

Congressional Democrats and Republicans are preparing to set aside their budget constraints as they negotiate the extension of income tax cuts scheduled to expire this month.

Their plans to declare a budget emergency as they approve the extension of tax cuts will override a “pay-as-you-go” law that was structured to limit Congress’s ability to finance higher spending or tax relief by expanding the budget deficit.

Extending all income-tax rates for two years, along with renewal of business tax breaks, relief from the alternative minimum tax and other moves such as expanded unemployment insurance could add about \$750 billion to the deficit over the next decade, about \$300 billion of which is beyond the deficit- expansion which the “pay-as-you-go” law would allow.

For all the campaign-trail rhetoric about deficit reduction and recent attention focused on a bipartisan fiscal commission, Republicans and Democrats alike say the so-called “paygo” law won’t be a procedural or political obstacle to extending all of the tax cuts without offsets in spending.

“I never think paygo is out the window, in my own personal view,” said Representative Baron Hill of Indiana, who lost his bid for re-election last month. “But any rate, that’s what’s going to happen.” Hill co-chairs the Blue Dog Coalition, a group of House Democrats that pushed for the law.

### Required Offsets

The paygo law, signed by President Barack Obama on Feb. 12, generally requires that tax cuts or increases in mandatory spending be offset by spending reductions or revenue-raising measures. The law allows Congress to exempt about \$1.5 trillion if needed to extend many of the Bush-era tax cuts.

Offsets aren’t needed to make the income tax cuts permanent on the first \$200,000 of gross

income for individuals or the first \$250,000 for married couples. Offsets also aren't needed to prevent the expansion of the alternative minimum tax through 2011 or to extend the 2009 parameters of the estate tax (a \$3.5 million per-person exemption and a 45 percent top rate) through 2011.

If, over the course of a year, Congress creates additional deficits under the law's parameters, its enforcement mechanism triggers automatic spending cuts in mandatory programs such as most Medicare payments, farm price supports and social service block grants.

The law's demand for offsets led Democrats to propose measures that were opposed by businesses, including higher per-barrel taxes on oil production and limits on several kinds of foreign tax-credit transactions.

### Emergency Declarations

Still, emergency declarations can be used to exempt particular bills from the law's enforcement rules.

Congress used such declarations this year to pass unemployment-insurance extensions without offsets. Democratic attempts to extend expired tax breaks failed because they were paired with revenue-raising offsets, such as higher taxes on the "carried interest" earned by private equity managers and real estate investors.

"That paygo law is just used to increase taxes," said Senator Orrin Hatch of Utah, who is in line to become the top Republican on the Finance Committee next year. "It doesn't make a hill of beans what the difference is as far as cutting back on spending and the overregulation that these Democrats have brought to this country."

### Spending Side

The law also has affected the spending side of the budget. The health-care overhaul, for example, increased spending on insurance for low-income people, and Democrats made it compliant with the paygo law, in part, by reducing future Medicare costs.

Historically, budget constraints have worked when they embodied an agreement about how to address fiscal policy, said James Horney, director of federal fiscal policy at the Center on Budget and Policy Priorities. Without that agreement, he said, the pay-as-you-go law is likely to be ignored or waived in the year-end tax bill.

“It’s more of a symptom of the lack of consensus about what to do on budgets and deficits,” Horney said.

The tax bill that the House passed Dec. 2 complied with the pay-as-you-go law, because it didn’t extend tax cuts on income above the specified thresholds. Senate Republicans have pledged to block that bill because they think tax cuts should be extended for taxpayers at every income level.

The main Senate Democratic alternative proposed by Finance Chairman Max Baucus on Dec. 2 features dozens of provisions that violate the pay-as-you-go law. They include a permanent extension of the 2009 estate tax parameters, extension of the “Making Work Pay” tax credit approved by President Barack Obama from the stimulus law and the extension of dozens of provisions favored by businesses such as a research tax credit.

Republicans voted unanimously against the pay-as-you-go law earlier this year, and they dismiss it as a Democratic gimmick.

### Changes Sought

Republicans, who will control the House in January, can’t eliminate or change the law without agreement from the Senate and Obama. They are weighing changes to the separate pay-as-you-go rules that the House has adopted, said Representative Greg Walden of Oregon, who is leading the Republican transition team.

Republicans complain that the law doesn't apply to discretionary spending, the main funding vehicle for federal agencies. They also say it ignores the positive economic effects of tax cuts.

*"The thing about paygo is it was specifically designed by the Democrats to encourage spending and discourage tax reductions,"* said **John Campbell**, a California Republican who sits on the House Budget Committee. *"We hate it."*