What is PAYGO?

Q. What is PAYGO?

A. A budget rule requiring that new legislation that affects revenues and spending on entitlement programs, taken as a whole, does not increase projected budget deficits.

OVERVIEW

PAYGO, which stands for "pay as you go," is a budget rule requiring that tax cuts and mandatory spending increases must be offset (i.e., "paid for") by tax increases or cuts in mandatory spending. PAYGO does not apply to discretionary spending (spending that is controlled through the appropriations process).

Various versions of PAYGO have been enacted in law, most recently in 2010. In addition, both the House and Senate have sometimes adopted their own PAYGO rules for considering new legislation.

HISTORY

The original PAYGO was part of the Budget Enforcement Act of 1990. In that year, President George H. W. Bush and congressional leaders painfully negotiated a large deficit reduction package combining spending cuts and tax increases. Having accomplished so much, Congress became concerned that future Congresses would reverse the agreement bit by bit. PAYGO helped prevent this, supplemented by caps on appropriations and outlays for discretionary spending programs. Budget experts generally agree that PAYGO worked extremely well from 1990 through 1997. In 1998, an unexpected budget surplus emerged and the discipline driven by PAYGO began to wane. The law officially expired at the end of fiscal 2002.

RECENT VERSIONS

The most recent version of statutory PAYGO was established in 2010. If legislation does not pay for increases in mandatory spending or cuts in tax revenues, the cumulative amount of the projected increase in the deficit is averaged over two periods—5 years and 10 years. (Budget imbalances in the current budget year are included so in practice, the averaging is over 6 and 11 years.) The president is then supposed to sequester (i.e., withhold) enough funding from mandatory programs to offset that deficit increase. To prevent manipulation of the rules, legislation subject to PAYGO cannot move costs outside the budget window (i.e., after 10 years) or move saving into the budget window from later years.

SEQUESTRATION

If the Office of Management and Budget determines that either the 5- or 10-year average cost is greater

What is PAYGO?

than zero when Congress adjourns, the president must sequester certain mandatory spending programs. In other words, those programs will face an across-the-board spending cut. The higher of the two averages determines the sequestered amount. Spending for each program is reduced by the same percentage for one year to offset the average projected deficit increase. Unless Congress acts to reduce or eliminate the projected deficit increase, there is another sequestration the following year.

Some programs are exempt from sequestration. Social Security and the postal service are exempt because they are classified as "off-budget" programs (although they are included in consideration of the unified budget). Moreover, numerous welfare and other safety net programs, such as Medicaid, the Supplemental Nutrition Assistance Program, and unemployment insurance, are also exempt. Medicare is subject to sequestration, but the spending reduction for Medicare is limited to 4 percent. If sequestration calls for an across-the-board reduction of more than 4 percent, the additional amount that would have come from Medicare is allocated proportionally to other programs.

ENFORCEMENT

The PAYGO rule has not been enforced consistently. For example, the 1997 budget act put in place a method, known as the SGR (the sustainable growth rate), for determining Medicare payments to physicians. Application of that formula threatened huge cuts in Medicare physician reimbursements. Congress prevented the payment rates determined by SGR from taking effect, but only for one year at a time. While Congress did pay for these one-year fixes, by limiting the fix to one year it did not need to pay the cost of the fix over the full budget window. When the Medicare Access and CHIP Reauthorization Act of 2015 replaced the SGR formula with a new system in 2015, Congress waived the PAYGO rules, exempting itself from paying for the entire cost of the new legislation. They again waived the PAYGO rules at the end of 2017 so that they did not have to pay for the 2017 tax cut and reform. It appears that PAYGO can no longer be considered an effective tool for imposing budget discipline.

CONGRESSIONAL PAYGO

The House and the Senate also have their own versions of PAYGO rules. These rules govern how legislation is handled in the respective chambers. Bills that violate PAYGO requirements face additional hurdles—such as points of order—before they can be enacted. Statutory PAYGO, in contrast, applies after laws are enacted, using sequesters to impose cuts on existing mandatory programs.

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Further Reading

Congressional Budget Office. 2015. "H.R. 2, Medicare Access and CHIP Reauthorization Act of 2015." Cost estimate, March 25. Washington, DC: Congressional Budget Office.

Keith, Robert. 2010. "The Statutory Pay-As-You-Go Act of 2010: Summary and Legislative History." Report R41157. Washington, DC: Congressional Research Service.
