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THE "STATUTORY PAY-AS-YOU-GO ACT OF 2009" LEGISLATIVE PROPOSAL

COMMUNICATION

FROM

THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

THE LEGISLATIVE PROPOSAL ENTITLED, "STATUTORY PAY-AS-YOU-GO ACT OF 2009," OR "PAYGO," TOGETHER WITH A SECTIONAL ANALYSIS

JUNE 10, 2009.—Referred to the Committee on the Budget and ordered to be printed

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To the Congress of the United States:

Today I am pleased to submit to the Congress the enclosed legislative proposal, the "Statutory Pay-As-You-Go Act of 2009," or "PAYGO," together with a sectional analysis.

The deficits that my Administration inherited reflect not only a severe economic downturn but also years of failing to pay for new policies—including large tax cuts that disproportionately benefited the affluent. This failure of fiscal discipline contributed to transforming surpluses projected at the beginning of this decade into trillions of dollars in deficits. I am committed to returning our Government to a path of fiscal discipline, and PAYGO represents a key step back to the path of shared responsibility.

PAYGO would hold us to a simple but important principle: we should pay for new tax or entitlement legislation. Creating a new non-emergency tax cut or entitlement expansion would require offsetting revenue increases or spending reductions.

In the 1990s, statutory PAYGO encouraged the tough choices that helped to move the Government from large deficits to surpluses, and I believe it can do the same today. Both houses of Congress have already taken an important step toward righting our fiscal course by adopting congressional rules incorporating the PAYGO principle. But we can strengthen enforcement and redouble our commitment by enacting PAYGO into law.

Both the Budget I have proposed and the Budget Resolution approved by the Congress would cut the deficit in half by the end of my first term, while laying a new foundation for sustained and widely shared economic growth through key investments in health, education, and clean energy. Enacting statutory PAYGO would complement these efforts and represent an important step toward strengthening our budget process, cutting deficits, and reducing national debt. Ultimately, however, we will have to do even more to restore fiscal sustainability.

I urge the prompt and favorable consideration of this proposal.

BARACK OBAMA.

THE WHITE HOUSE, *June 9, 2009.*

A bill to reinstitute and update the Pay-As-You-Go requirement of budget neutrality on new tax and mandatory spending legislation, enforced by the threat of annual, automatic sequestration.

SECTION 1. SHORT TITLE AND TABLE OF CONTENTS.

(a) Short Title.—This Act may be cited as the "Statutory Pay-As-You-Go Act of 2009".

(b) Table of Contents.

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SECTION 2. PURPOSE AND EXPIRATION.

(a) Purpose.—The purpose of this Act is to re-establish a statutory procedure to enforce a rule of budget neutrality on new tax and mandatory spending legislation enacted through the end of calendar year 2013, by creating an automatic statutory penalty that Congress and the President will seek to avoid.

(b) Expiration.—Sections 1 through 8 of this Act shall expire on the later of December 31, 2013, or the issuance and implementation of a sequestration order for fiscal year 2014 if one is required by this Act.

SECTION 3. DEFINITIONS.

As used in this Act—

(1) The term "BBEDCA" means the Balanced Budget and Emergency Deficit Control Act of 1985, as amended including by this Act.

(2) The terms "appropriations Act", "budget authority", and "outlays" have the meanings given to them in section 3 of the Congressional Budget and Impoundment Control Act of 1974.

(3) The terms "baseline", "budget year", "CBO", "current year", "deposit insurance", "OMB", "sequester", and "sequestration" have the meanings given to them in section 250 of BBEDCA.

(4) The term "AMT" means the Alternative Minimum Tax for individuals under sections 55-59 of the Internal Revenue Code of 1986, the term "EGTRRA" means the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), and the term "JGTRRA" means the Jobs and Growth Tax Relief and Reconciliation Act of 2003 (Public Law 108-27).

(5) The term "budgetary effects" means the amounts by which PAYGO legislation changes mandatory outlays or revenues relative to the baseline. Budgetary effects that increase mandatory outlays or decrease revenues are termed "costs" and budgetary effects that increase revenues or decrease mandatory outlays are termed "savings". For purposes of these definitions, off-budget effects and debt service effects are not counted as budgetary effects.

(6) The term "debit" refers to the net total amount, when positive, by which costs recorded on the PAYGO ledger for a fiscal year exceed savings recorded on that ledger for that year.

(7) The term "discretionary programs" refers to programs funded though appropriations Acts other than mandatory programs.

(8) The term "entitlement law" means the statutory mandate or requirement of the United States to incur a financial obligation unless that obligation is explicitly conditioned on the appropriation in subsequent legislation of sufficient funds for that purpose.

(9) The term "mandatory outlays" refers to outlays flowing from (A) budget authority provided by laws other than appropriations Acts, (B) entitlement laws, or (C) the Supplemental Nutrition Assistance Program, and the term "mandatory programs" refers to programs that produce mandatory outlays.

(10) The term "outyear" means a fiscal year that occurs one or more years after the budget year.

(11) The term "PAYGO ledger" refers to a table maintained by OMB (A) containing a column for each fiscal year 2010 through 2014 and recording in the applicable column or columns the average of the budgetary effects of each PAYGO Act enacted after the enactment of

this Act and before January 1, 2014, and (B) displaying the net sum for each of those fiscal years of the average budgetary effects of all such Acts.

(12) The term "PAYGO legislation" or a "PAYGO Act" refer to legislation that is scored as increasing or decreasing governmental receipts or mandatory outlays relative to the baseline, except that when those budgetary effects are caused by substantive legislative provisions in appropriations Acts, the current-year and budget-year effects of those provisions are not considered PAYGO legislation.

(13) The term "timing shift" refers to a delay of the date on which mandatory outlays would otherwise occur from the ninth outyear to the tenth outyear or an acceleration of the date on which revenues or offsetting receipts or collections would otherwise occur from the tenth outyear to the ninth outyear.

SECTION 4. PAYGO ESTIMATES AND PAYGO LEDGER.

(a) CBO Estimates.—As soon as practicable after Congress completes action on any PAYGO legislation, CBO shall provide an estimate of its budgetary effects to OMB.

(b) PAYGO Ledger.—OMB shall maintain and make publicly available a document containing a PAYGO ledger and, not later than 7 days (excluding weekends and legal holidays) after the enactment of any PAYGO legislation, OMB shall record on that ledger its estimate of the legislation's budgetary effects in each fiscal year, applying the look-back requirement of subsection (e) and the averaging requirement of subsection (h). The document shall also explain any major differences between the OMB and CBO estimates of the budgetary effects of PAYGO legislation.

(c) Basis of OMB Estimates.—When estimating and recording the budgetary effects of a PAYGO Act, OMB shall employ economic and technical assumptions consistent with those in the President's most recent Budget submitted under 31 U.S.C. §1105 and shall use probabilistic methods where appropriate. Once it enters budgetary effects on the ledger, OMB shall not change the entries other than to correct errors. OMB's assumptions, data, determinations, estimates, and methodology under this Act are not subject to review in any judicial or administrative proceedings.

(d) Current Policy Exceptions for Certain Legislation.—Notwithstanding the definitions in paragraphs (5), (11), and (12) of section 3, OMB estimates of provisions of legislation within

the four areas of the budget identified in section 7 shall be entered on the PAYGO scorecard as specified in that section, and the estimates so entered shall be treated as the budgetary effects of PAYGO legislation for purposes of this section.

(e) Look-Back to Capture Current-Year Effects.—For purposes of this section, OMB shall treat the budgetary effects of PAYGO legislation enacted during a session of Congress that occur during the current year as though they occurred in the budget year.

(f) Timing Shifts.—For purposes of this section, OMB and CBO shall not count timing shifts in their estimates of the budgetary effects of PAYGO legislation.

(g) Emergency Legislation.—If a provision of PAYGO legislation is enacted that the President designates as an emergency requirement and that the Congress so designates in statute, OMB shall display the budgetary effects of that provision as an addendum in the document containing the PAYGO ledger but shall not record the budgetary effects in the ledger itself.

(h) Averaging Used to Measure Compliance Over Ten Years.—OMB shall cumulate the budgetary effects of a PAYGO Act over the budget year (which includes any look-back effects under subsection (e)) and the nine subsequent outyears, divide that cumulative total by ten, and enter the quotient in the budget-year column of the PAYGO ledger and in each subsequent column, if any, through the column for 2014.

(i) Scorekeeping Guidelines.— OMB and CBO shall prepare estimates under this paragraph in conformance with scorekeeping guidelines determined after consultation among the House and Senate Committees on the Budget, CBO, and OMB.

(j) Treatment of Program Conversions.—For purposes of this section, and notwithstanding other provisions of this Act—

(1) If legislation converts an identifiable element of a mandatory program into a discretionary program (with that program element or a substantially similar one continuing to be authorized), OMB and CBO shall not score the conversion of that element as reducing mandatory outlays.

(2) If legislation converts an identifiable element of a discretionary program into a mandatory program, OMB and CBO shall estimate the legislation's budgetary effects in each year by subtracting the discretionary baseline levels of that element from the amount by which that legislation increases mandatory outlays in that year.

SECTION 5. ANNUAL REPORT AND SEQUESTRATION ORDER.

(a) Annual Report.—No later than 14 days (excluding weekends and holidays) after Congress adjourns to end a session, OMB shall make publicly available an annual PAYGO report and publish in the Federal Register a notice of the report and information on how it can be obtained. The report shall include an up-to-date document containing a PAYGO ledger and information about estimating differences as required by section 4(b), a description of and justification for any current policy exceptions made under section 4(d), information about emergency legislation (if any) required by section 4(g), information about any sequestration if required by subsection (b), and other data and explanations that enhance public understanding of this Act and actions taken under it. If Congress does not adjourn to end a session, then for the purposes of this Act it shall be deemed to have done so on December 31 of that session.

(b) Sequestration Order.—If the annual report issued at the end of a session of Congress under subsection (a) shows a debit on the PAYGO ledger for the budget year, OMB shall prepare and the President shall issue an order sequestering budgetary resources from mandatory programs by enough to fully offset that debit, as prescribed in section 6. OMB shall include that order in the annual report and transmit it to the House of Representatives and the Senate. If the President issues a sequestration order, the annual report shall contain, for each budget account to be sequestered, estimates of the baseline level of budgetary resources subject to sequestration, the amount of budgetary resources to be sequestered, and the outlay reductions that will occur in the budget year and the subsequent fiscal year because of that sequestration.

SECTION 6. CALCULATING A SEQUESTRATION.

(a) Sequestration Base.—For purposes of this section, OMB shall assume that mandatory programs are at the levels in the baseline before the implementation of the sequestration order.

(b) Reducing Non-Exempt Budgetary Resources by a Uniform Percentage.—OMB shall calculate the uniform percentage by which the budgetary resources of non-exempt mandatory programs are to be sequestered such that the outlay savings resulting from that sequestration, as calculated under subsection (c), shall fully offset the budget-year debit on the PAYGO ledger, if any. If the uniform percentage calculated under the prior sentence exceeds 4 percent, the Medicare programs described in section 256(d) of BBEDCA shall be reduced by 4 percent and the uniform percentage by which the budgetary resources of all other non-exempt mandatory

programs are to be sequestered shall be increased, as necessary, so that the sequestration of Medicare and of all other non-exempt mandatory programs together produces the required outlay savings.

(c) Outlay Savings.—In determining the amount by which a sequestration offsets a budget-year debit, OMB shall count –

(1) the amount by which the sequestration in a crop year of crop support payments, pursuant to section 256(j) of BBEDCA, reduces outlays in the budget year and the subsequent fiscal year;

(2) the amount by which the sequestration of Medicare payments in the 12-month period following the sequestration order, pursuant to section 256(d) of BBEDCA, reduces outlays in the budget year and the subsequent fiscal year; and

(3) the amount by which the sequestration in the budget year of the budgetary resources of other non-exempt mandatory programs reduces mandatory outlays in the budget year and in the subsequent fiscal year.

SECTION 7. SPECIAL, TEMPORARY RULE TO REFLECT CURRENT POLICY.

(a) Purpose.—The purpose of this section is to establish a temporary rule addressing the scoring of legislation affecting four areas of the budget and superseding the scoring rules otherwise provided by this Act to the extent they are inconsistent. The four areas covered by this section are—

(1) payments made under section 1848 of the Social Security Act (titled Payment for Physicians' Services),

(2) the Estate and Gift Tax under subtitle B of the Internal Revenue Code of 1986,

(3) the AMT, and

(4) provisions of EGTRRA or JGTRRA that amended the Internal Revenue Code of 1986 (or provisions in later statutes further amending the amendments made by EGTRRA or JGTRRA), other than—

(A) the provisions of those two Acts that were made permanent by the Pension Protection Act of 2006 (Public Law 109-280),

(B) amendments to the estate and gift tax referred to in paragraph (2), and

(C) the AMT referred to in paragraph (3).

(b) Duration.—This section shall remain in effect through December 31, 2010, for each of the four areas specified in subsection (a), except that if the President determines that legislation sufficiently consistent with current policy as described in subsection (c)(2) has not been enacted in one or more of those four areas by that date, the provisions of this section will remain in effect with respect to that area or those areas until such legislation has been enacted or until December 31, 2011, whichever occurs sooner.

(c) Current Policy Projection and Initial Current Law Projections.—

(1) For purposes of this section, the budgetary effects of legislation of the type referred to in subsection (a) shall be estimated relative to the baseline under section 257 of BBEDCA but the budgetary effects of that legislation shall be entered on the PAYGO ledger only to the extent that they fall outside a range bounded by the current policy projection under paragraph (2) and the initial current law projection under paragraph (3), as specified under subsections (d), (e), or (f), as applicable. Each of those two boundary projections shall be estimated using the policy assumptions stated in paragraph (2) or (3) as applicable, regardless of the enactment of subsequent legislation, but the estimates of the dollar levels of those two boundary projections shall change—

(A) when economic and technical assumptions change with the issuance of a new budget under 31 U.S.C. 1105,

(B) with changes in the assumed effective date of the legislation that is measured against those two projections, and

(C) to the extent the policy assumptions under either of those two projections interact with other aspects of law, when legislation affecting those other aspects of law is enacted.

With respect only to legislation affecting the AMT or the amendments to provisions of the income tax referred to in subsection (a)(4), the dollar levels of those two boundary projections shall be estimated separately, and the determination of whether and the extent to which budgetary effects fall outside the boundaries shall be made separately, for each separate provision within that legislation.

(2) During the period specified in subsection (b), there shall exist a current policy projection in addition to the baseline specified in section 257 of BBEDCA. This projection shall—

(A) with respect to payments made under section 1848 of the Social Security Act, assume that the applicable payment rates and payment policies in effect for 2009 remain in effect thereafter without change;

(B) with respect to the estate and gift tax, assume that the tax rates, nominal exemption amounts, and related parameters in effect for tax year 2009 remain in effect thereafter without change;

(C) with respect to the AMT, assume that the exemption amounts and related parameters in effect for tax year 2009 are increased in each subsequent year by an amount equal to the cost-of-living adjustment determined under section 1(f)(3) of the Internal Revenue Code of 1986 for the calendar year in which the taxable year begins, determined by substituting "calendar year 2008" for "calendar year 1992" in subparagraph (B) thereof ; and

(D) with respect to the income tax provisions referred to in subsection (a)(4), assume that each such separate provision scheduled on June 8, 2009, to be in effect for tax year 2010 remains in effect thereafter without change, other than applicable indexing.

(3) Initial Current Law Projection.—During the period specified in subsection (b), there shall exist an initial current law projection in addition to the baseline specified in section 257 of BBEDCA. This projection shall—

(A) with respect to payments made under section 1848 of the Social Security Act, assume that the applicable payment rates and payment policies scheduled on June 8, 2009, to be in effect for each subsequent fiscal year shall be in effect as scheduled;

(B) with respect to the estate and gift tax, assume that the tax rates, nominal exemption amounts, and related parameters scheduled on June 8, 2009, to be in effect for each subsequent tax year shall be in effect as scheduled;

(C) with respect to the AMT, assume that the exemption amounts and related parameters scheduled on June 8, 2009, to be in effect for each subsequent tax year shall be in effect as scheduled; and

(D) with respect to provisions of the income tax referred to in subsection (a)(4), assume that each such provision scheduled on June 8, 2009, to be in effect for each subsequent tax year shall be in effect as scheduled.

(d) Budgetary Effects of Certain Medicare Legislation.— Notwithstanding the definitions in paragraphs (5), (11), and (12) of section 3, OMB shall enter on the PAYGO ledger the budgetary effects of any provision of PAYGO legislation that amends or supersedes the system of payments under section 1848 of the Social Security Act—

(1) only to the extent that the level of net Medicare outlays are estimated to be higher in a fiscal year than if that provision of PAYGO legislation had instead enacted (or maintained) the current policy projection, or

(2) only to the extent that the level of net Medicare outlays are estimated to be lower in a fiscal year than if that provision of PAYGO legislation had instead enacted (or maintained) the initial current law projection.

(e) Budgetary Effects of Estate and Gift Tax Legislation.—Notwithstanding the definitions in paragraphs (5), (11), and (12) of section 3, OMB shall enter on the PAYGO ledger the budgetary effects of any provision of PAYGO legislation that amends the estate and gift tax—

(1) only to the extent that total revenues in a fiscal year are estimated to be changed because tax liability under the estate and gift tax is estimated to be higher in tax year 2010 than if that provision of PAYGO legislation had instead enacted (or maintained) the current policy projection,

(2) only to the extent that total revenues in a fiscal year are estimated to be changed because tax liability under the estate and gift tax is estimated to be lower in tax year 2010 than if that provision of PAYGO legislation had instead enacted (or maintained) the initial current law projection,

(3) only to the extent that total revenues in a fiscal year are estimated to be changed because tax liability under the estate and gift tax is estimated to be lower in a tax year after 2010 than if that provision of PAYGO legislation had instead enacted (or maintained) the current policy projection, or

(4) only to the extent that total revenues in a fiscal year are estimated to be changed because tax liability under the estate and gift tax is estimated to be higher in a

tax year after 2010 than if that provision of PAYGO legislation had instead enacted (or maintained) the initial current law projection.

(f) Budgetary Effects of AMT and Certain Income Tax Legislation Taken Separately; Stacking Order and Interactive Effects.—Notwithstanding the definitions in paragraphs (5), (11), and (12) of section 3, OMB shall enter on the PAYGO ledger the budgetary effects of any PAYGO legislation that amends the AMT or amends one of the income tax provisions referred to in subsection (a)(4)—

(1) only to the extent that the level of income tax revenues is estimated to be lower and the level of outlays for refundable tax credits is estimated to be higher in a fiscal year than if that PAYGO legislation had instead enacted (or maintained) the current policy projection with respect to that provision of the income tax, or

(2) only to the extent that the level of income tax revenues is estimated to be higher and the level of outlays for refundable tax credits is estimated to be lower in a fiscal year than if that PAYGO legislation had instead enacted (or maintained) the initial current law projection with respect to that provision of the income tax.

In making estimates under this section of the budgetary effects of a PAYGO Act that amends both the AMT and at least one separate provision of the income tax, or amends more than one separate provision of the income tax, OMB shall first estimate the budgetary effects of any amendment to the AMT contained in that Act, and shall then estimate the budgetary effects of each remaining amendment to the income tax contained in that Act as though any AMT amendments contained in that Act and the preceding amendments made by that Act had been enacted but the succeeding amendments had not. For purposes of this section, each separate income tax rate shall be considered a separate provision.

SECTION 8. APPLICATION OF BBEDCA.

For purposes of this Act—

(1) notwithstanding section 275 of BBEDCA, the provisions of sections 255, 256, and 257 of BBEDCA, as amended by this Act, shall apply to the provisions of this Act;

(2) references in sections 255, 256 and 257 to "this part" shall be interpreted as applying to this Act;

(3) references in sections 255, 256 and 257 of BBEDCA to "section 254" shall be interpreted as referencing section 5 of this Act;

(4) the reference in section 256(b) of BBEDCA to "section 252 or 253" shall be interpreted as referencing section 5 of this Act;

(5) the reference in section 256(d)(1) of BBEDCA to "section 252 or 253" shall be interpreted as referencing section 6 of this Act;

(6) the reference in section 256(d)(4) of BBEDCA to "section 252 or 253" shall be interpreted as referencing section 5 of this Act;

(7) section 256(k) of the BBEDCA shall apply to a sequestration, if any, under this Act;

(8) references in section 257(e) to "section 251, 252, or 253" shall be interpreted as referencing section 4 of this Act; and

(9) the term "direct spending" in section 257 of BBEDCA shall be interpreted as applying to mandatory programs or the funding for mandatory programs, as appropriate.

SECTION 9. AMENDMENTS TO THE BASELINE.

In section 257 of BBEDCA—

(a) Strike "entitlement authority" and insert in lieu thereof "entitlement laws".

(b) Amend subsection (b)(2)(A) to read—

"(A) If any law expires before the budget year or before any outyear, then any program with estimated current-year outlays of more than $50,000,000 operating under that law is assumed to continue to operate under that law as in effect immediately before its expiration. For purposes of the preceding sentence, the Food, Conservation, and Energy Act of 2008 or a similar successor act is treated as a program assumed to be continued after its scheduled expiration.".

(c) Amend subsection (b)(2)(D) to read—

"Payments of social insurance, deposit insurance, pension insurance, and any similar statutory financial insurance guarantees are assumed to be made in full regardless of the sufficiency of the funds supporting those programs, and funding for flood insurance and any similar contractual insurance programs is assumed to be sufficient to fulfill existing contracts.".

(d) Amend subsection (c)(1) by striking "Budgetary resources" and inserting in lieu thereof "Except as provided in subsection (d), budgetary resources" and by striking "to offset pay absorption and for pay annualization" and inserting in lieu thereof "to adjust Pell grant funding".

(e) Amend subsection (c)(2) to read—

"(2) EXPIRING HOUSING CONTRACTS.—New budget authority shall be added to the baseline in the budget year and the outyears to cover the costs of renewing expiring subsidized housing contracts that were funded in the current year under multiyear contracts whose budget authority was recorded in years prior to the current year. The amount added (before adjusting for inflation) shall be the amount needed to renew the expiring contracts through an uninterrupted series of 12-month contracts, assuming unchanged rental or equivalent prices.".

(f) Amend subsection (c) (4) to read—

"(4) PELL GRANTS.—Notwithstanding paragraph (1), new budget authority for the Pell grant program shall be included in the baseline in an amount sufficient to cover the costs of the program at the maximum award level specified in the most recently enacted full-year appropriations Act, the budget authority in the budget year shall be adjusted for any cumulative funding shortfall or surplus from prior academic years, and the adjustment for inflation under paragraph (5) shall not apply.".

(g) Insert after subsection (c) the following, and redesignate the subsequent subsections accordingly—

"(d) DISASTERS.—Notwithstanding subsections (b) and (c), temporary mandatory funding and tax provisions related to major natural or man-made disasters shall be assumed to expire on schedule, and discretionary funding for major natural or man-made disaster shall not be projected. In lieu, the baseline shall include a disaster allowance that is not designated as mandatory or discretionary and is not allocated to any committee of Congress. The amount of budget authority assumed for this disaster allowance shall equal a probabilistic estimate of the amount of federal exposure to the risk of major natural or man-made disasters occurring in the remainder of the current year, the budget year, and each outyear, and the amount of outlays shall equal the estimated expenditures of that budget authority. Major disasters shall include disaster

costs other than those normally covered by routine firefighting funding and normal and ongoing costs of disaster agencies, programs, or activities.".

SECTION 10.TECHNICAL CORRECTIONS.

(1) Section 250(c)(18) of BBEDCA is amended by striking "the expenses the Federal deposit insurance agencies" and inserting "the expenses of the Federal deposit insurance agencies".

(2) Section 256(k)(1) of BBEDCA is amended by striking "in paragraph (5)" and inserting "in paragraph (6)".

SECTION 11. CONFORMING AMENDMENTS.

(a) Section 256(a) of BBEDCA is repealed.

(b) Section 256(b) of BBEDCA is amended by striking "origination fees under sections 438(c)(2) and 455(c) of that Act shall each be increased by 0.50 percentage point." and inserting in lieu thereof "origination fees under sections 438(c)(2) and (6) and 455(c) and loan processing and issuance fees under section 428(f)(1)(A)(ii) of that Act shall each be increased by the uniform percentage specified in that sequestration order, and, for student loans originated during the period of the sequestration, special allowance payments under section 438(b) of that Act accruing during the period of the sequestration shall be reduced by the uniform percentage specified in that sequestration order.".

(c) Section 256(c) of BBEDCA is repealed.

(d) Section 256(d) of BBEDCA is amended—

(1) by redesignating paragraphs (2), (3), and (4) as paragraphs (3), (5), and (6);

(2) in paragraph (1) to read as follows:

"(1) CALCULATION OF REDUCTION IN PAYMENT AMOUNTS.—To achieve the total percentage reduction in those programs required by section 252 or 253, subject to paragraph (2), and notwithstanding section 710 of the Social Security Act, OMB shall determine, and the applicable Presidential order under section 254 shall implement, the percentage reduction that shall apply, with respect to the health insurance programs under title XVIII of the Social Security Act—

"(A) in the case of parts A and B of such title, to individual payments for services furnished during the one-year period beginning on the first day of the first month beginning after the date the order is issued (or, if later, the date specified in paragraph (4)), and

"(B) in the case of parts C and D, to monthly payments under contracts under such parts for the same one-year period,

such that the reduction made in payments under that order shall achieve the required total percentage reduction in those payments for that period.";

(3) by inserting after paragraph (1) the following:

"(2) UNIFORM REDUCTION RATE; MAXIMUM PERMISSIBLE REDUCTION.—Reductions in payments for programs and activities under such title XVIII pursuant to a sequestration order under section 254 shall be at a uniform rate, which shall not exceed 4 percent, across all such programs and activities subject to such order.";

(4) by inserting after paragraph (3), as so redesignated, the following:

"(4) TIMING OF SUBSEQUENT SEQUESTRATION ORDER.—A sequestration order required by section 252 or 253 with respect to programs under such title XVIII shall not take effect until the first month beginning after the end of the effective period of any prior sequestration order with respect to such programs, as determined in accordance with paragraph (1).";

(5) in paragraph (6), as so redesignated, to read as follows:

"(6) SEQUESTRATION DISREGARDED IN COMPUTING PAYMENT AMOUNTS.—The Secretary of Health and Human Services shall not take into account any reductions in payment amounts which have been or may be effected under this part, for purposes of computing any adjustments to payment rates under such title XVIII, specifically including—

"(A) the part C growth percentage under section 1853(c)(6);

"(B) the part D annual growth rate under section 1860D-2(b)(6); and

"(C) application of risk corridors to part D payment rates under section 1860D-15(e).";

(6) by adding after paragraph (6), as so redesignated, the following:

"(7) EXEMPTIONS FROM SEQUESTRATION.—In addition to the programs and activities specified in section 255, the following shall be exempt from sequestration under this part:

"(A) PART D LOW-INCOME SUBSIDIES.—Premium and cost-sharing subsidies under section 1860D-14 of the Social Security Act.

"(B) PART D CATASTROPHIC SUBSIDY.—Payments under section 1860D-15(b) and (e)(2)(B) of the Social Security Act.

"(C) QUALIFIED INDIVIDUAL (QI) PREMIUMS.—Payments to States for coverage of Medicare cost-sharing for certain low-income Medicare beneficiaries under section 1933 of the Social Security Act.".

SECTION 12. EXEMPT PROGRAMS AND ACTIVITIES.

(a) Designations.—Section 255 of BBEDCA is amended by redesignating paragraph (i) as (j) and striking "1998" and inserting in lieu thereof "2010".

(b) Social Security, Veterans Programs, Net Interest, and Tax Credits.—Subsections (a) through (d) of section 255 of BBEDCA are amended to read as follows—

"(a) SOCIAL SECURITY BENEFITS AND TIER I RAILROAD RETIREMENT BENEFITS.—Benefits payable under the old-age, survivors, and disability insurance program established under title II of the Social Security Act (Title 42, United States Code, section 401 et seq.), and benefits payable under section 231b(a), 231b(f)(2), 231c(a), and 231c(f) of Title 45 United States Code, shall be exempt from reduction under any order issued under this part.

"(b) VETERANS PROGRAMS.—The following programs shall be exempt from reduction under any order issued under this part:

Canteen Service Revolving Fund (36-4014-0-3-705);
National Service Life Insurance Fund (36-8132-0-7-701);
Native American Veteran Housing Loan Program (36-1120-0-1-704);
Service-Disabled Veterans Insurance Fund (36-4012-0-3-701);
Veterans Insurance and Indemnities (36-0120-0-1-701);
Veterans Reopened Insurance Fund (36-4010-0-3-701);
Veterans Special Life Insurance Fund (36-8455-0-8-701);
United States Government Life Insurance Fund (36-8150-0-7-701);

Benefits under chapter 21 of title 38, United States Code, relating to specially adapted housing and mortgage-protection life insurance for certain veterans with service-connected disabilities (36-0120-0-1-701);

Compensation and Pensions (36-0102-0-1-701) to include Burial Benefits under Chapter 23 of Title 38;

Benefits under chapter 33 of title 38, United States Code, relating to educational assistance provided by the Post-9/11 Educational Assistance Act of 2008 (36-0137-0-1-702);

Benefits under chapter 39 of title 38, United States Code, relating to automobiles and adaptive equipment for certain disabled veterans and members of the Armed Forces (36-0137-0-1-702);

Benefits under chapter 35 of title 38, United States Code, related to educational assistance for survivors and dependents of certain veterans with service-connected disabilities (36-0137-0-1-702);

Assistance and services under chapter 31 of title 38, United States Code, relating to training and rehabilitation for certain veterans with service-connected disabilities (36-0137-0-1-702);

Benefits under subchapters I, II, and III of chapter 37 of title 38, United States Code, relating to housing loans for certain veterans and for the spouses and surviving spouses of certain veterans Housing Program Account (36-1119-0-1-704); and

Special Benefits for Certain World War II Veterans (28-0401-0-1-701);.

"(c) NET INTEREST. —No reduction of payments for net interest (all of major functional category 900) shall be made under any order issued under this part.

"(d) REFUNDABLE INCOME TAX CREDITS.—Payments to individuals made pursuant to provisions of the Internal Revenue Code of 1986 establishing refundable tax credits shall be exempt from reduction under any order issued under this part.".

(c) Other Programs and Activities, Low-Income Programs, and Economic Recovery Programs.—Subsections (g) and (h) of section 255 of BBEDCA are amended to read as follows—

"(g) OTHER PROGRAMS AND ACTIVITIES.—

(1)(A) The following budget accounts and activities shall be exempt from reduction under any order issued under this part:

Activities resulting from private donations, bequests, or voluntary contributions to the Government;

Activities financed by voluntary payments to the Government for goods or services to be provided for such payments;

Administration of Territories, Northern Mariana Islands Covenant grants (14-0412-0-1-808);

Advances to the Unemployment Trust Fund and Other Funds (16-0327-0-1-600);

Appropriations for the District of Columbia (to the extent they are appropriations of locally raised funds);

Black Lung Disability Trust Fund Refinancing (16-0329-0-1-601);

Bonneville Power Administration Fund and borrowing authority established pursuant to section 13 of Public Law 93-454 (1974), as amended (89-4045-0-3-271);

Claims, Judgments, and Relief Acts (20-1895-0-1-808);

Colorado River Basins Power Marketing Fund, Western Area Power Administration, (89-4452-0-3-271);

Compact of Free Association (14-0415-0-1-808);

Compensation of the President (11-0209-0-1-802);

Construction, Rehabilitation, Operation and Maintenance, Western Area Power Administration (89-5068-0-2-271);

Comptroller of the Currency, Assessment Funds (20-8413-0-8-373);

Continuing Fund, Southeastern Power Administration (89-5653-0-2-271);

Continuing Fund, Southwestern Power Administration (89-5649-0-2-271);

Dual Benefits Payments Account (60-0111-0-1-601);

Emergency Fund, Western Area Power Administration (89-5069-0-2-271);

Exchange Stabilization Fund (20-4444-0-3-155);

Federal Deposit Insurance Corporation, Deposit Insurance Fund (51-4596-4-4-373);

Federal Deposit Insurance Corporation, FSLIC Resolution Fund (51-4065-0-3-373);

Federal Deposit Insurance Corporation, Non-Interest Bearing Transaction Account Guarantee (51-4458-0-3-373);

Federal Deposit Insurance Corporation, Office of Inspector General (51-4595-0-4-373);

Federal Deposit Insurance Corporation, Senior Unsecured Debt Guarantee (51-4457-0-3-373);

Federal Housing Finance Agency, Administrative Expenses (95-5532-0-2-371);

Federal Payment to the District of Columbia Judicial Retirement and Survivors Annuity Fund (20-1713-0-1-752);

Federal Payment to the District of Columbia Pension Fund (20-1714-0-1-601);

Federal Payments to the Railroad Retirement Accounts (60-0113-0-1-601);

Federal Reserve Bank Reimbursement Fund (20-1884-0-1-803);

Financial Agent Services (20-1802-0-1-803);

Foreign Military Sales Trust Fund (11-8242-0-7-155);

Hazardous Waste Management, Conservation Reserve Program (12-4336-0-3-999);

Health Education Assistance Loans Program Account (75-0340-0-1-552);

Host Nation Support Fund for Relocation (97-8337-0-7-051);

Internal Revenue Collections for Puerto Rico (20-5737-0-2-806);

Intragovernmental funds, including those from which the outlays are derived primarily from resources paid in from other government accounts, except to the extent such funds are augmented by direct appropriations for the fiscal year during which an order is in effect;

Medical Facilities Guarantee and Loan Fund (75-9931-0-3-551);

National Credit Union Administration, Central Liquidity Facility (25-4470-0-3-373);

National Credit Union Administration, Corporate Credit Union Share Guarantee Program (25-4476-0-3-376);

National Credit Union Administration, Credit Union Homeowners Affordability Relief Program (25-4473-0-3-371);

National Credit Union Administration, Credit Union Share Insurance Fund (25-4468-0-3-373);

National Credit Union Administration, Credit Union System Investment Program (25-4474-0-3-376);

National Credit Union Administration, Operating fund (25-4056-0-3-373);

National Credit Union Administration, Share Insurance Fund Corporate Debt Guarantee Program (25-4469-0-3-376);

National Credit Union Administration, U.S. Central Federal Credit Union Capital Program (25-4475-0-3-376);

Office of Thrift Supervision (20-4108-0-3-373);

Operation and Maintenance, Alaska Power Administration (89-0302-0-1-271);

Operation and Maintenance, Southeastern Power Administration (89-0302-0-1-271);

Operation and Maintenance, Southwestern Power Administration (89-0303-0-1-271);

Panama Canal Commission Compensation Fund (16-5155-0-2-602);

Payment of Vietnam and USS Pueblo prisoner-of-war claims within the Salaries and Expenses, Foreign Claims Settlement account (15-0100-0-1-153) ;

Payment to Civil Service Retirement and Disability Fund (24-0200-0-1-805);

Payment to Department of Defense Medicare-Eligible Retiree Health Care Fund (97-0850-0-1-054);

Payment to Judiciary Trust Funds (10-0941-0-1-752);

Payment to Military Retirement Fund (97-0040-0-1-054);

Payment to the Foreign Service Retirement and Disability Fund (19-0540-0-1-153);

Payments to Copyright Owners (03-5175-0-2-376);

Payments to Health Care Trust Funds (75-0580-0-1-571);

Payments to Social Security Trust Funds (28-0404-0-1-651);

Payments to the United States Territories, Fiscal Assistance (14-0418-0-1-806);

Payments to trust funds from excise taxes or other receipts properly creditable to such trust funds;

Payments to widows and heirs of deceased Members of Congress (00-0215-0-1-801);

Postal Service Fund (18-4020-0-3-372);

Reimbursement to Federal Reserve Banks (20-0562-0-1-803);

Salaries of Article III judges;

Soldiers and Airmen's Home, payment of claims (84-8930-0-7-705);

Tennessee Valley Authority Fund, except non-power programs and activities (64-4110-0-3-999);

Tribal and Indian trust accounts within the Department of the Interior which fund prior legal obligations of the Government or which are established pursuant to Acts of Congress regarding Federal management of tribal real property or other fiduciary responsibilities, including but not limited to Tribal Special Fund (14-5265-0-2-452), Tribal Trust Fund (14-8030-0-7-452), Indian Land and Water Claims Settlements (14-2303-0-1-452), White Earth Settlement (14-2204-0-1-452), and Indian Water Rights and Habitat Acquisition (14-5505-0-2-303);

United Mine Workers of America 1992 Benefit Plan (95-8260-0-7-551);

United Mine Workers of America 1993 Benefit Plan (95-8535-0-7-551);

United Mine Workers of America Combined Benefit Fund (95-8295-0-7-551);

United States Enrichment Corporation Fund (95-4054-0-3-271);

Universal Service Fund (27-5183-0-2-376);

Vaccine Injury Compensation (75-0320-0-1-551);

Vaccine Injury Compensation Program Trust Fund (20-8175-0-7-551); and

Western Area Power Administration, Borrowing Authority, Recovery Act (89-4404-0-3-271).

(B) The following Federal retirement and disability accounts and activities shall be exempt from reduction under any order issued under this part:

Black Lung Disability Trust Fund (20-8144-0-7-601);

Central Intelligence Agency Retirement and Disability System Fund (56-3400-0-1-054);

Civil Service Retirement and Disability Fund (24-8135-0-7-602);

Comptrollers general retirement system (05-0107-0-1-801);

Contributions to U.S. Park Police annuity benefits, Other Permanent Appropriations (14-9924-0-2-303);

Court of Appeals for Veterans Claims Retirement Fund (95-8290-0-7-705);

Department of Defense Medicare-Eligible Retiree Health Care Fund (97-5472-0-2-551);

District of Columbia Federal Pension Fund (20-5511-0-2-601);

District of Columbia Judicial Retirement and Survivors Annuity Fund (20-8212-0-7-602);

Energy Employees Occupational Illness Compensation Fund (16-1523-0-1-053);

Foreign National Employees Separation Pay (97-8165-0-7-051);

Foreign Service National Defined Contributions Retirement Fund (19-5497-0-2-602);

Foreign Service National Separation Liability Trust Fund (19-8340-0-7-602);

Foreign Service Retirement and Disability Fund(19-8186-0-7-602);

Government Payment for Annuitants, Employees Health Benefits (24-0206-0-1-551);

Government Payment for Annuitants, Employee Life Insurance (24-0500-0-1-602);

Judicial Officers' Retirement Fund (10-8122-0-7-602);

Judicial Survivors' Annuities Fund (10-8110-0-7-602);

Military Retirement Fund (97-8097-0-7-602);

National Railroad Retirement Investment Trust (60-8118-0-7-601);

National Oceanic and Atmospheric Administration retirement (13-1450-0-1-306);

Pensions for former Presidents (47-0105-0-1-802);

Postal Service Retiree Health Benefits Fund (24-5391-0-2-551);

Rail Industry Pension Fund (60-8011-0-7-601);

Retired Pay, Coast Guard (70-0602-0-1-403);

Retirement Pay and Medical Benefits for Commissioned Officers, Public Health Service (75-0379-0-1-551);

Special Benefits for Disabled Coal Miners (16-0169-0-1-601);

Special Benefits, Federal Employees' Compensation Act (16-1521-0-1-600);

Special Workers Compensation Expenses (16-9971-0-7-601);

Tax Court Judges Survivors Annuity Fund (23-8115-0-7-602);

United States Court of Federal Claims Judges' Retirement Fund (10-8124-0-7-602);

United States Secret Service, DC Annuity (70-0400-0-1-751); and

Voluntary Separation Incentive Fund (97-8335-0-7-051).

(2) Prior legal obligations of the Government in the following budget accounts and activities shall be exempt from any order issued under this part:

Biomass Energy Development (20-0114-0-1-271);

Check Forgery Insurance Fund (20-4109-0-3-803);

Credit liquidating accounts;

Credit reestimates;

Employees Life Insurance Fund (24-8424-0-8-602);

Federal Aviation Administration, Aviation Insurance Revolving Fund (69-4120-0-3-402);

Federal Crop Insurance Corporation fund (12-4085-0-3-351);

Federal Emergency Management Agency, National Flood Insurance Fund (58-4236-0-3-453);

Geothermal resources development fund (89-0206-0-1-271);

Homeowners Assistance Fund (97-4090-0-3-051);

International Trade Administration, Operations and administration (13-1250-0-1-376);

Low-Rent Public Housing—Loans and Other Expenses (86-4098-0-3-604);

Maritime Administration, War Risk Insurance Revolving Fund (69-4302-0-3-403);

Natural Resource Damage Assessment Fund (14-1618-0-1-302);

Overseas Private Investment Corporation, Noncredit Account (71-4184-0-3-151);

Pension Benefit Guaranty Corporation Fund (16-4204-0-3-601);

Rail service assistance within the Safety and Operations account (69-0700-0-1-401);

San Joaquin Restoration Fund (14-5537-0-2-301);

Servicemembers' Group Life Insurance Fund (36-4009-0-3-701); and

Terrorism Insurance Program (20-0123-0-1-376).

(3) Non-budgetary accounts and activities, including the following, are exempt from sequestration under this part:

Credit financing accounts;

Deposit funds;

Federal Reserve;

Government Sponsored Enterprises, including the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation; and

Thrift Savings Fund.

"(h) LOW-INCOME PROGRAMS. —The following programs shall be exempt from reduction under any order issued under this part:

Academic Competitiveness/Smart Grant Program (91-0205-0-1-502);

Child Care Entitlement to States (75-1550-0-1-609);

Child Enrollment Contingency Fund (75-5551-0-2-551);

Child Nutrition Programs (with the exception of special milk programs) (12-3539-0-1-605);

Children's Health Insurance Fund (75-0515-0-1-551);

Commodity Supplemental Food Program (12-3512-0-1-605);

Contingency Fund (75-1522-0-1-609);

Family Support Programs (75-1501-0-1-551);

Federal Pell Grants under section 401 Title IV of the Higher Education Act;

Grants to States for Low-Income House Projects in Lieu of Low-Income Housing Credit Allocations, Recovery Act (20-0139-0-1-604);

Grants to States for Medicaid (75-0512-0-1-551);

Payments for Foster Care and Permanency (75-1545-0-1-609);

Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (12-3510-0-1-605);

Supplemental Nutrition Assistance Program (12-3505-0-1-605);

Supplemental Security Income Program (28-0406-0-1-609); and

Temporary Assistance for Needy Families (75-1552-0-1-609).".

(d) Economic Recovery Programs.—Section 255 of BBEDCA is amended by adding the following after subsection (h)—

"(i) ECONOMIC RECOVERY PROGRAMS.—The following programs shall be exempt from reduction under any order issued under this part:

All programs enacted in, or increases in programs provided by, the American Recovery and Reinvestment Act of 2009;

Exchange Stabilization Fund-Money Market Mutual Fund Guaranty Facility (20-4274-0-3-376);

Office of Financial Stability (20-0128-0-1-376);

Financial Stabilization Reserve (20-0131-4-1-376);

GSE Mortgage-Backed Securities Purchase Program Account (20-0126-0-1-371);

GSE Preferred Stock Purchase Agreements (20-0125-0-1-371);

Office of Financial Stability (20-0128-0-1-376);

Special Inspector General for the Troubled Asset Relief Program (20-0133-0-1-376);

Troubled Asset Relief Program Account (20-0132-0-1-376);

Troubled Asset Relief Program Equity Purchase Program (20-0134-0-1-376);

Troubled Asset Relief Program, Home Affordable Modification Program (20-0136-0-1-604).".

Section-by-Section Analysis and Explanation of the "Statutory Pay-As-You-Go Act of 2009"

Summary.

The legislation reestablishes a statutory pay-as-you-go rule (PAYGO), requiring that new mandatory spending increases or tax reductions be fully offset, or "paid for."

The PAYGO Act would apply to legislation enacted through the end of 2013, so it would cover five fiscal years, 2010-2014. For legislation enacted during this period, the Office of Management and Budget would estimate its cost over a ten-year period under the estimating rules specified by this Act. The average annual cost (or savings) over this ten-year period would then be entered in the appropriate columns of the "PAYGO ledger."

As in the statutory PAYGO rule that was created by the Budget Enforcement Act of 1990 and expired in 2002, this new PAYGO rule would be enforced by sequestration. If new legislation increasing mandatory spending or reducing tax revenues were not fully paid for by the time Congress adjourns, the President would be required to reduce non-exempt mandatory programs by an amount sufficient to pay for the net mandatory spending increases or tax reductions; the sequestration would offset the average debit or net cost recorded on the PAYGO ledger.

The Act specifies how the sequestration, if one were necessary, would run. As under the 1990 law, a number of accounts – including Social Security, most benefits for veterans, refundable tax credits, and programs focused on low-income populations – would be exempt from sequestration. The remaining mandatory spending would be cut by a uniform percent sufficient to pay off the debit in the budget year, with the exception that Medicare would be limited to a four percent reduction.

In four policy areas – the Medicare sustainable growth rate formula (SGR), the estate tax, the Alternative Minimum Tax (AMT), and the 2001 and 2003 income tax reductions – "current policy" deviates substantially from "current law." In each of these areas, the policies currently in place are set to expire or substantially change within the next 18 months in ways that unrealistically reduce costs – for instance, payments to doctors under Medicare are scheduled to be cut by 21 percent next year under the SGR, and the 2001 and the 2003 tax cuts are scheduled to expire entirely at the end of 2010. For these four areas, the PAYGO statute would not require a continuation of current policy to be paid for.

In 2007 both houses of Congress took an important step toward restoring fiscal discipline by using congressional rules to restore enforcement of the PAYGO principle. This PAYGO statute is meant to serve as a supplement to these rules, providing an enforcement mechanism, sequestration, that is unavailable without statutory PAYGO. Sequestration is designed to be a threat, not a remedy; it is intended to increase the number of persons and groups who have a stake in maintaining the PAYGO principle rather than allowing its violation. The combination of congressional PAYGO rules and statutory PAYGO would better facilitate the hard decisions necessary to maintain fiscal discipline than either of these mechanisms alone.

Section-by-Section Analysis and Explanation.

Sections 1 through 8 of the legislation create a freestanding law defining terms, setting forth rules for scoring and measuring tax and mandatory spending legislation, and providing for a sequestration if the legislation is not budget neutral in net. These sections are based on the PAYGO provisions enacted in 1990, but largely replace rather than revive the 1990 statute. Sections 9 through 12, however, amend the 1990 law with respect to the baseline, the list of mandatory programs exempt from sequestration, and some other matters; the freestanding provisions enacted in section 1 through 8 operate in part by cross-reference to existing or amended portions of the 1990 law.

Section 1 creates a short title, the Statutory Pay-As-You-Go Act of 2009, and lays out a table of contents.

Section 2 states the purpose of the Act, re-establishing a statutory procedure to enforce a rule of budget neutrality on new tax and mandatory spending legislation. This section also sets an expiration date of December 31, 2013, for Sections 1 through 8. Sections 9 through 12 would be permanent. Because this Act employs the threat of sequestration through fiscal year 2014, if a sequestration for that year is required, the Act would continue to operate with respect to that sequestration order for as long as that order remains in effect. Because sequestrations in a few programs (such as crop support payments and Medicare) operate on a 12-month basis that does not necessarily correspond to the fiscal or calendar year, a sequestration for FY 2014 might remain in effect through the end of calendar 2014 and possibly into the beginning of 2015.

Section 3 sets forth definitions. Many terms are defined by simple cross-references to the standard definitions used in other budget laws. A number of these definitions deserve further comment.

- **Budgetary effects.** PAYGO applies only to legislation with "budgetary effects." "Budgetary effects" are here defined as the amounts by which PAYGO legislation changes mandatory outlays or revenues relative to the baseline; thus, PAYGO is limited to these areas. Note that off-budget effects (e.g., Social Security) and debt service effects are not counted as budgetary effects.

- **Mandatory outlays.** The term "mandatory outlays" is essential to the definition of "budgetary effects." As defined in the Act, it refers to outlays flowing from: (A) budget authority provided by laws other than appropriations Acts; (B) entitlement laws; or (C) the Supplemental Nutrition Assistance Program.

- **Entitlement law.** The key to the definition of entitlement law is that an entitlement exists when a provision of law mandates that payments be made even if the funding

needed to make those payments, to be provided in a subsequent law, is inadequate or nonexistent.[1]

- **PAYGO legislation or a PAYGO Act.** Laws increasing or reducing revenues or increasing or reducing the cost of mandatory programs are PAYGO laws. The changes in the estimated or projected levels of revenues and mandatory spending are measured relative to what revenues or mandatory spending would otherwise have been if not for the legislation, as measured by the baseline defined in the 1990 statute, section 257 of the Balanced Budget And Emergency Deficit Control Act (BBEDCA) of 1975 as amended (including as amended by section 9 of this legislation[2]).

  In addition, this term defines the treatment of legislative language contained in appropriations bills: if an appropriations bill contains changes to tax or mandatory law, those changes are considered discretionary in the current and budget years, since the Appropriations Committees can offset the costs or use the savings by adjusting funding levels for discretionary programs in the current and budget years. But any outyear effects of such tax or mandatory program language are considered PAYGO legislation.

- **PAYGO ledger.** The PAYGO ledger is defined as covering five fiscal years, from 2010-2014. As described in section 5, the net sum of "budgetary effects" of PAYGO legislation entered on the PAYGO ledger determines whether a sequestration is triggered in these years. That is, each fiscal year is a column on the ledger, and if the sum of the entries in the column is a debit – because net mandatory spending increases exceed net revenue increases, or net revenue losses exceed net mandatory spending reductions – then a sequestration must be ordered.

- **Timing shift.** To prevent gaming of the PAYGO system, the Act defines "timing shifts," which are not counted for purposes of PAYGO. A "timing shift" involves a shift of costs from within the PAYGO window to outside the window (or savings from outside the window to within the window). More technically, the term is defined to refer to a delay of the date on which mandatory outlays would otherwise occur from the ninth outyear (the last year taken into account in the PAYGO calculation) to the tenth outyear (not taken into account in the PAYGO calculation) or an acceleration of the date on which revenues or offsetting receipts or collections would otherwise occur from the tenth outyear to the ninth outyear.

Section 4 describes how estimates for purposes of PAYGO are to be made and details how the PAYGO ledger works.

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[1] Sometimes the same law that establishes a mandate in one provision conditions that mandate on the availability of funding – and then provides the funding in a separate section of the same law. In this case, the law is an entitlement if the first provision is a clear mandate *aside from* the conditionality, but is not an entitlement if the first condition merely establishes the purposes for which the funding provided elsewhere in the statute is authorized to be used.

[2] There are a few cases in which the 1990 baseline does not literally follow "current law," that is, law as it is currently scheduled to be in effect in each future year.

The Office of Management and Budget (OMB) is assigned the responsibility of maintaining the PAYGO ledger, as it was under the 1990 law.[3] This Section imposes a number of important requirements on how the ledger is to be kept:

- **Release of PAYGO estimates.** The PAYGO ledger maintained by OMB is to be publicly available and regularly updated. No more than seven days (excluding weekends and legal holidays) after the enactment of any PAYGO legislation, OMB is to enter on the ledger its estimate of the legislation's budgetary effects. OMB must explain any significant deviations between its estimates and those of the Congressional Budget Office (CBO), which is required to submit its estimates of PAYGO legislation to OMB as soon as practicable.

- **Basis of estimates.** All estimates of budgetary effects of PAYGO legislation are to be done on the basis of the economic and technical assumptions underlying the latest President's Budget. The estimates will use probabilistic methods where appropriate, e.g., in evaluating "one-sided bets," in which costs increase on one side of a boundary or threshold but do not decrease symmetrically on the other side. Once entered onto the ledger, budgetary effects are only to be changed in order to correct an error in the original estimate – but not, for instance, in light of new economic or technical assumptions.

  Estimates are to be prepared in conformance with scorekeeping guidelines determined after consultation among the House and Senate Committees on the Budget, CBO, and OMB. Since 1990, the Executive and Legislative Branches have chosen to employ nearly identical scorekeeping procedures, concepts, approaches, and guidelines.

- **Averaging.** For the budget year and any remaining years (columns) on the PAYGO ledger, OMB is to enter the ten-year annual average budgetary effect associated with PAYGO legislation. This ten-year window covers the budget year and the nine years that follow.

  For instance, a bill that pays for itself over ten years will have a total, and thus average, score of zero, so zero would be entered in each column of the PAYGO ledger. If a bill enacted in 2009 costs a net of $10 billion over 2009-2019, OMB would insert +$1 billion in each of the five columns on the PAYGO ledger (FY10, 11, 12, 13, and 14). If a bill enacted in 2011 *saves* a net of $5 billion over the period 2011-2021, OMB would insert $-0.5 billion in the remaining three columns of the PAYGO ledger (FY12, 13, and 14).

- **Look back.** To take into account any budgetary effects of PAYGO legislation in the current year (i.e. the year of enactment), a "look back" rule is included. The rule provides that budgetary effects in the current year are to be treated as if they were budgetary effects in the budget year (which is the year subsequent to the current year). This is why

[3] In holding the 1985 version of the BBEDCA unconstitutional, the Supreme Court ruled in 1986 that a legislative branch agency such as GAO or CBO cannot make determinations, such as bill cost estimates, that would have the effect of changing law, as a sequestration would do. Therefore, the 1987 and 1990 versions of BBEDCA, and this proposal, lodge estimating authority in OMB.

the averaging provision just described actually sums eleven years of costs (the current year, the budget year, and the nine outyears) and divides the sum by ten.

- **Timing shifts.** As noted, the PAYGO legislation would prevent gaming of the PAYGO rules via timing shifts. Timing shifts, as defined in Section 3, would not be taken into account for the purposes of estimating budgetary effects to be entered on the PAYGO ledger. Since the PAYGO ledger represent an average, timing shifts between any two years within the window do not affect the average in any case. This is why the proposal defines timing shifts to be those that occur between year ten and year eleven – that is where the possibility of gaming arises.

- **Treatment of program conversions.** The PAYGO statute is not meant to either encourage or discourage the budget-neutral conversion of programs from discretionary to mandatory or vice versa. But, without a special rule, the statute would treat the conversion of a program from discretionary to mandatory – even if projected outlays would remain exactly the same – as a cost to be entered on the PAYGO ledger. And the opposite conversion – from mandatory to discretionary – would be treated as a savings, even if no net savings would be produced once the additional discretionary spending were taken into account. To avoid this, the proposal provides that:

    - *Mandatory to discretionary conversion.* The conversion of an identifiable element of a mandatory program into a discretionary one would not be scored as reducing mandatory outlays.

    - *Discretionary to mandatory conversion.* The conversion of an identifiable element of a discretionary program into a mandatory one would be scored as having a budgetary effect equal to the difference between the amount by which the conversion increases mandatory outlays and the discretionary baseline outlays associated with the converted element of the discretionary program.

  This treatment is consistent with scorekeeping rule #13, previously agreed to by Congress and the Executive, but that rule has not always been adhered to.

- **Emergency legislation.** The statute allows Congress and the President to declare emergency exceptions to the PAYGO rules. For such an emergency exception to be declared, Congress must, in statute, designate the relevant legislation or portions of it to be an emergency, and the President must separately do so as well; his signature on the statutory designation does not by itself constitute a presidential agreement that the cost is an emergency. If both these requirements are met, the budgetary effects of the emergency legislation are displayed as an addendum to the PAYGO ledger and are not entered into the ledger itself. Note that the President and the Congress might declare some provisions of a statute to be emergencies and others not, in which case only those provisions that both agree are emergencies are excluded from the PAYGO ledger. In the early 1990s, Congress and the President agreed that a temporary continuation of extended unemployment benefits while unemployment was exceptionally high because of a recession was an emergency.

Section 5 defines the timing of the annual PAYGO report and, if one is needed, the sequestration order.

- **Annual report.** OMB is to produce an annual PAYGO report. The report is to include an up-to-date PAYGO ledger, as well as other information, such as about estimating differences between OMB and CBO (also required under Section 4) and about any sequestration if required. The report is to be released no more than 14 days (excluding weekends and legal holidays) after Congress adjourns to end a session.

- **Sequestration order.** If the annual report shows a debit (i.e., net budgetary cost) on the PAYGO ledger for the budget year, the President is required to issue an order sequestering obligation authority from non-exempt mandatory programs sufficient to fully pay off that debit. If the President issues this order, then the PAYGO annual report must contain its details, including such information as the outlay reductions that would occur in the budget year and the subsequent fiscal year for each affected account.

Section 6 describes how sequestration is to be implemented if triggered. It should be noted that most mandatory programs, such as Social Security, veterans' disability and related benefits, and major low-income entitlements such as Supplemental Security Income and Medicaid, are totally exempt from sequestration. (Section 12 updates the 1990s list but does not change its approach or character.) With the exception of Medicare, *non-exempt* mandatory programs would be cut by a uniform percent, such that the outlay savings produced in the budget year and the subsequent fiscal year would be sufficient to fully offset the budget-year debit on the PAYGO ledger. Medicare can be cut by at most four percent. If a larger cut than four percent is needed to offset the debit on the PAYGO ledger, the uniform percentage cut to the other non-exempt mandatory programs would be increased so that the sequester of Medicare and the other non-exempt programs would together produce sufficient savings to offset the budget-year debit.

Sequestrations are temporary, not permanent, and with a few exceptions occur only in the budget year. Some points are worth noting.

- The uniform sequestration percentage is intended to reduce mandatory obligations in non-exempt programs by a specified percent over the course of the entire fiscal year. If a sequestration starts a month or more into the fiscal year because Congress adjourns in November or even December, then the reduction during the *remaining* 9, 10, or 11 months of the fiscal year will be a bit larger than the uniform percentage so that the average sequestration over the year equals the required uniform percentage.

- In the case of Medicare, the sequestration lasts for a full 12 months even if it takes effect after the beginning of the fiscal year, in which case it will run into the start of the next fiscal year. This approach means that the uniform percentage cut in payments to providers or insurance plans will not be higher at any time than the four percent limit (or the calculated uniform percentage, if lower).[4]

[4] If sequestrations are required in two consecutive years, there will be no overlapping sequestration; the second will start no earlier than the first ends.

- In the case of price support payments for crops, the sequestration for any given crop will start at the beginning of the next crop year. As a consequence, sequestrations for crops will not all be running concurrently, and some sequestrations may occur partly in the following fiscal year.

Section 7 establishes a temporary scoring rule for purposes of statutory PAYGO, to adjust for the substantial deviation between "current policy" and "current law" in four policy areas: Medicare's "Sustainable Growth Rate" for paying physicians under Part B, the estate tax, the AMT, and the 2001 and 2003 income tax cuts. As noted in the summary, the policies currently in place in each of these areas are set to expire or substantially change in the coming years in ways that unrealistically reduce costs – scheduled cost reductions that in most cases are quite unlikely to occur. For these four areas where current law does not reflect current policy, the PAYGO statute would not require a continuation of current policy to be paid for.

Note that this scoring rule would apply only for the purposes of statutory PAYGO. For other purposes, including the Congressional Budget Act and the congressional PAYGO rules, such legislation would still be scored as it is currently.

- **General approach.** The statute defines a "current policy projection" and an "initial current law projection" with respect to the SGR, estate tax, AMT, and Bush tax cuts. The current policy projection equals 2009 or 2010 policy made permanent, while the "initial current law projection" represents the projection under the laws in place as of now. The policy assumption behind these two projections would not be affected by the enactment of later legislation, and the two projections are independent of the §257 baseline against which PAYGO legislation would otherwise be scored.

  If a bill in one of the four areas is enacted and its costs in a given fiscal year fall between the two projections, the bill is considered to have zero cost or savings for that fiscal year. If the bill is more costly than the current policy projection, the excess cost is a PAYGO cost and is recorded on the PAYGO ledger. If it is less costly than the initial current law projection, the savings is scored. (Note, though, that the system works somewhat differently for the estate tax in 2010. This is because, in 2010, the initial current law projection is more costly than the current policy projection, so the relationship between the initial current law projection and current policy projection is reversed for that year.)

- **Duration.** The two projections, and the attendant scoring, remain in effect through the end of 2010. At that point, they cease to exist, and any new legislation in these areas would be measured, like other legislation, relative to the standard baseline under §257 of BBEDCA.

  As an exception, if the President determines that "legislation substantially consistent with current policy" has not been enacted in any one or more of these four areas by the end of 2010, the two projections and the special scoring will remain in place with respect to that area or those areas for one more year or until such legislation has been enacted, whichever comes sooner.

The expectation is that within the next few years, the sharp divergence between current policy and current law with respect to those four areas of the budget will be resolved by legislation that constitutes a permanent policy without artificial sunsets or cliffs. After this occurs, that new legislation will be the base against which future legislation is measured, because the standard §257 baseline will again be the benchmark against which legislation is measured.

In short, for a temporary period, legislation in these four areas is scored (and the scores entered on the PAYGO ledger) only to the extent that its costs fall outside a range bounded by current policy on the one hand and current law on the other. As noted, there are four policy areas to which this section applies:

- **Medicare's SGR formula.** Under Medicare's SGR formula, Medicare's payments to physicians under Part B would automatically be cut by 21 percent next year, when this year's temporary fix expires. For purposes of Section 7, the "current policy projection" for Medicare Part B instead assumes that the nominal payment rates to physicians and related policies in effect for 2009 are permanently continued. Thus, under Section 7, legislation providing relief from the scheduled SGR cut would only be scored for PAYGO purposes to the extent that it costs more than this current policy projection (or less than the "initial current law projection").

- **Estate and gift tax.** Under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the estate tax exemption was gradually increased and the tax rate gradually lowered until, as of this year, the exemption stands at $3.5 million for an individual and $7 million for a couple, and the rate is 45 percent for amounts above the exemption level. Under EGTRRA, the estate tax is scheduled to be entirely repealed in 2010, but then with EGTRRA's expiration at the end of that year, return to the parameters under pre-2001 law, with an exemption of $1 million and a 55 percent rate.

  Section 7 defines the "current policy projection" for the estate and gift tax as assuming that the tax rates, nominal exemption amounts, and related parameters in effect for tax year 2009 remain in effect thereafter. The "initial current law projection" assumes that the estate tax expires as scheduled in 2010 and then returns to its parameters under pre-2001 law thereafter.

  For 2010 (when the estate tax is entirely repealed), legislation would only be scored to the extent that total revenues are lower because the legislation produces less estate and gift tax liability than under the initial current law projection or are higher because the legislation produces greater estate and gift tax liability than under the current policy projection.

  For years thereafter, the relationship between the current policy projection and the initial current law projection reverses, with the former then producing less estate and gift tax revenue then the latter. So, for these years, legislation would only be scored to the extent that total revenues are greater because the legislation produces greater estate and gift tax

liability than under the initial current law projection or are lower because the legislation produces less estate and gift tax liability than under the current policy projection.

Because of the major behavioral interactions between the estate and gift tax and the income tax with respect to savings versus giving versus consumption, the test to see if policy falls outside the range is applied with respect to estate and gift tax liability in a tax year, but the scoring applies to the amount of total revenues over the a series of fiscal years caused by the incremental amount of estate and gift-tax liability in the tax year or years.

- **Alternative Minimum Tax.** With the expiration at the end of this year of the current AMT patch, which provides an increased AMT exemption for 2009, the number of AMT taxpayers would rise from about four million to about 30 million. The "current policy projection" assumes that this does not occur and that, instead, the AMT's 2009 exemption amounts and related parameters are continued thereafter, indexed to inflation.

  As long as Section 7 is in effect, AMT relief or reform would only be scored for PAYGO purposes to the extent that, as a result of that legislation, income tax revenue would be lower than under the current policy projection or higher than under the initial current law projection.

- **2001 and 2003 tax reductions.** The 2001 and 2003 income tax reductions enacted under EGTRRA and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) are scheduled to expire at the end of 2010. The "current policy projection" assumes that these expirations do not occur and that the income tax provisions in EGTRRA and JGTRRA as amended by later legislation (other than those provisions made permanent in the Pension Protection Act of 2006) are continued in future years as they are scheduled to be in effect in 2010.

  Under Section 7, legislation relating to any of the provisions or rates set under EGTRRA or JGTRRA would only be scored for PAYGO purposes to the extent that income tax revenue is, as a result, estimated to be lower than under the current policy projection or higher than under the initial current law projection. Note that EGTRRA and JGTRRA included amendments dealing with refundable tax credits such as the Child Tax Credit, and those tax credits are considered increase in outlays rather than reductions in revenues. Therefore, a more precise statement is that scoring for PAYGO purposes occurs to the extent that income tax revenues are lower than, and outlays for refundable tax credits are higher than, under the current policy projection. The scoring with respect to the initial current law projection is analogous.

In the case of the AMT and EGTRRA and JGTRRA, it is plausible or likely that a single bill may address more than one of the provisions of these laws. In that case, this proposal requires that the wedge between the current policy and the initial current law projection is calculated separately for each provision of the AMT, EGGTRRA, and JGTRRA.[5] Thus, tax legislation will be scored to the extent that any one (or more) of its individual provisions falls outside the wedge

[5] For this purpose, each individual income tax rate is considered to be a separate provision.

associated with that provision, even if the bill as a whole produces revenues that are inside the "sum of all wedges."

Because of relationships among the AMT, tax rates, and other tax provisions such as Pease and PEP, there also needs to be an estimating and scoring rule that accounts for interactive effects in determining which provisions (if any) have costs that fall outside their respective wedges. This proposal provides that, in estimating a bill dealing with a *single* provision of the AMT, EGTRRA, or JGTRRA, it is assumed that the other provisions of those laws are as under the §257 baseline, i.e., as they are actually scheduled to apply. And in estimating a bill dealing with *more than one* of the AMT and a provision or provisions in EGTRRA or JGTRRA, the AMT provision is stacked (and tested against the AMT's wedge) first, and each subsequent provision is then scored assuming the enactment of the proposed AMT provision and the enactment of each provision in that legislation already scored.

Section 8 makes the list of exempt accounts in section 255 of BBEDCA, the special sequestration rules in §256 of BBEDCA, and the baseline rules in §257 of BBEDCA apply to this new PAYGO statute, just as they applied to the original PAYGO statute. It accomplishes this by overriding the expiration of those three sections of BBEDCA for the purposes of this proposal, and by interpreting some terms, and cross-references to other provisions of the original PAYGIO law, contained in those three sections as applicable to the analogous terms and provisions in this proposal.

Section 9 amends the baseline in §257 of BBEDCA. Because §257 has a life of its own, these amendments could affect other applications of the baseline.

- The rule for the baseline treatment of entire mandatory programs that expire is returned to the form it took in 1990, which treats all such entire programs with annual costs greater than $50 million the same; when such a program is created or extended "temporarily," the costs are assumed to be permanent.

- The standard practice OMB and CBO have used for entitlement benefits in insurance programs (Social Insurance, Deposit Insurance, Pension Insurance, and so on) is to assume that the benefits will be paid even if the resources of the trust, special, or revolving fund that pays them are inadequate. This long-time approach is codified.

- The rule for reflecting the BA needed to renew expiring multiyear housing contracts (for which there was no BA in the base year because the contracts were enacted before the period covered by the baseline) is clarified to provide that the renewal contracts should be assumed to be 12-month contracts. The previous rule was not clear about the duration of the assumed renewal contracts.

- A new rule is created to bring consistency between the scoring of the Pell program as a discretionary program and its projection as a discretionary program.[6] CBO and OMB

[6] The Administration proposes to convert the Pell program to an entitlement. If and when that occurs, this language would no longer govern the projection of Pell grants, which instead would be projected consistent with the requirements of the entitlement law. But until that occurs, this proposed language would govern.

score the amount of discretionary BA for Pell grants as though it were a quasi-entitlement; the amount of BA scored is not necessarily the amount actually appropriated, but rather the amount estimated to be needed given any shortfalls or surpluses, and given the level of the "maximum award" specified in law (usually in that appropriations bill).[7] The projection rule would be made similar: BA would be projected based on any shortfall or surplus, and based on the cost of the programs given the award level in law (which would not be inflated). Thus, BA would grow with caseload rather than with inflation, and the base level would be the level actually needed in the base year, which may not be the same as the level provided in appropriations.

- The existing rule for annualizing pay raises when projecting Federal funding for salaries and expenses is repealed; that rule turned out to be in error and overstated baseline costs.

- A new rule for projecting the Federal costs for natural disasters is created. Under existing projection rules, whatever amounts happen to have been appropriated in the base year are projected forward. This could produce massive overstatements of future disaster costs (e.g., in the year after hurricane Katrina) or noticeable understatements if no disasters had yet occurred in the base year. The new rule inserts, in lieu of the inflated level of base-year BA, a probabilistic estimate (which CBO and OMB will have to make based on their best analysis and research) of the Federal exposure to the risk of major natural or man-made disasters that have not yet occurred. This type of approach to considering the costs of future disasters has been recommended by GAO.

Section 10 corrects a few typographical errors in the text of the original law that is referred to in this proposal.

Section 11 makes conforming amendments to section 256 of BBEDCA, the special rules for sequestration for those programs that are subject to sequestration and for which it is not enough to know that a percentage cut would apply to funding or benefits.

Of the mandatory programs that are subject to sequestration, many are simple grants to States. In those cases, a sequestration would do no more than reduce the size of an annual grant by the uniform percentage. Thus, if the sequestration percentage were two percent, the total amount of a grant paid to a State during the fiscal year of the sequestration would be reduced two percent. If grant payments to a State are made monthly (for example) and the sequestration does not start until one or more months into the fiscal year, the percentage reduction in payments would be slightly higher in each of the remaining months of the fiscal year so that the total cut would equal two percent for the entire fiscal year. As discussed earlier, cuts to Medicare providers are handled differently; in the case of Medicare, if a sequestration starts one or more months after the start of the fiscal year, it remains in effect for a total of 12 months and so can continue into the start of the next fiscal year. This way, the required percentage cut (which is capped at four percent in any case) does not increase slightly during the remaining months of the fiscal year.

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[7] One reason this scoring rule was adopted in recent years is that the level of BA, even if inadequate, did not restrain programs spending because the programs could "borrow" against the next year's appropriation. Thus, since BA was not a constraint on spending, it made sense to score the amount BA consistent with expected costs.

(Because a Medicare sequestration of 12 months can extend beyond the end of a fiscal year, there is an additional rule that if two successive sequestrations occur, the second does not start until the first ends.)

Section 12 restates the list of exempt programs and activities, correcting account names and numbers where they have changed, and adding some accounts enacted since 1990.

During the 1990 development of the original PAYGO statute, a considerable amount of time, attention, and concern was devoted to the exemption list. Hindsight reveals that the exemption list may be of less significance than meets the eye. Recall that sequestration is not conceived of as a desirable outcome or a remedy, but rather as a threat or penalty designed to promote compliance with the PAYGO rule. From 1990 to 1999, that conception proved valid; Congress complied with the PAYGO rule and there was never a PAYGO sequestration. Starting in 1999 and lasting through the expiration of the statute in 2002, Congress began to violate the rule, first in small ways and then large ways. In each such case, though, Congress also enacted legislation exempting the violations from PAYGO enforcement – again, there was no sequestration. This history – in which a PAYGO sequestration never occurred – suggests that a program's presence or absence from the exemption list is a less important question than it might appear at first.

The approach in this proposal is to remain as consistent as possible with the exemption list that was created in 1990. Therefore, accounts or programs that were fully exempt in 1990 remain exempt, and those subject to sequestration remain so.

This proposal would amend the exemption list, however, for a number of reasons. To begin with, many accounts have changed their names or account numbers since 1990, or have been merged or have divided; for this reason the list needs to be updated, even though this does not change the status of the programs concerned. In addition, there are a considerable number of new accounts that have been created since 1990 or since the last update in 1997. This proposal treats new accounts the same way that analogous prior accounts were treated. For example, in the 1990 law the major low-income programs such as Medicaid were exempted from sequestration. The Children's Health Insurance Program (CHIP), new since 1990, is placed in the same category as Medicaid and therefore added to the exempt list.

There are four special cases that deserve mention. In section 6, the sequestration mechanism is described; all non-exempt accounts are subject to a single, uniform percentage cut if a sequestration is required (except Medicare, where the cut is limited to four percent). This approach is a notable simplification of the 1990 law, which placed four programs at the head of the line to be sequestered; if a small sequestration was needed, those four programs would be the first ones sequestered and the sequestration would be a specified amount unrelated to the seize of the PAYGO violation. With a very small violation and therefore very small sequestration, those four programs would be reduced while the programs in the general pot could be completely spared. The four programs are special milk, vocational rehabilitation state grants, student loans, and foster care / adoption assistance. The proposal moves the first three of those programs to the general pot, removing them from the head of the line, and exempts the foster care program on the grounds that it is like other low-income programs that were exempted from sequestration in the 1990 law.

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