Can Congress Use Budget Rules To Improve Tax Policy?

By Rudolph G. Penner

Rudolph G. Penner is a senior fellow at the Urban Institute and a former director of the Congressional Budget Office.

Ovid said that ''Gods have their own rules.'' So does Congress — a vast multitude of rules. The history of the Budget and Impoundment Control Act of 1974 and the Budget Enforcement Act of 1990 is one in which rules have been promulgated; Congress has found loopholes in those rules; more rules have been designed to plug the loopholes; and then the process starts over again. The end result is a set of budget rules that is so complicated that no single human understands them all. I have heard budget committee staffs admit that they sometimes make mistakes in knowing what actions are permitted and what actions are not.

This is extremely important, because Congress is the true 500-pound gorilla that can do whatever it wants. It can follow the rules, or it can break them, if it finds them inconvenient. The only restraint is public opinion as shaped by the media. If the rules are so complex that no one understands them, it is impossible for the public and the media to know whether Congress is behaving responsibly or irresponsibly.

That is not to say that rules are totally useless. There are limited circumstances in which they can nudge Congress into behaving better than they would otherwise. The pay-as-you-go rule (PAYGO) established in 1990 was one that worked extremely well for a time. It required that all tax cuts or entitlements be paid for, both in the first year and over whatever time horizon was being used by Congress for its budget resolution. Another successful rule helped shape the Tax Reform Act of 1986. It required that the act be revenue neutral and that all amendments be revenue neutral while the act was being written.

What made these rules successful when so many others failed or have been easily circumvented? First, these rules were backed by a broad bipartisan consensus. Second, while they helped encourage responsible actions, neither rule imposed significant political pain.

To understand the success of PAYGO, it is vitally important to understand its history. It was preceded by the bipartisan budget agreement of 1990, which was the biggest deficit reduction package in history. Both political parties shed much blood in negotiating the package's large spending cuts and tax increases. The first attempt at a package failed to pass and negotiators had to try a second time. Having endured so much pain in getting the package, members of both parties were concerned that it would quickly erode. To protect the budget agreement, they invented PAYGO along with caps on discretionary appropriations and outlays.

But it is very important to note that the only purpose of PAYGO was to prevent Congress from increasing the deficit. *It did not force Congress to reduce the deficit.* Thus, it was relatively painless compared to the negotiated budget agreement that preceded it.

PAYGO continued to be successful in enforcing the budget agreement of 1993, which was almost as large as that of 1990. That is a bit harder to explain, because the 1993 agreement was not bipartisan. To pass, it had to rely entirely on Democratic votes. Although the agreement may not have been bipartisan, I would argue that the goal of deficit reduction still was.

PAYGO continued to work well until a budget surplus emerged by surprise in 1998. After that, it totally broke down, even though it did not legally expire until the end of fiscal 2002. The rule had little political support after the deficit problem seemed to disappear. But rather than repeal the rule, Congress circumvented it.

Some, mainly Democrats, would like to reinstitute a traditional PAYGO. I think that there is essentially no chance that it would work under current circumstances. A new PAYGO, based on current law, would force Congress to pay for any relief that it provides for the alternative minimum tax and for any extension of the Bush tax cuts. Thus, unlike the original PAYGO, it would require a major cut in the deficit through either a major tax increase above current levels or a significant cut in entitlements. That is too much pain to ask any rule to impose. PAYGO could impose some discipline if it were redefined to start with current tax burdens or based on a new bipartisan budget deal, but the latter is hard to imagine given the current poisonous atmosphere on Capitol Hill.

The whole panoply of rules associated with the congressional budget process needs a critical reexamination. Indeed, it may be time to admit that the budget process is broken beyond repair. It is hard to seriously discuss redesigning the rules for enforcing congressional budgets when Congress has not even passed a budget for fiscal 2007.

Anyone trying to reformulate the rules should be guided by one admonition. Keep it simple. Yes, simple rules will often be circumvented, but so are complicated rules. The main point is that everyone must be able to understand when the rules are broken. Then, there is some chance that Congress can be embarrassed into behaving better.