retained by the BEA of 1990 and later laws as the means of enforcing the PAYGO requirement (as well as the discretionary spending limits).[7] Under current sequestration procedures, the OMB director issues a sequestration report at the time the President's budget is submitted to Congress (the preview report), midway through the congressional session (the update report), and within 15 days after the end of the session (the final report). The Congressional Budget Office (CBO) issues sequestration reports in advance of the OMB reports, but they are advisory only.

If the OMB director's final sequestration report indicates that enacted direct spending and revenue levels have incurred a net cost for the fiscal year on the PAYGO scorecard, then the President must immediately issue a sequestration order to remedy the violation through automatic, across-the-board spending reductions.

If a sequester under this process is required, it must occur within 15 calendar days after Congress adjourns at the end of a session and on the same day as any sequestration tied to enforcement of the discretionary spending limits. The sequester would eliminate any net positive balance on the PAYGO scorecard, for that fiscal year and the prior fiscal year combined, caused by the enactment of legislation during the session and in prior years.

Any required reductions would be made in non-exempt direct spending programs. Emergency direct spending and revenue legislation, so designated by the President and in statute, is not covered by the PAYGO sequestration process. As mentioned previously, spending for the Social Security program, except for administrative expenses, is exempt from sequestration, as are many other direct spending programs. Any reductions in Medicare spending are limited to 4%.

Enforcement in the Congressional Budget Process

The congressional budget process, established by the Congressional Budget Act of 1974, contains several mechanisms to enforce decisions regarding the recommended levels of direct spending and revenues. First, under Section 311 of the act, the aggregate levels in the budget resolution serve as a ceiling on total spending and a floor under total revenues. Second, under Section 302 of the act, the total amount of direct spending in the budget resolution is allocated among the various legislative committees of jurisdiction. Third, Section 310 provides for a reconciliation process, under which the budget resolution may contain instructions to the legislative committees to develop changes to direct spending or revenue laws to bring them into conformity with budget resolution policies. The resultant legislation is considered under expedited procedures in the House and Senate, usually in the form of an omnibus bill. Finally, the so-called elastic clause in Section

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[7] For a more detailed discussion of the sequestration process, see: CRS Report RL31137, *Sequestration Procedures Under the 1985 Balanced Budget Act*, by Robert Keith.

301(b)(4) authorizes the budget resolution to "set forth such other matters, and require such other procedures, relating to the budget, as may be appropriate to carry out the purposes of this Act."

Pursuant to the elastic clause authority, the House and Senate sometimes include special procedural features in the budget resolution. The Senate, for example, established a "pay-as-you-go" point of order several years ago which remains in effect. This provision, most recently set forth in Section 207 of the FY2000 budget resolution (H.Con.Res. 68), bars the consideration of any legislation that would increase or cause an on-budget deficit for any one of three applicable time periods: (1) the first year covered by the budget resolution; (2) the first 5 years covered by the budget resolution; and (3) the 5 fiscal years following the first 5 years covered by the budget resolution. Although the Senate's PAYGO point of order is comparable in purpose to the statutory PAYGO requirement, it differs in that it takes effect during the consideration of legislation rather than after the session ends and it applies to a much longer time frame.

The policies in the budget resolution regarding direct spending and revenue levels may be at odds with the statutory PAYGO requirement. During the past few years, as the deficit changed to a growing surplus, the budget resolution has recommended substantial reductions in revenues, coupled with increases in direct spending, that would incur substantial nets costs on the PAYGO scorecard. The "firewall" between the PAYGO process and procedures to enforce the discretionary spending limits does not permit savings from constraints on the growth of discretionary spending to offset or "pay for" revenue reductions. Accordingly, Congress has had to resort to procedural devices to prevent a sequester from occurring while pursuing revenue-reduction legislation (see later discussion).

FY2002 Policy Regarding the PAYGO Requirement

The initial policy for FY2002 regarding the PAYGO requirement was established by the submission of the President's budget and the adoption by the House and Senate of the annual budget resolution. As revenue and direct spending legislation is considered, the initial policy may be modified by various means, including the designation of revenue or direct spending changes as emergency requirements.

The President's Budget. President George W. Bush submitted his budget for FY2002 on April 9, 2001, recommending that Congress pass legislation extending the PAYGO requirement (and discretionary spending limits).[8] With regard to revenues and direct spending, his budget proposed a 10-year tax cut of $1.6 trillion, with a revenue loss for FY2002 of $29 billion, and direct spending increases,

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[8] U.S. Executive Office of the President, Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2002, Analytical Perspectives* (Washington: April 9, 2001), see the "Preview Report" on pages 243-251.

amounting to $13 billion in FY2002, for Medicare modernization, his Immediate Helping Hand proposal, and other initiatives.[9]

While the President indicated that his proposals would use only a portion of the projected on-budget surplus for FY2002 and later years, reserving some of it for debt reduction and contingencies, he acknowledged that his proposals would incur a sizeable impact on the PAYGO scorecard that would have to be remedied in order to prevent a PAYGO sequester at the end of the session. Further, the President's FY2002 proposals would only compound an existing problem regarding the PAYGO scorecard, which already recorded at the beginning of the session a balance of $16.053 billion for the fiscal year. Legislation enacted at the end of the second session of the 106th Congress, the Consolidated Appropriations Act for FY2001 (P.L. 106-554; December 21, 2001) had instructed the OMB director to reset the PAYGO balance for FY2001 to zero, but no such instructions applied to FY2002 or later years.[10]

Accordingly, President Bush pledged in his FY2002 budget to

> ...work with Congress to ensure that any unintended sequester of spending does not occur under current law or from the enactment of any other proposals that meet the President's objectives to reduce the debt, fund priority initiatives, and grant tax relief to all income tax paying Americans.[11]

In an analysis of the President's budget, the Congressional Budget Office (CBO) estimated the revenue loss from his proposals to be somewhat greater over 10 years (by $86 billion) and direct spending increases from his proposals to be significantly greater over the same period (by $160 billion, including additional debt service and the outlay effects of tax proposals) compared to his own estimates.[12]

The Congressional Budget Resolution. On May 10, the House and Senate reached final agreement on the budget resolution for FY2002, H.Con.Res. 83. According to the joint explanatory statement accompanying the conference report, the budget resolution assumed revenue reductions of $1.369 trillion over 10 years, beginning with $65.3 billion for FY2002 and rising to $191.3 billion for FY2011.[13] Additionally, the budget resolution assumed a total surplus for FY2002 of $218.6 billion and net increases for FY2002 and later years in direct spending to accommodate Medicare reform and other initiatives. Consequently, congressional

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[9] Executive Office of the President, Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2002*, (Washington: April 9, 2001), see Summary Table S-2 on page 224.

[10] See Section 2(b) of the act (114 *Stat*. 2763-2764), which is reprinted in: CRS Report RS20756, *FY2001 Consolidated Appropriations Act: Reference Guide*, by Robert Keith.

[11] *Analytical Perspectives*, *op. cit*., page 250.

[12] U.S. Congressional Budget Office. *An Analysis of the President's Budgetary Proposals for Fiscal Year 2002* (Washington: May 2001), Table 2, page 13.

[13] See the conference report on H.Con.Res. 83, H.Rept. 107-60 (May 8, 2001), 105 pages.

budget policy for FY2002 implied action on a procedural device later in the session to prevent a PAYGO sequester for that year.

Reconciliation instructions to the Senate Finance Committee and the House Ways and Means Committee were included in the budget resolution, in Sections 103 and 104, respectively. The instructions were intended to enforce the policy calling for revenue reduction over 10 years. Revenue reductions were targeted at $1.250 trillion during this period, with associated outlay increases (needed to accommodate refundable tax credits) of $100 billion. The reconciliation directives in total were expected to yield a $1.35 trillion reduction in the surplus over the ensuing decade. A relatively small amount of revenue losses were expected to be associated with legislation considered outside of the reconciliation process.

Implementation of the FY2002 Policy

Congressional Action on PAYGO Legislation. Following adoption of the FY2002 budget resolution, the House and Senate began consideration of various "PAYGO measures" (that is, measures affecting direct spending, revenues, or both). The centerpiece of congressional action on PAYGO measures during the 2001 session, the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16; 115 *Stat*. 38-150), was signed into law on June 7, 2001. The measure, which was developed in response to the President's tax-cut proposals and the reconciliation directives in the FY2002 budget resolution, placed balances of $69.501 billion and $35.691 billion on the PAYGO scorecard for FY2001 and FY2002, respectively.[14] (As previously stated, the FY2001 and FY2002 balances are combined to determine whether a PAYGO sequester for FY2002 is needed.)

Another major PAYGO measure enacted during the session was the Crop Year 2001 Agricultural Economic Assistance Act (P.L. 107-25; August 13, 2001). Although it had no budgetary impact for FY2002, it added $5.5 billion to the PAYGO balance for FY2001. In the wake of the September 11 terrorist attacks on the United States, Congress and the President enacted the Air Transportation Safety and System Stabilization Act into law (P.L. 107-42; September 22, 2001). The act incurred over $1 billion in net costs in compensating air carriers for losses due to the attacks and for related purposes. Section 101(b) of the act (115 *Stat*. 230) designated the direct spending in the act to be an emergency requirement. Finally, a third major PAYGO measure completed by Congress during the session was the Investor and Capital Markets Fee Relief Act (P.L. 107-123; January 16, 2002), which also provided more than $1 billion for FY2002.

In August 2001, the sequestration update report, included in the *Mid-Session Review* of the President's budget, indicated a combined balance for FY2001 and FY2002 on the PAYGO scorecard of $126.7 billion[15] This balanced was expected

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[14] The OMB cost estimate for pay-as-you-go calculations related to this and other PAYGO measures enacted during the session is available on the OMB Website [www.omb.gov] under "Legislative Information."

[15] U.S. Executive Office of the President, Office of Management and Budget, *Budget of the* (continued...)

to increase as Congress and the President enacted additional PAYGO legislation during the session. Further, the report noted that the maximum savings achievable from a PAYGO sequester for FY2002 would be $33.3 billion. Consequently, a full PAYGO sequester (including a 4% cut in Medicare) still would leave a balance on the scorecard violating the PAYGO requirement by nearly $100 billion. The August OMB estimates also showed PAYGO balances for FY2003-2006 exceeding $100 billion in each year.

In late December, the House and Senate brought their budgetary actions during the 2001 session to a close by enacting the Defense Appropriations Act for FY2002, H.R. 3338. President George W. Bush signed the measure into law on January 10, 2002 (P.L. 107-117). In addition to revising the discretionary spending limits, the act also included a provision to prevent a PAYGO sequester for FY2002. Section 102 in Division C of the act (115 *Stat*. 2342) instructed the OMB director in preparing his final sequestration report to set the PAYGO balances for FY2001 and FY2002 to zero.

Issuance of the OMB Final Sequestration Report. OMB's *Final Sequestration Report for FY2002* was issued on January 31, 2002.[16] As instructed by P.L. 107-117, the OMB director set the PAYGO balances to zero for FY2001 and FY2002 (see **Table 1**) and determined that no PAYGO sequester was required. The balances for FY2003-2006 were increased modestly above the levels reported in August, ranging from over $110 billion to nearly $135 billion.

According to the OMB director's report, a combined balance of $130.279 billion ($75.271 billion for FY2001 and $55.008 billion for FY2002) was removed from the scorecard pursuant to the scorekeeping directive in P.L. 107-117.

The FY2002 effects of any PAYGO legislation enacted during the 2002 session (through September 30) will be added to the balance for FY2003 to determine whether a PAYGO sequester will be needed for that year.

Table 1. OMB Estimate of PAYGO Balances
(as of January 2002; amounts in $ billions)

FY2001	FY2002	FY2003	FY2004	FY2005	FY2006
0	0	110.694	129.857	130.571	134.698

[15] (...continued)
United States Government, Fiscal Year 2002, Mid-Session Review, Appendix B (Washington: August 2001), page 67.

[16] The *Final Sequestration Report for FY2002* is available on the OMB Website [www.omb.gov].

Previous Techniques for Preventing a Sequester

Congress and the President have been able to avoid a sequester under the PAYGO requirement largely by not enacting legislation that in the net would cause a balance on the PAYGO scorecard at the end of the session. In the two years prior to the FY2002 cycle, however, Congress and the President intervened in the normal operation of the PAYGO process with the aim of preventing a current-year or future-year sequester.[17] The intervention took the form of an instruction to the OMB director either not to count the direct spending or revenue effects of legislation or to set the PAYGO balance for one or more years to zero.

It should be noted that legislative provisions containing such techniques could violate Section 306 of the 1974 Congressional Budget Act. The section bars the consideration in the House or Senate of any legislation containing subject matter within the jurisdiction of the respective Budget Committee unless it has been reported by (or discharged from) that committee. Violations of Section 306 may be waived, typically by a special rule in the House or a motion in the Senate. In the Senate, such waivers require a three-fifths majority. Further, the prohibition in Section 306 is not self-enforcing; a Member must raise a point of order to enforce the prohibition.

In 2000, the statutory intervention resulted in the removal from the PAYGO scorecard of costs that would have led to a $10.5 billion PAYGO sequester for FY2001; for the year before that, the statutory intervention removed future-year costs to minimize the possibility of future-year sequesters. Both vehicles were annual appropriations acts considered toward the very end of the session (the Consolidated Appropriations Acts for FY2000 and FY2001).

The Consolidated Appropriations Acts for FY2000 and FY2001 both enacted by cross-reference legislation that made changes in direct spending and revenues. Under current scorekeeping rules, any such changes made in an annual appropriations act must be scored under the discretionary spending limits rather than the PAYGO scorecard. However, provisions in the two consolidated appropriations acts set aside this requirement.

FY2000. Section 1001 (113 *Stat*. 1537) in Division B of the Consolidated Appropriations Act for FY2000 (P.L. 106-113; November 29, 1999), in addition to prohibiting the scoring of direct spending and revenue changes made in the act under the discretionary spending limits, also prohibited the scoring of these changes under the PAYGO scorecard. This prevented costs of $1.552 billion for FY2000 (and costs of $15.193 billion for FY2000-2004) from being added to the PAYGO scorecard. However, even if the $1.552 billion for FY2000 had been added to the PAYGO scorecard, it would not have triggered a PAYGO sequester for that year because a savings balance of $1.462 billion would have remained.

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[17] For more detailed information on this matter, see: CRS Report 31155, *Techniques for Preventing a Budget Sequester*, by Robert Keith.

Section 1001 of the act also instructed the OMB director to change any balances on the scorecard for FY2000-2004 to zero on January 3, 2000. This action removed the combined FY1999-2000 savings of $3.014 billion from the scorecard, but also removed costs for FY2001-2004 amounting to $15.763 billion (from the Consolidated Appropriations Act and other measures) that could have triggered PAYGO sequesters in those years if not offset or otherwise prevented.

FY2001. At the end of the 2000 session, Congress and the President wrapped up business by enacting the Consolidated Appropriations Act for FY2001 (P.L. 106-554; 114 *Stat*. 2763-2764; December 21, 2000), which enacted regular appropriations as well as significant direct spending and revenue legislation by cross-reference. Section 2 of the act prohibited scoring the direct spending and revenue changes made in the act under the discretionary spending limits, but did require them to be scored on the PAYGO scorecard. This resulted in costs of $7.170 billion for FY2001 (and costs of $49.463 billion for FY2001-2005) being added to the PAYGO scorecard.

Further, Section 2 of the act instructed the OMB director to change the balance on the scorecard for FY2001 to zero in the course of preparing the *Final Sequestration Report* for that year. This action removed the combined FY2000-2001 costs of $10.542 billion from the scorecard, thereby preventing a PAYGO sequester. Costs on the PAYGO scorecard for FY2002-2005 amounting to $74.527 billion, which will trigger PAYGO sequesters for those years if not offset or otherwise prevented, were not affected.