

2015

FISCAL SUMMIT

OPPORTUNITY FOR AMERICA

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THE SOLUTIONS INITIATIVE III

MAY 2015

AMERICAN ACTION
FORUM




BIPARTISAN POLICY CENTER

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The mission of the Peter G. Peterson Foundation is to increase public awareness of the nature and urgency of key fiscal challenges threatening America's future and to accelerate action on them. To address these challenges successfully, we work to bring Americans together to find and implement sensible, long-term solutions that transcend age, party lines and ideological divides in order to achieve real results.

To learn more about the Foundation and our initiatives, visit www.pgpf.org.

Introduction

The Long-term Fiscal Challenge

Despite recent improvements in short-term deficits, America remains on a dangerous long-term fiscal path that threatens our future economy.

The nonpartisan Congressional Budget Office (CBO) projects that, under current law, federal debt will climb from 74 percent of gross domestic product (GDP) in 2014 to more than 100 percent of GDP in 25 years. Under its less optimistic alternative scenario with economic feedback, CBO predicts that debt could rise to a staggering 183 percent of GDP over the same time period. These levels far exceed debt's 50-year historical average of approximately 40 percent of GDP.

With retirement and healthcare programs growing at a faster pace than tax revenue, our fiscal outlook is unsustainable—and that affects our economy. Absent reforms, rising interest costs will crowd out programs that invest in our future, including education, infrastructure, research and development, and national security. Federal borrowing could crowd out private investments that promote growth in the economy. In addition, programs that protect the most vulnerable Americans could face sharp, sudden reductions.

The Solutions Initiative

The good news is that we can choose a better path. Building a solid, sustainable long-term fiscal foundation will support a strong and prosperous American economy that has resources to invest in the future of our children, unleashes capital that our businesses need to grow, and provides a reliable safety net for our citizens.

In 2011, the Peter G. Peterson Foundation launched the Solutions Initiative to demonstrate that comprehensive solutions to the nation's long-term fiscal challenges do exist. This unique project convened policy organizations from across the ideological spectrum to put forward comprehensive plans for stabilizing America's fiscal outlook in the decades ahead. Importantly, each group successfully stabilized America's debt over the long term, demonstrating that there is indeed a range of viable options available to policymakers.

In 2012, with the nation on the verge of the "fiscal cliff," we asked these groups to update their long-term plans, while also addressing the nation's near-term budget standoff. Once again, each group offered specific policy recommendations, reflecting their unique perspectives and priorities, to resolve the fiscal cliff impasse and put the nation on a sustainable long-term path.

Today, America's economic recovery is finally taking hold and current deficits are down from the record highs during the recession. But at the same time, far too many American families are being left out of the recovery, and our nation still faces an unsustainable long-term fiscal outlook, which threatens economic growth.

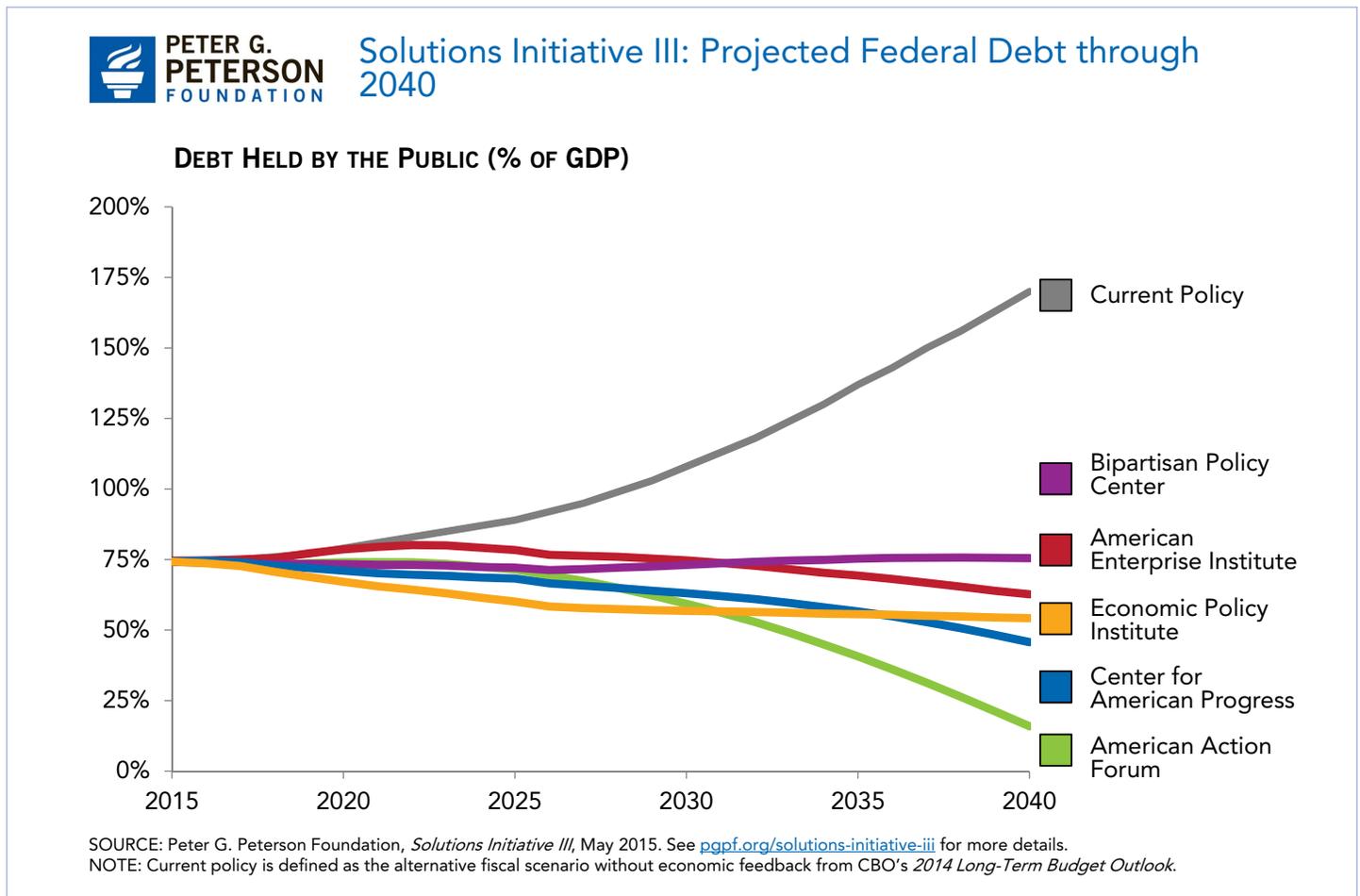
Against this backdrop—with progress made, but serious work to be done—we are undertaking **Solutions Initiative III**.

Today, the economic recovery presents a new opportunity to address the long-term fiscal challenges that have so far evaded us. In recent years, many have said that the fragile nature of the recovery meant that it was not the right time to take fiscal action. Now, as the economic recovery strengthens and a new political landscape begins to take shape, we have a new setting in which to address America's unsustainable long-term fiscal outlook. The current economic environment allows more room to maneuver, and provides a

window to plan for success—making smart, reasoned decisions that will benefit America over the long term. Now is the time to develop the roadmap for long-term fiscal sustainability and economic growth.

The plans presented under Solutions Initiative III make clear that there are many options available to build a brighter future. They provide a blueprint for lawmakers to chart a better course for America, with less debt, faster economic growth, broader prosperity, and enhanced economic opportunity and mobility.

Once again, experts from five leading organizations—the American Action Forum (AAF), the American Enterprise Institute (AEI)¹, the Bipartisan Policy Center (BPC), the Center for American Progress (CAP), and the Economic Policy Institute (EPI)—developed specific, “scoreable” policy proposals to set the federal budget on a sustainable, long-term path for prosperity and economic growth. The groups then recommended their top policy priorities for congressional policymakers and the incoming presidential administration.



The results? Each group has stabilized America’s long-term debt over the decades to come. Not surprisingly, each plan is different and reflects each organization’s policy priorities, but they all successfully put the nation on a more sustainable fiscal path. The plans reflect the reality that many solutions to our fiscal and economic challenges exist. They make clear that lawmakers have the opportunity to build a solid fiscal foundation for the nation, which will enable the economic opportunity that is the basis of the American dream.

The Foundation presents these plans to inform the national debate, demonstrating to policymakers and everyday Americans alike that we can choose a better fiscal path and ensure greater economic growth and prosperity for future generations.

¹ The views expressed by the researchers from AEI are solely those of the authors and do not reflect the position of the American Enterprise Institute or any other organization.

Summary of Plans

For Solutions Initiative III, the Peter G. Peterson Foundation asked each group to develop a comprehensive long-term budget plan that includes specific federal spending and revenue policies beginning in Fiscal Year 2017, and extending over the next 25 years. Each plan identified proposed changes to the major components of the budget.

We also asked each organization to draft a memo for the next President and Congress that presents the organization's vision and goals, together with the steps that policymakers need to take to achieve them.

To enable an accurate comparison of the plans, we asked the Tax Policy Center and Barry Anderson (former acting director at CBO) to serve as independent scorekeepers, reviewing the plans and applying consistent analytical techniques to all of the proposals. The end result is an apples-to-apples quantitative assessment of spending, taxes, deficits, and debt that illustrates the impact of various policy choices made by each organization.

All five plans successfully address America's long-term fiscal challenge by stabilizing our long-term debt over the decades to come. Taken together, these plans present a deep and broad selection of viable policy options for lawmakers to consider and pursue to lay a more sustainable fiscal foundation for economic growth and prosperity.

The following is a summary of how the Solutions Initiative III organizations approached five key components of the federal budget: federal healthcare programs, Social Security, discretionary spending, other non-interest spending and revenues.

Federal Healthcare Programs

Improving our healthcare system to deliver better quality care at lower cost is an essential part of ensuring our nation's long-term economic and fiscal well-being. Our inefficient and wasteful healthcare system—currently the most expensive system among advanced nations—will need to care for a growing number of aging Americans. Fueled by the demands of our aging population, absent reform, this system will cause healthcare costs to continue rising faster than inflation and to take over increasing shares of the federal budget and the overall economy.

The growth in healthcare costs per person has moderated in the last few years, but it is uncertain how long this welcome trend will continue. Even with this slowdown, over the next 25 years, CBO projects that total spending on the major federal healthcare programs will increase by almost 60 percent, which is faster than the growth of any other category of the budget except net interest on the debt.

Recognizing this dangerous trend, Solutions Initiative III organizations presented a range of proposals aimed at reducing healthcare costs.

Both AAF and AEI gradually convert Medicare to a "premium support" model, with seniors receiving a subsidy to purchase private health plans. AEI gradually raises Medicare's eligibility age from 65 to 67. AEI proposes replacing Medicaid with a block grant program, while AAF introduces competitive bidding to Medicaid. These groups also highlight medical liability reform as an important way to limit cost growth.

BPC proposes a number of cost-saving changes to Medicare, including a *Medicare Networks* proposal that creates incentives for providers and beneficiaries to participate in lower-cost, higher-quality healthcare plans. In addition, BPC creates a single combined deductible for Parts A and B, simplifies the copay schedule

and changes the rules on supplemental coverage. BPC also advocates greater progressivity in Medicare's benefits, including increased assistance to protect low-income beneficiaries and reduced subsidies for higher-income beneficiaries. BPC does not propose major changes to Medicaid.

CAP and EPI maintain the current Medicare system, focusing on stricter cost controls and enhanced protections for low-income beneficiaries. CAP implements its Accountable Care States proposal to encourage the use of lower-cost, higher-quality healthcare in Medicare, Medicaid and the health exchanges. EPI advocates an expanded "supercharged" version of the Independent Payment Advisory Board, which would have additional powers to control healthcare spending for Medicare, Medicaid, and the health exchanges.

AAF and AEI repeal both the tax and spending provisions of the Affordable Care Act (ACA). BPC, CAP, and EPI retain the law while strengthening cost-control tools at the federal level. EPI proposes a public option as part of the ACA health insurance exchanges.

Social Security

Social Security currently provides benefits to 59 million Americans, including retired workers, disabled workers, and their spouses and survivors. As the population ages and the large baby boom generation enters retirement, the number of people receiving benefits is expected to swell to 88 million by 2033.

Social Security faces major financial challenges. In their most recent report, the Social Security Trustees projected that without action, program beneficiaries will face automatic, across-the-board cuts of 23 percent in 2033. That means that enrollees with average pre-retirement earnings would face a cut of \$5,750 per year in real (inflation-adjusted) benefits in 2033. The Disability Insurance (DI) Trust Fund is in even worse condition. The Trustees expect the fund will be fully exhausted in less than two years, which would result in a 19 percent sudden automatic benefit cut in 2016 for the 11 million disabled beneficiaries and their families.

In view of Social Security's long-term imbalances, all of the Solutions Initiative III participants propose reforms to make the program sustainable in the decades ahead.

AAF proposes a combination of changes to slow the growth of the existing benefits, including raising the normal retirement age to 70 and adopting a new index of inflation known as chained-consumer price index (chained-CPI) to calculate cost-of-living adjustments. AAF also changes certain eligibility rules for disability insurance.

AEI proposes a range of gradually-implemented reforms, including a new "flat dollar benefit." This benefit would be set at the elderly poverty threshold and indexed to wage growth. It would be supplemented by employer-sponsored retirement accounts. The group also proposes raising the early retirement age from 62 to 65 and eliminating the 12.4 percent Social Security payroll tax for all workers age 62 and older. AEI would also "experience rate" the disability portion of the employer payroll tax to create incentives for companies to accommodate workers with disabilities in order to keep them employed.

BPC includes both spending reductions and revenue increases to make Social Security solvent over the long term. BPC's proposals include indexing benefits for increases in longevity, adopting chained-CPI for cost-of-living adjustments, and reducing benefits for high-income retirees, while adding new protections for lower-income beneficiaries and older retirees. BPC also recommends increasing the maximum amount of taxable earnings (currently \$118,500) subject to the payroll tax.

CAP increases the minimum benefit for low-income recipients and increases revenue by removing the cap on the employer's share of the Social Security tax. EPI does not change Social Security benefits, but it raises new revenue for the program by increasing the maximum amount of taxable earnings subject to the payroll tax.

Discretionary Spending

The Budget Control Act of 2011 imposed tight nominal dollar caps on future discretionary spending, which were lowered as a result of the failure of the congressional Supercommittee to reach agreement on further spending cuts. Half of these additional cuts applied to defense spending, while most of the remaining cuts reduced nondefense discretionary spending—in areas such as scientific and medical research, education, national parks, food inspections, law enforcement, federal employee pay, grants to state and local governments, and the Head Start pre-school program. The Murray-Ryan Bipartisan Budget Act of 2013 temporarily loosened the caps for FY 2014 and FY 2015, but did not adjust the caps for FY 2016 and beyond.

Several of the Solutions Initiative III organizations propose to increase the caps. However, they have sharply different views about the total level of discretionary expenditures—and the mix between defense and nondefense spending.

AAF modestly increases nominal spending for both defense and nondefense discretionary programs above current law levels over the next ten years. However, as a share of GDP, total spending on discretionary programs declines from 6.5 percent of GDP in 2015 to 5.4 percent of GDP in 2024 and remains at that level through 2040. In 2040, defense spending falls to 2.7 percent of GDP, and nondefense discretionary spending drops to 2.6 percent of GDP.

Under AEI's plan, defense spending increases significantly from 3.2 percent of GDP in 2015 to 3.8 percent of GDP by 2030 and remains at that level thereafter. Nondefense discretionary spending levels do not change and continue to be set by the current-law caps. As a share of GDP, nondefense discretionary spending declines from 3.3 percent of GDP in 2015 to 2.6 percent of GDP in 2040.

BPC proposes modest increases in nominal spending on nondefense discretionary programs and modest decreases in nominal defense spending. However, as a share of GDP, nondefense discretionary spending would decline from 3.3 percent of GDP in 2015 to 2.6 percent of GDP in 2040. Defense spending would decline from 3.2 percent of GDP in 2015 to 2.5 percent of GDP in 2040.

CAP proposes significant short-term increases in nominal spending on nondefense discretionary programs, focusing on additional public investments in infrastructure, education, and R&D. As a share of GDP, nondefense spending rises from 3.3 percent of GDP in 2015 to 3.6 percent of GDP in 2016 and then gradually declines to 3.1 percent of GDP in 2040. Defense spending is reduced under CAP's plan from 3.2 percent of GDP in 2015 to 2.2 percent in 2040.

EPI advocates a sharp and sustained increase in nondefense discretionary spending, with large investments in infrastructure, education and training, and R&D. As a share of GDP, nondefense discretionary spending rises from 3.3 percent of GDP in 2015 to 5.0 percent of GDP in 2017 before gradually declining to 4.8 percent of GDP in 2040. Defense spending is reduced from 3.2 percent of GDP in 2015 to 2.3 percent of GDP in 2040.

Other Non-interest Spending

Other non-interest spending covers a diverse set of programs that affect a wide range of people: low-income families, unemployed workers, veterans, farmers, students, and federal civilian and military retirees. However,

these programs are a relatively small portion of the budget, and they are projected under current law to decline over the next 25 years.

In their plans, BPC, CAP, and EPI raise other non-interest spending as a share of GDP, while AAF keeps it close to current-law levels and AEI significantly reduces it. There is a near consensus among the groups about agricultural subsidies. Four of the five groups—AAF, AEI, BPC, and CAP—recommend reducing them.

However, the groups differ in how they would change other programs in this category. AAF recommends directing Pell grants to the neediest students, eliminating loan subsidies to graduate students, and changing programs for family support and work support. AEI slows the overall growth of spending in this category, while BPC uses chained CPI to index federal benefit programs in this category. Three groups—AAF, AEI, and BPC—propose reforms to reduce the costs of federal employee pensions. CAP recommends significantly higher spending on income-support programs, higher spending on infrastructure, higher education, preschool and paid family leave. The EPI plan proposes higher spending on income-support programs, extending unemployment benefits, and restoring benefits provided under the Supplemental Nutrition Assistance Program that were cut by the 2014 farm bill.

Revenues

Our tax system is complex, confusing, inefficient and unfair. The tax code is riddled with tax expenditures, or “tax breaks,” including loopholes, deductions, exemptions, credits and preferential rates. Because these tax breaks provide financial assistance to specific activities and groups, many are nothing more than government spending in disguise that create market distortions harmful to economic growth and productivity. Without reform, our current tax system will not produce sufficient revenues to keep up with projected spending levels—contributing to our long-term fiscal challenges.

Many economists and policymakers believe that our economic prospects would be improved by reforms to the tax code to make it simpler, more equitable, and more supportive of growth. The Solutions grantees present a range of proposals in this area.

There are many areas of agreement. All of the groups except AAF recommend raising the gas tax. AEI, CAP, and EPI propose a carbon tax. AAF, BPC, and CAP advocate for immigration reform as part of their proposals, noting that reform will increase the number of workers paying taxes and raise revenues.

The American Action Forum and American Enterprise Institute replace the current income tax system with a progressive consumption tax, which effectively exempts all income devoted to saving and investment from taxation. On the individual side, they both establish three tax rates—15 percent, 25 percent, and 35 percent. On the corporate side, AEI sets a flat corporate tax rate of 37 percent and AAF sets it at 35 percent. AAF replaces all tax expenditures—and AEI replaces most of them—with a much simpler system of tax credits. AAF creates tax credits for charitable contributions and first-time homebuyers and converts the existing child tax credit and Earned Income Tax Credit (EITC) into equal-dollar spending programs. AEI creates credits for charitable contributions, mortgage interest, children, and health insurance, while expanding the EITC and restructuring the existing research and experimentation tax credit.

The Bipartisan Policy Center reforms the existing income tax system using an approach similar to the one endorsed by a bipartisan supermajority of the Bowles-Simpson Commission in 2010. BPC’s approach broadens the tax base by eliminating tax expenditures, lowers ordinary income tax rates and raises revenue for deficit reduction. The BPC plan sets just two tax rates of 15 percent and 30 percent for individual taxpayers and reduces the corporate top income tax rate from 35 percent to 30 percent. Dividends and

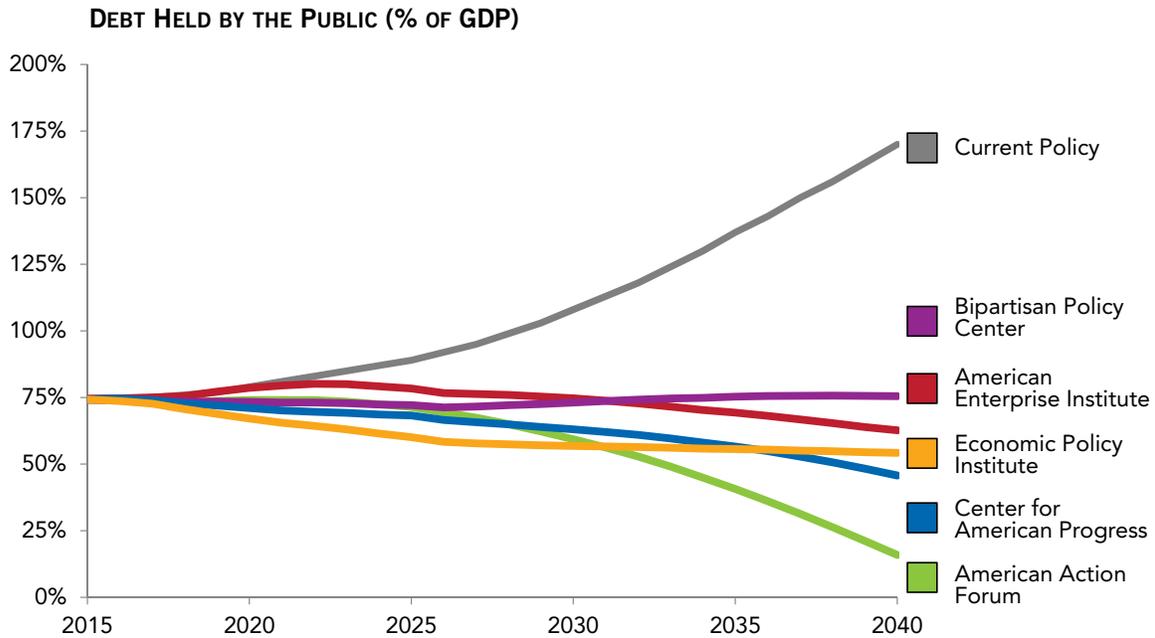
capital gains no longer receive preferential treatment and are taxed as ordinary income. Most other individual and corporate tax preferences are replaced with a much simpler set of tax credits for mortgage interest, charitable contributions, children, and the elderly. BPC also expands the EITC.

The Center for American Progress proposes changes to the existing individual income tax system that primarily raise more revenue from high-income families. The reforms include an additional 5 percent surtax on incomes above a million dollars, higher taxes on capital gains and dividends, higher revenues from estate and gift taxes, and a new financial transactions fee. CAP also proposes a temporary middle-class tax credit. In addition, CAP raises more revenue from corporations by eliminating many corporate tax expenditures and imposes a financial crisis responsibility fee on large banks and financial institutions. Lastly, CAP eliminates most individual tax expenditures and replaces them with tax credits for charitable contributions, mortgage interest, saving, children, early childcare, and an expanded EITC.

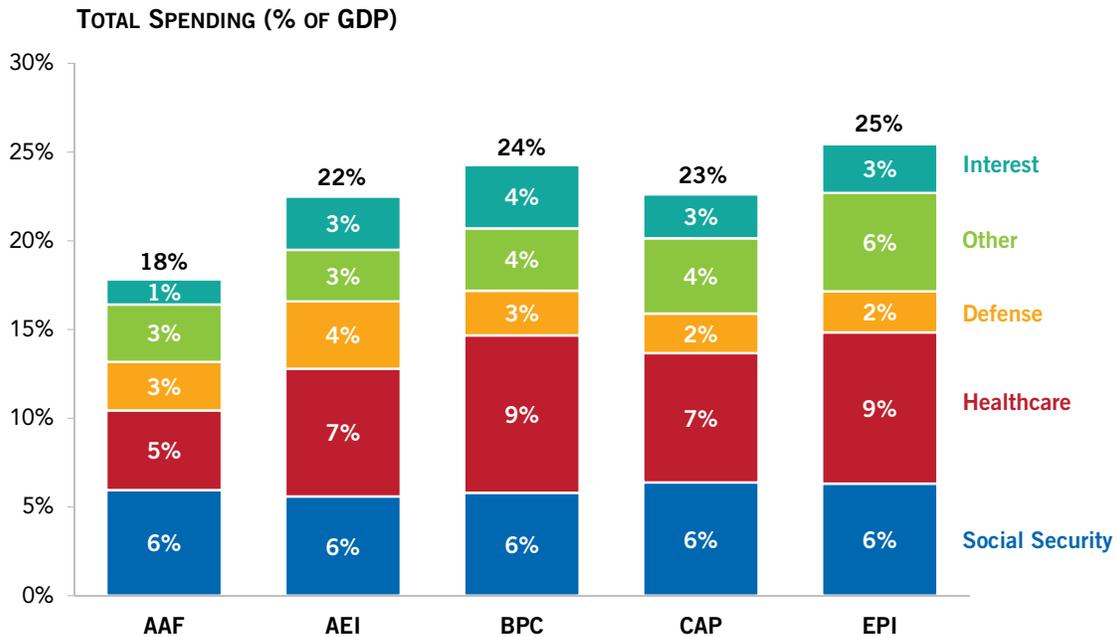
The Economic Policy Institute raises revenue by raising tax rates on families in the highest income quintile. Its reforms include higher tax rates on capital gains and dividends, an increase in estate and gift taxation, and the creation of a new 43 percent tax rate on incomes between \$2 million and \$10 million and a 47 percent tax rate on incomes above \$10 million. EPI also eliminates the deduction for state and local taxes and phases out the mortgage interest deduction, while expanding the EITC. On the corporate side, EPI eliminates a number of business tax preferences and creates a fee on “too big to fail” financial institutions.

Peter G. Peterson Foundation Solutions Initiative III **Projected Budget Levels in 2040** (as a percentage of GDP)

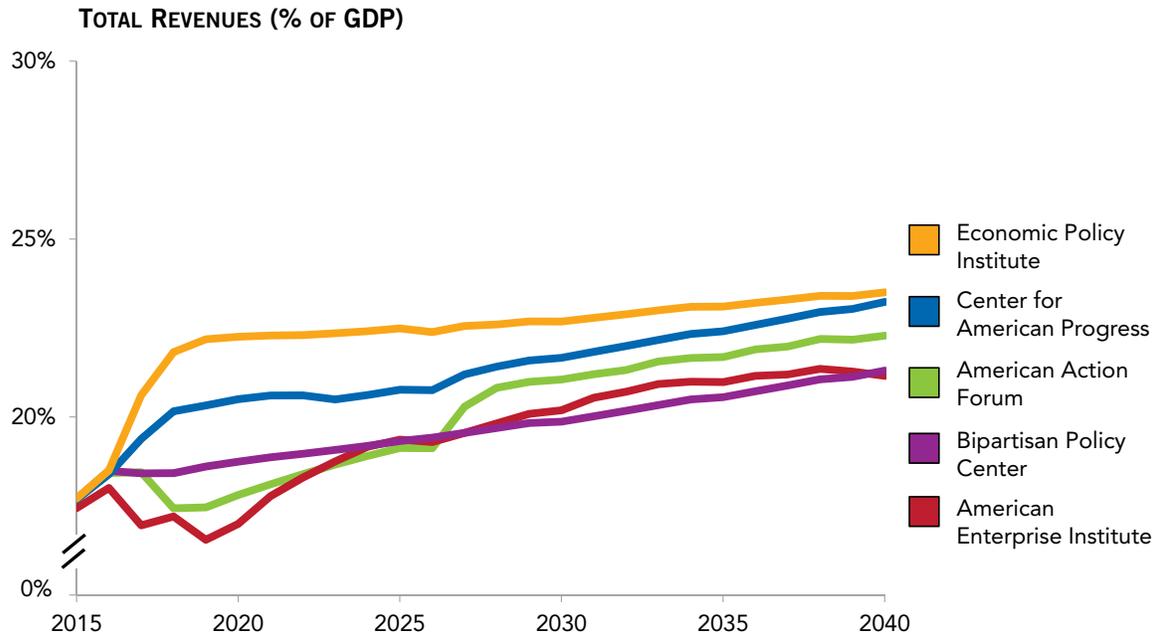
	American Action Forum	American Enterprise Institute	Bipartisan Policy Center	Center for American Progress	Economic Policy Institute
Revenues	22.3	21.2	21.3	23.2	23.5
Spending	17.8	22.5	24.3	22.6	25.4
Deficit (-)/ Surplus (+)	4.5	-1.4	-3.0	0.6	-1.9
Debt Held by the Public	15.9	62.7	75.5	45.8	54.2



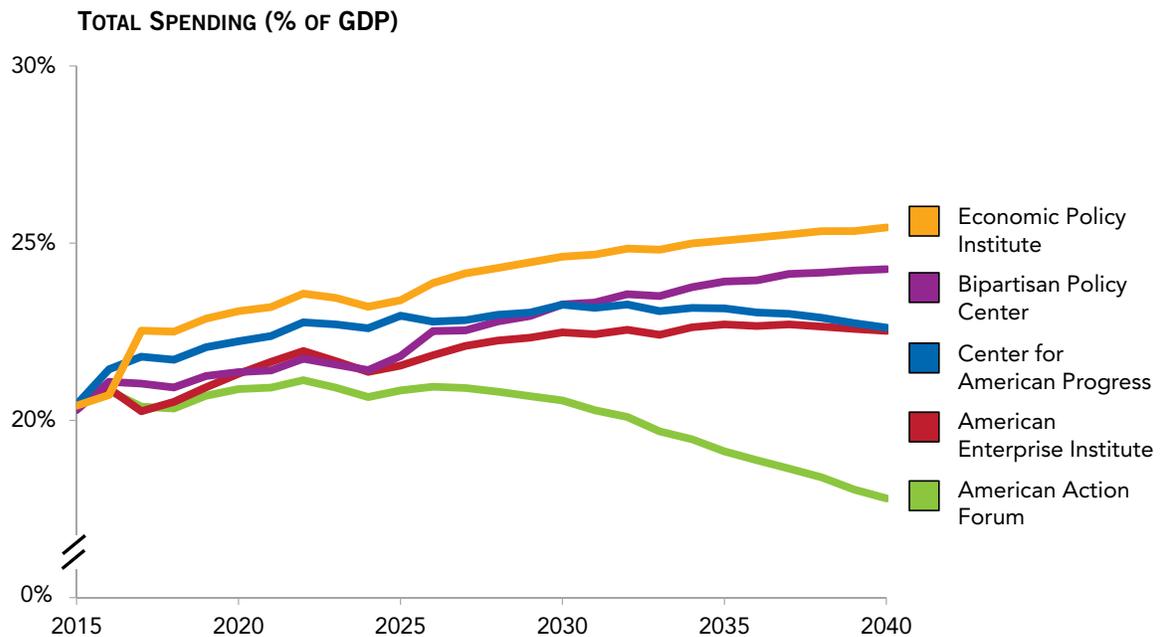
SOURCE: Peter G. Peterson Foundation, *Solutions Initiative III*, May 2015. See pgpf.org/solutions-initiative-iii for more details.
 NOTE: Current policy is defined as the alternative fiscal scenario without economic feedback from CBO's 2014 Long-Term Budget Outlook.



SOURCE: Peter G. Peterson Foundation, *Solutions Initiative III*, May 2015. See pgpf.org/solutions-initiative-iii for more details.
 NOTE: Other includes nondefense discretionary and other mandatory spending. Numbers may not sum to totals due to rounding.



SOURCE: Peter G. Peterson Foundation, *Solutions Initiative III*, May 2015. See pgpf.org/solutions-initiative-iii for more details.



SOURCE: Peter G. Peterson Foundation, *Solutions Initiative III*, May 2015. See pgpf.org/solutions-initiative-iii for more details.



Peter G. Peterson Foundation Solutions Initiative III

Composition of Budget Levels in 2026 and 2040 (as a percentage of GDP)

	American Action Forum		American Enterprise Institute		Bipartisan Policy Center		Center for American Progress		Economic Policy Institute	
	2026	2040	2026	2040	2026	2040	2026	2040	2026	2040
Spending										
Health	5.3	4.5	5.8	7.2	6.9	8.9	6.4	7.3	6.7	8.5
Social Security	5.6	6.0	5.4	5.6	5.6	5.8	5.8	6.4	5.8	6.3
Defense Discretionary	2.7	2.7	3.6	3.8	2.5	2.5	2.5	2.2	2.3	2.3
Nondefense Discretionary	2.6	2.6	2.5	2.6	2.6	2.6	2.9	3.1	4.7	4.8
Other Non-interest Spending	1.5	0.6	1.1	0.3	1.6	0.9	2.2	1.1	1.7	0.8
Interest	3.2	1.4	3.4	3.0	3.2	3.6	3.1	2.5	2.8	2.7
Total Spending	20.9	17.8	21.8	22.5	22.5	24.3	22.8	22.6	23.9	25.4
Revenues	19.1	22.3	19.3	21.2	19.4	21.3	20.8	23.2	22.4	23.5
Deficit (-)/Surplus (+)	-1.8	4.5	-2.5	-1.4	-3.1	-3.0	-2.0	0.6	-1.5	-1.9
Debt Held by the Public	69.4	15.9	76.7	62.7	71.3	75.5	66.6	45.8	58.4	54.2

Peter G. Peterson Foundation Solutions Initiative III

Comparing Policy Proposals

HEALTH

	American Action Forum	American Enterprise Institute	Bipartisan Policy Center	Center for American Progress	Economic Policy Institute
MEDICARE	Convert to premium support. Retain traditional Medicare as option for current retirees.	Convert to premium support. Retain traditional Medicare.	Reform traditional Medicare	Reform traditional Medicare	Reform traditional Medicare
	Cost containment through competitive bidding and market forces	Cost containment through competitive bidding and market forces	Cost containment through <i>Medicare Networks</i> proposal and other reforms	Cost containment through the <i>Accountable Care States</i> proposal and other reforms	Cost containment through <i>Supercharged IPAB</i> and other reforms
			Encourage generic drug use	Various reforms to lower drug prices	Negotiate lower drug prices
		Raise Medicare eligibility to 67			
MEDICAID, CHIP, HEALTH EXCHANGES	Repeal ACA	Repeal ACA	Maintain ACA	Maintain ACA	Maintain ACA. Add public option.
	Use competitive bidding and limit growth of federal contribution	Medicaid block grant to states		Target for state healthcare cost growth	<i>Supercharged IPAB</i> cost containment
TAXES	Repeal ACA taxes	Repeal ACA taxes	Repeal ACA taxes on net investment income, high-income wages, and high-cost "cadillac" health plans	Retain ACA taxes	Retain ACA taxes
	Eliminate exclusion of employer-sponsored health insurance	Replace exclusion of employer-sponsored health insurance with refundable health insurance tax credit	Limit exclusion of employer-sponsored health insurance	Limit exclusion of employer-sponsored health insurance	
OTHER	Reform medical liability	Reform medical liability			

SOCIAL SECURITY

	American Action Forum	American Enterprise Institute	Bipartisan Policy Center	Center for American Progress	Economic Policy Institute
CHANGES TO BENEFITS	Reduce growth of initial benefits	Flat monthly benefit indexed to wage growth, with retirement accounts	Reduce growth of initial benefits for high earners. Index benefits for longevity.		
			Raise minimum benefit. Increase benefits for very old.	Raise minimum benefit	
	Raise normal retirement age	Raise early retirement age			
	Use chained CPI for cost of living adjustments		Use chained CPI for cost of living adjustments		
	Changes DI eligibility				
CHANGES TO PAYROLL TAXES		"Experience rate" employer share of DI payroll tax	Increase the maximum taxable earnings	Eliminate cap on employer share of payroll tax	Increase the maximum taxable earnings
		Eliminate payroll tax on workers age 62 and older			

DISCRETIONARY SPENDING

	American Action Forum	American Enterprise Institute	Bipartisan Policy Center	Center for American Progress	Economic Policy Institute
DEFENSE	Increase \$377 billion from 2017-2026	Increase \$1.4 trillion from 2017-2026	Reduce \$122 billion from 2017-2026	Reduce \$258 billion from 2017-2026	Reduce \$736 billion from 2017-2026
	2.7% of GDP in 2040	3.8% of GDP in 2040	2.5% of GDP in 2040	2.2% of GDP in 2040	2.3% of GDP in 2040
NONDEFENSE	Increase \$289 billion from 2017-2026	No change	Increase \$115 billion from 2017-2026	Increase \$1.6 trillion from 2017-2026	Increase \$5.1 trillion from 2017-2026
	2.6% of GDP in 2040	2.6% of GDP in 2040	2.6% of GDP in 2040	3.1% of GDP in 2040	4.8% of GDP in 2040

OTHER NON-INTEREST SPENDING

American Action Forum	American Enterprise Institute	Bipartisan Policy Center	Center for American Progress	Economic Policy Institute
Reform agricultural subsidies	Reform agricultural subsidies	Reform agricultural subsidies	Reform agricultural subsidies	
Reform federal civilian and military retirement	Reform federal civilian and military retirement	Reform federal civilian and military retirement		
Convert EITC and child credit into equal-dollar spending programs		Use chained CPI for cost of living adjustments	Increase spending on income support programs, infrastructure, higher ed, preschool, and paid family leave	Increase spending on income support programs, extended unemployment benefits, and child nutrition programs

INDIVIDUAL INCOME TAX REVENUES

American Action Forum	American Enterprise Institute	Bipartisan Policy Center	Center for American Progress	Economic Policy Institute
Repeal individual income tax. Replace with progressive wage tax, as part of Bradford X Tax.	Repeal individual income tax. Replace with progressive wage tax, as part of Bradford X Tax.	Broaden base. Reduce number of tax brackets. Lower tax rates.	Broaden base. Increase tax rates on higher incomes. Millionaire surtax.	Broaden base. Increase tax rates on higher incomes. Millionaire surtax.
No household-level taxes on investment income	No household-level taxes on investment income	Higher taxes on dividends and capital gains	Higher taxes on dividends and capital gains	Higher taxes on dividends and capital gains
Repeal AMT	Repeal AMT	Repeal AMT	Repeal AMT	
			Temporary middle class tax credit	

CORPORATE INCOME TAX REVENUES

American Action Forum	American Enterprise Institute	Bipartisan Policy Center	Center for American Progress	Economic Policy Institute
Repeal corporate income tax. Replace with business cash-flow tax, as part of Bradford X Tax. No marginal tax on new investment.	Repeal corporate income tax. Replace with business cash-flow tax, as part of Bradford X Tax. No marginal tax on new investment.	Broaden corporate income tax base. Lower tax rate.	Broaden corporate income tax base. Keep tax rates the same.	Broaden corporate income tax base. Replace graduated rates with flat 35% tax rate.

TAX EXPENDITURES

	American Action Forum	American Enterprise Institute	Bipartisan Policy Center	Center for American Progress	Economic Policy Institute
INDIVIDUAL	Eliminate individual tax expenditures. Phaseout mortgage interest deduction. Replace with credits for charity and first-time homebuyers.	Eliminate most individual tax expenditures. Replace with credits for mortgage interest, charity, children, and health insurance.	Eliminate most individual tax expenditures. Replace with credits for mortgage interest, charity, children, and elderly.	Eliminate most individual tax expenditures. Replace with credits for mortgage interest, charity, children, saving, and early childcare.	Eliminate deduction for state and local taxes. Phase out deduction for mortgage interest. Limit value of deductions to 28%.
	Replace EITC with equal-dollar spending program	Expand EITC	Replace EITC with new, expanded credit for low earnings	Expand EITC	Expand EITC
CORPORATE	Eliminate all corporate tax expenditures	Eliminate all corporate tax expenditures, except restructured R&E credit	Eliminate most corporate tax expenditures. Retain R&E credit.	Eliminate many corporate tax expenditures. Retain credits for R&E and clean energy.	Eliminate corporate tax expenditures for fossil fuels, debt financing, and certain inventory methods

OTHER REVENUE PROPOSALS

American Action Forum	American Enterprise Institute	Bipartisan Policy Center	Center for American Progress	Economic Policy Institute
Immigration reform		Immigration reform	Immigration reform	
Repeal estate and gift taxes	Repeal estate and gift taxes		Increase estate and gift taxes	Increase estate and gift taxes
	Increase gas tax	Increase gas tax	Increase gas tax, then replace with vehicle miles traveled tax	Increase gas tax
	Carbon tax		Carbon tax	Carbon tax
		Increase alcohol and tobacco taxes. Tax sweetened beverages.	Increase alcohol and tobacco taxes	Increase alcohol tax. Tax sweetened beverages and firearms.
			Financial crisis responsibility fee	Financial crisis responsibility fee
			Financial transaction tax	

Memos to the Next President and Congress

As part of this exercise, the Peterson Foundation asked each group to draft a memo for the 45th President and 115th Congress, dated January 1, 2017, identifying its top three priorities for policymakers following the next election cycle. The following summarizes their recommendations:

- **American Action Forum**
 - Tax reform
 - Entitlement reform
 - Immigration reform

- **American Enterprise Institute**
 - Make healthcare programs more efficient
 - Better target Social Security
 - Switch to a growth-friendly consumption tax

- **Bipartisan Policy Center**
 - Tax reform
 - Control of healthcare cost growth
 - Greater public investments

- **Center for American Progress**
 - Grow the economy by strengthening and expanding the middle class
 - Slow healthcare cost growth
 - Increase federal revenues

- **Economic Policy Institute**
 - Increase spending for public investments
 - Strengthen America's social welfare system
 - Raise additional revenues

AMERICAN ACTION FORUM

MEMORANDUM

TO: The 45th President and 115th Congress
FROM: Douglas Holtz-Eakin and Gordon Gray
DATE: January 1, 2017
SUBJECT: Balanced: 2028

Introduction

The debt currently stands at over \$14 trillion and is growing, while the economy is on track to grow at a rate of only about two percent per year. Left unchanged, these trends endanger the future prosperity of the nation. The debt is no longer an abstract, distant challenge, but rather a headwind to economic growth that must be addressed now. Persistently sluggish economic growth will bequeath to the next generation a standard of living unworthy of the American Experiment. Both of these challenges threaten to break the nation's social compact that successive generations bequeath to the next a brighter future. But this is only one possible future. An alternative can promise declining debt through a balanced budget and future surpluses and a policy environment to support higher economic growth.

Top Three Policy Recommendations

A brighter future is achievable by focusing on what is driving the structural budgetary challenges confronting the nation, and where federal policy is failing the economy. Addressing the nation's broken tax code, the rapid growth of health, retirement, and other entitlement programs, and the U.S.'s irrational immigration system will improve both the nation's fiscal and economic outlook and should be the top three priorities of the administration.

Tax Reform

Fundamental modernization and simplification of the tax system has been an elusive dream for Congresses and administrations over the past 30 years. Indeed, over the 100-year history of the U.S. income tax system, only a handful of meaningful simplification efforts have seen success. This administration should defy history and enact comprehensive tax reform. This effort should be even more ambitious than the 1986 Tax Reform Act. Instead, this administration should pursue a wholesale rewrite of the tax code, one that moves to a

consumption-based system that, while retaining progressivity, spurs savings and investment and imposes taxes on commerce in the least harmful way.

“Balanced: 2028” would eliminate the current individual and corporate tax code. Businesses would be taxed on cash flows, with businesses able to deduct purchases and employee compensation, at a flat rate initially set at the same top rate as the household portion of tax.

Individuals above an exemption would be taxed progressively up to a top rate of 35 percent. The plan would raise adequate revenue to fund the nation’s priorities, but do so in a manner that is far more efficient, and therefore more conducive to economic growth, than the current system—indeed such a reform could boost long-term economic growth by 6 percent.

Entitlement Reform

The primary causes for our growing debts have been largely untouched by past deficit reduction efforts. Discretionary spending, reduced by the Budget Control Act, and tax revenue, recently hiked, are not driving debt. Mandatory spending and interest payments are. Mandatory spending has been growing as the nation ages, health costs grow, and policy-makers create new entitlements and expand old ones. In 1974, mandatory spending was 41 percent of the budget. By 2025, it will be 64 percent. Meanwhile, interest payments on the debt will continue to crowd out the budget as the debt portfolio remains outsized, and interest rates normalize.

These pressures reflect legacy costs—past promises—crowding out investment in the future in the form of infrastructure, basic research, and education. This budget pressure strains the capacity to adequately fund what should be the first priority of the federal government: national defense. Absent restraint on entitlement programs, the United States will be unable to budget for these priorities.

Immigration Reform

The demography of the nation is graying. Low U.S. birth rates are falling short of the aging of the population. As the baby-boom generation continues to reach retirement age, the U.S. labor force will face additional downward pressure, and with it, the economy as a whole. A rational immigration system that refocuses on economic goals could help reverse this trend by raising population and labor force growth, and thus economic growth as a whole.

In addition to the mere mechanics of raising the U.S. population, immigrants have displayed entrepreneurial rates above that of the native-born population. New entrepreneurial vigor embodied in new capital and consumer goods can raise the standard of living.

Conclusion

In the absence of fundamental reforms to every major federal policy area and on both sides of the nation’s ledger book, the U.S. faces the threat of debt-driven financial crisis and stagnant trend economic growth. “Balanced: 2028” proposes overhauls of the nation’s tax code, and reform to every major area of federal spending—reducing growth in spending over time and reaching balance by 2028. These reforms target the drivers of the nation’s budget challenges and the policy impediments to economic growth. While the incoming administration should pursue each of the elements of this blueprint—it should start with the three most important: tax, entitlement, and immigration. If pursued successfully, the administration will have 4 more years to implement the rest of the plan.



MEMORANDUM

TO: The 45th President and 115th Congress

FROM: Joe Antos, Andrew Biggs, Alex Brill, and Alan Viard¹

DATE: January 1, 2017

SUBJECT: A Balanced Plan for Fiscal Stability and Economic Growth

Introduction

Our plan seeks to achieve long-term fiscal stability and promote economic growth by aligning federal spending and revenue and pursuing market-based policy reforms. The plan limits the national debt to approximately two-thirds of annual GDP in 2040.

The plan emphasizes cuts in the major entitlement programs—Social Security, Medicare, Medicaid, and health insurance subsidies—but still ensures those less fortunate are protected. The plan increases revenue above its recent historical average share of GDP while switching to a consumption tax that allows additional revenue to be raised without hampering economic growth.

Top Three Policy Recommendations

Make Health Care Programs More Efficient

Incentives, rather than controls, would be used to promote greater efficiency while allowing patients and their health care providers to make the best individual decisions within a responsible budget framework. All subsidies would be reformulated to provide greater support to those with greater financial need or higher health risks.

Medicare would be converted to a premium support plan, providing a subsidy to beneficiaries who would choose from among competing health plans. Those selecting more expensive plans (including traditional Medicare) would be responsible for any premium amount above the subsidy.

Federal matching payments for Medicaid would be replaced with block grants, enabling states to manage their Medicaid programs more efficiently and eliminating the incentive to draw more federal funds without

¹ The views expressed here are solely those of the authors and do not reflect the position of the American Enterprise Institute or any other organization.

necessarily providing more or better services. The tax exclusion for employer-provided health insurance would be replaced by a refundable health insurance tax credit providing a fixed dollar subsidy. Subsidies for lower-income individuals who buy insurance through the exchanges would be converted to a block grant to underwrite state-level subsidy programs for private insurance.

Better Target Social Security

The current Social Security benefit formula would be replaced with a flat dollar benefit for all retirees, disabled persons, and survivors, regardless of their earnings history or labor force attachment. The benefit would initially be set at the elderly poverty threshold, but would thereafter be indexed to wage growth. To supplement this flat benefit, workers would be automatically enrolled in employer-sponsored retirement plans with a default contribution of 3 percent of earnings, split evenly between the worker and employer.

The early retirement age would gradually increase from 62 to 65 and the 12.4 percent Social Security payroll tax would be eliminated for all workers age 62 and older. "Experience rating" would be instituted for the employer share of the disability insurance (DI) payroll tax, which would give employers the incentive to provide accommodations to workers with disabilities in order to keep them on the job.

Switch to a Growth-Friendly Consumption Tax

The individual and corporate income taxes and the estate and gift tax would be replaced by the Bradford X Tax, a progressive consumption tax. The X tax consists of a flat-rate, firm-level tax on business cash flow and a graduated-rate household-level tax on wages and fringe benefits.

For married couples, the first \$80,000 of taxable earnings would be taxed at 15 percent, the next \$160,000 of earnings would be taxed at 25 percent, and earnings above \$240,000 would be taxed at 35 percent (bracket ranges would be half as large for unmarried taxpayers). Households would be allowed a nonrefundable credit of \$1,000 for each adult and \$500 for each dependent. There would be no standard deduction or personal exemptions. An earned income tax credit and credits for charitable contributions, health insurance, mortgage interest payments (on mortgages of up to \$250,000), and deductions for child care costs and large employee business expenses would be permitted.

Business firms' cash flow would be taxed at a flat rate of 37 percent. Firms would immediately expense (rather than depreciate over a period of years) all investment, including equipment, structures, land, and inventories. Business tax preferences, except a reformed and permanent research tax credit, would be abolished.

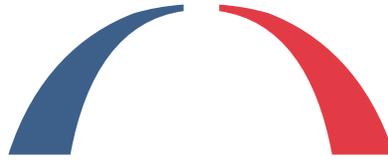
Conclusion

The health care proposal caps federal subsidies for insurance, promotes effective competition and innovation in the health sector, reduces regulatory burden, and develops better consumer information. Subsidies in all federal health programs would be made more progressive, helping those who most need the help. Such policies will provide strong incentives for the private sector to develop new ways to deliver care that improve efficiency and lower the cost per unit of service. Spending reductions are substantial, requiring beneficiaries to shoulder more of the cost of their health care. However, health system improvements are expected to maintain quality of care and access to essential services.

The Social Security proposal protects low earners, is more conducive to saving and longer work lives, and better aligns the work and retirement conditions that will prevail in the coming decades. That will make Social Security solvent and sustainable while reducing program outlays to better accommodate rising costs for other priorities.

The tax proposal increases saving and promotes long-run economic growth by removing the marginal tax penalty on new saving and investment. Because no household-level tax is collected on interest, dividends, capital gains, or other income from savings, there is no household-level penalty on saving. And there is no net business-level tax on a marginal new investment because the tax savings that firms receive from immediately deducting investment costs fully offsets the present value of the taxes on the investment's subsequent cash flows.

Fiscally sound policy will require greater self-reliance, but does not require us to turn our backs on the elderly and the less fortunate. Our proposal narrows the fiscal imbalance, limits the size of government and adopts a more growth-friendly tax code. Although these policies will require difficult choices, they will ensure a vibrant economy and fiscal stability, now and in the future.



BIPARTISAN POLICY CENTER

MEMORANDUM

TO: The 45th President and 115th Congress

FROM: Bipartisan Policy Center

DATE: January 1, 2017

SUBJECT: A Bipartisan Approach to America's Fiscal Future

Introduction

Congratulations on your election victories. You all will shortly take an oath of office to preserve, protect, and defend the Constitution and this great country. The American public has high expectations that you will live up to that oath, but you face many difficult tasks. High among these are achieving strong economic growth while reducing the burden of accumulating debt to be passed on to future generations.

America is at a turning point. We are almost ten years removed from the financial crisis, and the economy is slowly returning to a healthier state. Unemployment is low, some wage growth has returned, and the deficit is lower than it's been since before the Great Recession. But, this year it will start rising again. The annual deficit will exceed \$1 trillion again in less than a decade, and the nation's public debt will exceed the size of the entire economy in less than two decades. The Social Security Old Age and Survivors Insurance Trust Fund is on track for insolvency in 2033, or around the time when a child born this year qualifies for a driver's license.

The challenge is daunting: the baby boomers are entering retirement in large numbers and living longer in retirement than previous generations, and the nation has not yet determined how it will pay for these costs. But that is now your challenge as America's newly elected leaders. Delay will only make the problem more onerous for the leaders who follow you and impose greater burdens on the American people. But, if you choose to accept it, this challenge is also an opportunity. An opportunity to build a more efficient, effective government: a tax system that eases compliance burdens and improves international competitiveness, while raising the revenue necessary to keep our nation's promises to future generations; health care programs that spend taxpayer money more wisely and incentivize quality outcomes over volume of services delivered; and a sustainable, modernized Social Security system that protects older Americans and people with disabilities. These issues loom large, but the potential reward for tackling them is a stronger, more prosperous, and more just nation.

Answering these challenges will require candor, bipartisanship, and willingness to risk the next election. The nation needs leaders who are upfront about the problems we face and bold and straightforward in how to address them. Because the trade-offs are demanding and every American will be affected by these decisions, a bipartisan approach is most likely to succeed. BPC suggests a balanced package of recommendations for your consideration. Reform of our nation's budget and tax system should set the course for prosperity, opportunity, and security for our nation well into the future. If enacted, the proposals developed at the Bipartisan Policy Center (BPC) would stabilize our long-term debt outlook, increase investment in areas that will improve competitiveness and increase prosperity, provide for the nation's defense, and ensure that our federal entitlement programs are protected for existing and future generations.

Top Three Policy Recommendations

While BPC's plan includes recommendations for nearly every major category of fiscal policy, BPC believes that proposals for tax reform, Medicare reform, and greater investment in discretionary spending categories are of the highest priority.

Tax Reform

America's tax system is inefficient and will not raise adequate revenues to meet the nation's needs well into the 21st century. While we must reduce the growth in federal spending on entitlements, we also need a tax code that adequately finances the inevitable expansion of spending on programs for older Americans as the boomers stream into retirement. BPC's proposal envisions a radically streamlined and more equitable tax code for both individuals and corporations. A new code would have only two brackets for the individual income tax with rates of 15 and 30 percent, capital gains and dividends would be taxed at the same rates as earnings, and corporate income would be taxed at a flat rate of 30 percent. BPC's plan would also eliminate most exemptions, deductions, and credits and replace them with a simpler and fairer set of tax credits. These changes would increase the progressivity of the tax system, raise revenue, and ensure that most Americans would no longer have to file an annual tax return.

Health Care Cost Growth

Spending on federal health care programs is estimated to increase by nearly 6.5 percent annually over the next decade, faster than the economy is expected to grow. While Medicare spending per capita has slowed over the last few years, it is unclear to what degree these savings are the result of the recession as opposed to a slowing in the long-term upward march of health care spending. Further, even if per capita spending has slowed, the population eligible for benefits will expand rapidly over the coming decades, driving increased federal and state spending. Therefore, we should implement reforms that help to further reduce health care cost growth and reorient payment systems toward quality outcomes. BPC proposes to build on Medicare physician-payment legislation passed during the 114th Congress to further reduce cost growth in the Medicare program and improve the experience of, and protections for, beneficiaries. These reforms would provide more choices and better incentives for Medicare providers and beneficiaries to participate in alternative payment models, implement competitive pricing in the Medicare Advantage program, and modernize the basic Medicare benefit, among other reforms.

Investments

Discretionary spending, which is appropriated each year, funds many important investments that have the potential to improve American competitiveness and prosperity. For example, these funds fuel many of our nation's scientific endeavors, our investments in education, health, and training, and our investments in transportation. Moreover, virtually all of America's defense budget is supported by discretionary funding. These accounts have been squeezed since sequestration took effect as mandated by the Budget Control

Act of 2011. They have borne the brunt of efforts to reduce the deficit, despite the fact that they are not the long-term drivers of the nation's unsustainable debt trajectory. There has been some relief from these overly-restrictive spending caps in the Murray-Ryan agreement that restored some funding for Fiscal Years 2014 and 2015, but the sequestration of discretionary funds is still the law through 2021. BPC proposes to dedicate a portion of the savings from entitlement reforms and revenue from tax reform to pay for partial reversal of the sequester cuts to fund essential investments in America's future.

Conclusion

This is a crucial moment for America. As the impact of the Great Recession recedes, our nation has a unique opportunity. Our economy has been tentatively restored and we have avoided a crisis—but that doesn't mean it's time to rest. It's time to make decisions that can provide the largest generation of retired Americans to date with security and working America with prosperity.

The three proposals emphasized above would keep the promise of America for all generations: increased revenues, collected more efficiently, to begin paying down our debt; reforms to entitlement programs, to ensure sustainability while protecting those who depend upon them the most; and strategic investments in the nation's future. All three elements are essential to ensure prosperity, opportunity, and fairness for Americans well into the 21st century.

Center for American Progress



MEMORANDUM

TO: The 45th President and 115th Congress

FROM: The Center for American Progress

DATE: January 1, 2017

SUBJECT: Laying the Foundation for Inclusive Prosperity

The beginning of a new Administration and a new Congress presents an opportunity to take a fresh approach to the federal budget, one that lays the foundation for a strong economy that works for everyone.

There are three tests that any budget plan must pass to be taken seriously: it must contain measures to grow the economy by strengthening and expanding the middle class, slow the growth of health care costs for both American families and the federal government, and increase federal revenues over the long term.

A healthy budget requires a healthy economy, and a healthy economy requires a thriving middle class. Recent analysis from the Organisation for Economic Co-operation and Development finds that “income inequality has a negative and statistically significant impact on subsequent growth.” Excessive inequality and a struggling middle class also weaken critical federal programs. For example, a CAP analysis found that the surplus currently in the Social Security trust funds would be more than \$1 trillion larger if payroll taxes still covered 90 percent of wages. Excessive inequality is fiscally irresponsible.

The Center for American Progress quantified the economic struggles facing middle-class families in a report titled “The Middle-Class Squeeze,” and published a detailed policy agenda to address these challenges and build an economy that works for everyone in the “Report from the Commission on Inclusive Prosperity.” The Inclusive Prosperity Commission’s recommendations included investing in infrastructure, innovation, and national service to create jobs; helping middle-class families afford child care, higher education and retirement; and making the tax code more fair and efficient for everyone, in part by eliminating preferences that give special treatment to the wealthy few.

Health care is among the most significant expenses squeezing family budgets, and rising health care costs are also a primary driver of the federal government’s long-term fiscal imbalance. The Affordable Care Act included many policies to slow the growth of health care costs, and these costs have indeed grown unusually slowly over the last few years. Those who care about fiscal discipline should be highly skeptical of any plan

that repeals the Affordable Care Act and starts from scratch, given the tremendous difficulty of enacting lasting policy to control health care costs.

A fiscally responsible budget should build on the successful cost control policies of the Affordable Care Act. President Barack Obama has proposed smart Medicare reforms in his budgets, and “The Senior Protection Plan” from the Center for American Progress offers a set of policies to reduce costs in federal programs without harming patients. To control health care cost growth over the long term, CAP’s “Accountable Care States” proposal would enable states to partner with the federal government to improve their health care systems, with federal and state governments sharing in the savings from these improvements.

Finally, a responsible budget must increase tax revenues over the long term. Maintaining the fiction that tax cuts will lead to economic growth is dishonest, as recent history demonstrates, and creates the false impression that all Americans will benefit. The truth is that the long-term gap between spending and revenues cannot be closed with spending cuts alone—not without damaging or even eliminating programs that are critical to retirement security, poverty reduction, infrastructure, and security, as well as programs that will ensure America continues to innovate and meet the challenges of a digitally connected world.

Bipartisan fiscal commissions consistently recognize that a responsible long-term federal budget plan requires additional tax revenue. Unfortunately, a majority of the House of Representatives and nearly half of the Senate have sworn to oppose any attempt to raise revenue, by signing the “Taxpayer Protection Pledge” circulated by Americans for Tax Reform. As long as so many members of Congress remain sworn opponents of bipartisan fiscal responsibility, the prospects for sustainable action on the long-term debt will remain dim.

We encourage you to review our proposed budget, which increases tax revenues through reasonable measures that also ensure every American and every corporation is paying their fair share. It eliminates wasteful spending through the tax code on both the wealthy, who are better able to pay their fair share, and on industries that do not need special treatment. Where it does spend through the tax code, it does so because the tax code is an efficient and appropriate tool for the specific purpose. For example, we use it to ensure that young children receive high-quality child care so that both of their parents can work. And we use the tax code responsibly, providing a temporary tax credit for middle-income families to share the prosperity of the recovering economy until their wages catch up with the growth in profits of corporations.

Balancing targeted spending cuts with reasonable tax increases prevents the need for catastrophic measures. The good news is that, if done properly and combined with measures to strengthen the middle class and control health care costs without losing the progress from the Affordable Care Act, the benefits to the U.S. economy will be immediate.

We can have an economy that works for all if we have a budget that works for all.



MEMORANDUM

TO: The 45th President and 115th Congress

FROM: Economic Policy Institute

DATE: January 1, 2017

SUBJECT: Investing in America's Economy: A Budget Blueprint for Today and Tomorrow

Introduction

The American economy continues to struggle after the end of the Great Recession and five years of fiscal austerity measures. Economic growth is half of what it normally should be after a recession, and the labor market still displays signs of slack with little wage growth and a high proportion of long-term unemployed. Even with the ruinous austerity measures enacted in the Budget Control Act of 2011 (BCA), the long-term budget outlook sees rising debt ratios even if the economy reaches full employment, largely because too many members of Congress have pledged not to raise taxes.

Our budget proposal starts from a vision shared by most Americans: rising living standards, greater economic opportunity and security, and provision for future generations. To this end, we propose a long-term budget that invests in America's future by repealing the BCA austerity measures and increasing critical public investments, reduces economic inequality and improves economic opportunity, and strengthens our social protection system. Although our budget is crafted to meet these economic and social goals, our proposals also yield sustainable budget deficits and debt over the long term, with debt held by the public falling relative to GDP from its current 74 percent to less than 59 percent by 2026 and finally to 54 percent by 2040.

Policy recommendations

We offer several specific budget provisions to meet these goals, but three are particularly important: increasing public investments, strengthening the social welfare system, and paying for the goods and services Americans need and want from the federal government.

First, we propose to increase spending for public investments by about 1.5 percent of GDP per year (by almost \$400 billion for fiscal year 2018, for example). These investments include increased infrastructure spending for repairing and improving roads, bridges, water and sewage systems, waterways, schools, and

computer infrastructure for important agencies such as the Federal Aviation Administration and the National Weather Service. Our budget further increases spending for education (primary, secondary, and post-secondary), job training, and scientific research and development. These investments will not only boost future economic growth by increasing public capital, human capital, and knowledge, but also will create good jobs in the near term to rebuild America's infrastructure.

Second, our budget preserves and strengthens our country's social welfare system, which helps to soften the sharp edges of our market economy and to maintain public support for the market economy. Social Security finances are improved by raising the cap on taxable earnings. The Supplemental Nutrition Assistance Program (food stamps) cuts are repealed to help feed low-income families and children. The Earned Income Tax Credit (EITC), which encourages work and reduces poverty, is expanded for childless workers. The 2009 expansions of the child tax credit and the EITC, both of which expire in 2017, are made permanent. Our budget further improves unemployment insurance (UI) extended benefits by creating a permanent, federally-funded program that provides benefits for up to 52 weeks.

Lastly, our budget would pay for the increased spending by raising revenue, mostly by reversing recent decades' cuts in top tax rates and by closing tax loopholes. This reversal simply means asking for a bit more from those households that have seen the most rapid income growth in recent decades. Accordingly, we propose broadening the tax base by eliminating many wasteful tax expenditures and tax breaks, such as the mortgage interest deduction and corporate deferral of foreign source income. In addition, we propose increasing the top tax rates for taxpayers earning over \$2 million per year and instituting a carbon tax. These proposals will raise needed revenue, simplify the tax code, help reduce income inequality, and reduce our reliance on fossil fuels. Eliminating wasteful tax breaks will also improve tax compliance and administration. The tax increases are designed to minimize any adverse effects on the economy.

Conclusion

Budget policies adopted in recent years under the misguided notion that budget deficits should be eliminated quickly and only through spending cuts have had devastating consequences. The long-term budget outlook still shows rising debt ratios even if the economy recovers. Our crumbling national infrastructure has caused many preventable deaths and contributes to low economic growth. The recovery from the Great Recession can best be described as anemic. We appear to be well on the road to leaving our children with substantial hurdles to future success: poor infrastructure as well as other substandard public assets, a tattered social safety net, and no ladder to upward economic mobility.

In closing, we strongly urge you to adopt our budget to put America on a long-term path for strong economic growth, rising living standards, greater economic opportunity, and a secure future for our children. The key feature of our budget is our proposal to pay for the necessary increases in federal spending. At the same time, our proposal lowers budget deficits to sustainable levels and gradually reduces the debt-to-GDP ratio from its current 74 percent to 58 percent by the end of the 10-year budget window in 2027. Even after raising taxes to pay for the increased spending, the United States will still have one of the lowest tax burdens of any developed country.

AMERICAN ACTION FORUM

Balanced: 2028

American Action Forum

Douglas Holtz-Eakin and Gordon Gray

INTRODUCTION

The United States currently faces two interrelated challenges: a precarious debt problem and the threat of persistently weak economic growth. Over the long term, dramatically tackling the U.S.'s fiscal challenges would remove an important impediment to growth and increased standards of living, while improved growth eases the difficulty of major fiscal policy changes. Weak economic growth damages the nation's bottom line by reducing revenues and prompting higher spending. Interest on the existing debt compounds these challenges. A pro-growth budget plan reflects these interdependencies and focuses budget savings where they are needed most, while pursuing additional policy goals to spur trend economic growth.

"Balanced: 2028" reflects the experience that the United States is served best by a contained, efficient government focused on core national security and domestic activities, including a durable social safety net. It is guided by the lesson of history that the best approach to simultaneous poor growth and explosive debt is to reform taxes to be more pro-growth, preserve core functions of government, and focus on streamlining transfer programs—entitlement programs in the United States—as the route to controlling debt. It enacts these reforms in a disciplined fashion that avoids precipitous cuts that would harm economic growth and the national well-being.

SPENDING

Medicare, Medicaid, and Other Federal Health Programs

This plan includes the repeal of the Affordable Care Act—on both the tax and spending sides of the federal ledger. The plan would restore provider reductions to Medicare and DSH payments to Medicaid while eliminating the planned expansions in Medicaid and the creation of new health subsidies. The plan also repeals the narrow, industry-level taxes, as well as the new Medicare investment tax and the health insurance surtax.

Instead, the plan would take the approach of beginning with "cost containment"—slowing the growth of

per person health spending and raising the value of healthcare. This means a more modest approach to coverage relative to the costly coverage expansions associated with the Affordable Care Act. However, the approach taken addresses the underlying challenges confronting the nation's healthcare system: cost and the associated pressure on federal resources. This plan would provide states with resources to engage private markets in Medicaid coverage through the private bidding process, yielding savings. Similar market forces would be brought to bear on Medicare. Research suggests that competitive bidding in a reformed premium support program could yield savings approaching 10 percent (relative to a baseline that excludes the changes made by the Affordable Care Act).¹ The approach taken by this plan would gradually phase in with new Medicare enrollees, ultimately yielding significant savings over time. Medicare's outsized share of the health care market means that delivery system changes will permeate the health sector and introduce additional national cost savings. Reform to medical liability should also further constrain cost growth.

Social Security

Avoiding sharp benefit reductions is the goal of any Social Security reform. Gradual reforms that *slow the growth* in promised benefits—not cut them outright—is the responsible approach to the challenge of an aging population and projected benefits that significantly exceed program income. This plan suggests a combination of policy changes that would address the structural imbalance in Social Security over the long term. Importantly, the plan would also address structural challenges in the Disability insurance program and place the program on a sounder structural footing. These reforms largely target future beneficiaries, and also contribute to the sustainability of the overall system.

Defense and Non-Defense Discretionary

The plan restores funding to both defense and non-defense discretionary spending and averts the cuts to these programs arising from the reduced spending caps under current law. However, while overall discretionary funding levels are increased, the plan includes savings within these areas, including the implementation of reforms to constrain growth in civilian and military health costs. The discretionary component of the budget also includes reforms to better target Pell grants. Both defense and non-defense discretionary spending is fixed as a percentage of GDP at the end of the 10-year window, and, thus, grows at the same pace as GDP thereafter.

Other Mandatory

Reform of these programs would see the major income and family support reappropriated to two principal assistance regimes: work support and family support. The Earned Income Tax Credit, SSI, and unemployment insurance would constitute work support programs. Real, per capita benefits would be maintained as under current law. The Earned Income Tax Credit would be repealed as a tax measure, but reinstated as a work incentive payment on a dollar-for-dollar basis. The same approach would be taken with major family assistance programs to include the Child Tax credit, which would be added to support a regime of family assistance programs, such as SNAP. Over ten years, these programs would see comparatively minor savings relative to aggregate program expenditures. Greater savings would accrue over the long term. The plan also includes limitations to mandatory agriculture program spending, as well as additional savings from federal student loan programs.

Additionally, the plan assumes a fundamental immigration reform. On net, such a reform would reduce the deficit and have a positive effect on economic growth—as much as a percentage point over the near term, which would translate into a per capita gain of \$1,500.² Conversely, enforcing existing immigration policies would have a detrimental budgetary and economic effect, requiring an increase in federal spending of

¹ <http://www.aei.org/outlook/health/healthcare-reform/competitive-bidding-can-help-solve-medicare-fiscal-crisis/>

² <http://americanactionforum.org/sites/default/files/Immigration%20and%20the%20Economy%20and%20Budget.pdf>

between roughly \$400 billion to \$600 billion to address the 11.2 million undocumented immigrants and prevent future unlawful entry into the United States. In turn, this would shrink the labor force by 11 million workers and reduce real GDP by \$1.6 trillion.³

REVENUES

“Balanced: 2028” incorporates a fundamental tax reform that would move the U.S. to a progressive consumed-income tax code. This plan would be pro-growth and not penalize savings and investment. Research suggests that implementing a progressive consumed-income tax consistent with AAF’s tax plan would improve long-run economic growth by over 6 percent.⁴

The plan includes a progressive consumption tax in the style of David Bradford’s X-tax and built on by the American Enterprise Institute. The plan would eliminate the current individual and corporate tax code. On the business side, the tax base would be cash flow of all businesses, corporate and non-corporate. Firms would be able to deduct, among other items, purchases from other businesses and employee compensation. The rate applied to the remaining income is flat and set at the same top rate for household portion of tax.

On the individual side, tax rates for joint filers would be 15 percent on the first \$50,000; 25 percent on the next \$100,000; and 35 percent over \$150,000. Brackets for all unmarried taxpayers are half these amounts. All brackets are indexed after 2017 by chained CPI (CCPI)—consistent with other elements of reform on the spending side of the budget. We would provide an exemption for 100 percent of poverty up to a family of 2. This limit would grow at the rate of CCPI.

We should note that this plan does not retain preferential tax treatment for employer-provided health insurance. We believe that this reform is consistent with the goal of addressing health costs first, rather than significant coverage expansions.

The only credits allowed would be: a new credit of 15 percent of charitable contributions in excess of \$500 (indexed by CCPI after 2017) and a new refundable credit for first-time homebuyers (as defined for the American Recovery and Reinvestment Act credit) of 15 percent of the value of the purchased home, claimed in five equal installments (i.e., 3 percent of the value) in each of the first 5 years of ownership. The existing mortgage interest deduction would be phased out for existing mortgages over 10 years.

The goal of this plan is to average 18.2 percent of GDP in revenue over the first ten years, which is equal to the current law revenue baseline. This is consistent with the goal of comprehensive revenue-neutral tax reform. Revenues would continue to rise as a percent of GDP in the future. This plan also assumes across-the-board rate reduction. To the extent revenue continues to increase and surpass outlays, additional rate reduction should be pursued.

CONCLUSION

This approach seeks to address the top domestic policy goals—the need for stronger economic growth and long-term debt reduction—without harming near-term growth. The plan achieves balance by 2028—reflecting the need for significant debt reduction that begins immediately and accrues over time. A central part of the plan is a fundamental restructuring of the tax code—a restructuring that would significantly broaden tax collection to a more economically efficient consumption base, increase simplicity, and generate

³ <http://americanactionforum.org/research/the-budgetary-and-economic-costs-of-addressing-unauthorized-immigration-alt>

⁴ David Altig, Alan J. Auerbach, Laurence J. Kotlikoff, Kent A. Smetters, and Jan Walliser, “Simulating Fundamental Tax Reform in the United States,” *American Economic Review*, 91(3), June 2001, pp. 574-595.

economic growth. The plan relies heavily on reforms to major health entitlement programs, which are the principle drivers of our long-term fiscal challenge. The plan would propose modest reforms to Social Security that would ultimately balance the program over the long term. The plan also imposes modest savings on “other mandatory” programs through reforms that would seek to sustain real per capita benefits for eligible participants. The plan *increases* both defense and non-defense discretionary spending, albeit modestly, compared to current law, while implementing reforms to constrain growth in civilian and military health costs.

Taken together, these changes would set forth a credible and consistent improvement in the U.S. fiscal position. It is indeed this gradual approach that properly balances the near-term impact of unduly precipitous fiscal contraction with the need to address the longer-term drivers of our economic challenges.

Percentage of GDP	2026	2040
Revenues	19.1	22.3
Spending	20.9	17.8
Deficit (-)/ Surplus (+)	-1.8	4.5
Debt Held by the Public	69.4	15.9



A Balanced Plan for Fiscal Stability and Economic Growth

American Enterprise Institute¹

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INTRODUCTION

The objective of this plan is to achieve long-term fiscal stability and promote economic growth. We cannot simply tax our way to fiscal stability without suffering the consequences of a sluggish economy and reduced prosperity. We also cannot simply cut spending without risking the loss of essential services for an aging population, undercutting our infrastructure on which economic growth builds, and reducing our ability to defend the country against its enemies.

Our proposals reduce the national debt from 105.8 percent to 62.7 percent of annual GDP in 2040. Ambitious cuts in federal spending are required to achieve that goal while minimizing tax burdens on the American people and the drag that high marginal tax rates impose on long-run economic growth. The plan emphasizes cuts in the major entitlement programs—Social Security, Medicare, Medicaid, and health insurance subsidies established by the Patient Protection and Affordable Care Act (PPACA).

Many of the policies will undoubtedly be politically unpopular, but some version of our proposal is necessary. None of the authors of this plan fully agree with every policy advanced here, but we have been able to reach the kind of compromise that is needed to address the long-run fiscal imbalance.

Health Care. Our proposed health reforms are intended to slow the growth of spending—both federal and system-wide—while maintaining access to high-quality health services. The reforms establish a clear understanding that there are binding resource constraints without imposing burdensome regulations that impose unnecessary restrictions on consumer choice. Incentives, rather than controls, promote greater efficiency and allow patients and their health care providers to make the best individual decisions within a responsible budget framework. That requires shifting away from the defined-benefit approach that characterizes Medicare and Medicaid today to a defined-contribution philosophy that places a limit on federal spending while recognizing the changing needs of the population. To develop an effective plan, it is necessary to repeal major sections of PPACA and replace them with a new set of policies based on market

¹ The views expressed here are solely those of the authors and do not reflect the position of the American Enterprise Institute or any other organization.

principles and budget realities. Nonetheless, the major objectives of that legislation (such as creating an organized marketplace for insurance, better information for consumers, and expanded federal insurance subsidies for those most in need) are reflected in new policies better able to achieve those goals.

Social Security. The Social Security reform is designed to make the program more effective in protecting low earners, simpler for individuals of all earnings levels to understand, more conducive to saving and longer work lives, and better aligned with the work and retirement conditions that will prevail in the coming decades. That will make Social Security solvent and sustainable over the long term while reducing program outlays to better accommodate rising costs for other priorities, including health care.

Taxes. The federal government raises most of its revenue from individual and corporate income taxes, which are biased against saving and investment. Our proposed tax reform replaces the income tax system and the estate and gift tax with a progressive consumption tax, thereby eliminating the tax penalty on saving and investment. To address environmental concerns in a more market-friendly manner, the proposal replaces an array of energy subsidies, tax credits, and regulations with a modest carbon tax.

Our proposal brings federal spending and revenue into closer alignment, thereby sparing future generations from the explosive growth of federal debt. At the same time, it promotes economic growth by emphasizing spending cuts rather than tax increases and by using an economically efficient consumption tax to raise the revenue that is needed. Real federal spending would continue to increase under the proposal, but at a significantly slower pace than under current law.

SPENDING

Medicare, Medicaid, and Other Federal Health Programs

Our proposal caps federal subsidies for insurance, promotes effective competition and innovation in the health sector, reduces regulatory burden, and develops better consumer information. Subsidies in all federal health programs would be made more progressive, helping those who most need the help. Such policies will provide strong incentives for the private sector to develop new ways to deliver care that improve efficiency and lower the cost per unit of service. Spending reductions are substantial, requiring beneficiaries to shoulder more of the cost of their health care. However, health system improvements are expected to maintain quality of care and access to essential services.

Medicare Reform. Medicare is primarily a fee-for-service program that offers little incentive to patients or providers to hold down costs. It would be converted to a premium support plan, in which a subsidy would be provided to beneficiaries who would choose from among competing health plans. Larger subsidies would be paid to beneficiaries who are in greater financial need or who have higher health risks. Those selecting more expensive plans (including traditional Medicare, which would remain available but at a premium commensurate with its cost) would be responsible for any premium amount above the subsidy.

The annual growth in the premium subsidy would be determined by Congress in conjunction with decisions about other spending priorities. Growth in total Medicare spending would be 1.2 percentage points slower than under current law. This policy is effective starting in 2018. It would be desirable to phase premium support in over 10 or more years, allowing individuals and the health system time to adjust to placing Medicare on a budget. However, a phase-in period also delays the spending reductions needed to achieve our long-term fiscal goal.

Other reforms would address longstanding problems in traditional Medicare. Medicare's eligibility age would be increased gradually to 67, consistent with Social Security. Until premium support is effective, the basic

premiums for Medicare Part B and Part D would increase from 25 percent to 40 percent of each program's cost. Traditional Medicare's cost-sharing arrangements would be simplified, replacing the current cost-sharing rules with a single deductible for Part A and Part B and 20 percent coinsurance for all covered services, and incentives to drop Medigap coverage would be offered to promote cost awareness.

Medicaid Reform. The federal government subsidizes state Medicaid programs through matching payments that cover about 62–64 percent of total costs on average, accounting for the higher match rates for newly eligible beneficiaries established by PPACA. States have developed complex financial arrangements that allow them to draw more federal funds without necessarily providing more or better services. Replacing matching payments with block grants eliminates this perverse incentive and permits states to manage their Medicaid programs more efficiently. Federal Medicaid costs would grow with the economy, allowing for some additional savings due to increased efficiency in the health sector.

States would be permitted to offer premium support for private insurance to Medicaid beneficiaries, on a voluntary basis. In addition, benefit payments for individuals who receive both Medicaid and Medicare benefits (the "dual eligibles") would be converted into fixed payments for insurance plus a contribution to a medical savings account. Dual eligibles may enroll in either a Medicaid or Medicare managed care plan, rather than drawing fee-for-service benefits from both programs.

Insurance Subsidy Reform. Workers currently are not taxed on contributions for health insurance made by their employers. That creates an open-ended and regressive subsidy that has promoted first-dollar coverage and rapid growth in health spending. The tax exclusion would be replaced by a refundable health insurance tax credit that provides a flat dollar subsidy, with higher payments to those with lower incomes and greater health risk. That eliminates the current system's incentive to purchase more expensive coverage and its favoritism toward higher-income purchasers. The health reform legislation establishes a new subsidy for individuals with incomes below 400 percent of poverty who buy insurance through the exchanges. Those subsidies would be converted to a block grant to underwrite state-level subsidy programs for private insurance that are coordinated with the state's Medicaid policies.

Other Reforms. Financing reforms must be accompanied by a host of other changes in the design and operation of the health system. Organized insurance markets, similar in concept to the exchanges but with less federal control that would stifle innovation and competition, are needed to foster effective consumerism. Better information on treatment options, including information on cost and provider performance, is necessary for patients to make informed decisions in conjunction with their doctors. Medical liability reforms are needed to reduce defensive medicine and to give all patients fairer recourse if medical errors occur.

Social Security

The proposal will reduce the growth rate of Social Security outlays in future years to keep the program solvent and to make room in the budget for the growth of other programs, particularly the health-related entitlements. Important changes will be made to the structure of Social Security benefits, to focus more heavily on providing a safety net against poverty for the aged, disabled, and survivors, while instituting new savings accounts outside of Social Security to buttress retirement preparation for middle- and high-earning individuals.

The core element of the reform is a flat dollar benefit that would be paid to all retirees, disabled persons, and survivors, regardless of their earnings history or labor force attachment. The benefit would initially be set at the elderly poverty threshold, but would thereafter be indexed to wage growth rather than the Consumer Price Index. To supplement this flat benefit, workers would be automatically enrolled in employer-sponsored retirement plans with a default contribution of 3 percent of earnings, split evenly between the worker and

employer. Assuming that accounts earn the Trust Fund bond rate of return, the combined benefits of the account and the flat benefit would roughly replicate the generosity and progressivity of Social Security under current law, but would provide significantly better poverty protection for low earners while reducing tax burdens. These reforms would be introduced gradually, taking full effect only when an individual entering the workforce today reaches retirement age.

The reforms also would encourage delayed retirement to ameliorate the effects of population aging. The early retirement age would gradually increase from 62 to 65, and the 12.4 percent Social Security payroll tax would be eliminated for all workers age 62 and older. The combined effect would enhance both individuals' retirement income and the economy.

The reforms address the Disability Insurance (DI) program by coupling policy reforms to reduce medium- and long-term costs with short-term borrowing between the Social Security retirement fund and the disability fund. The plan would institute "experience rating" for the employer share of the DI payroll tax, which would give employers the incentive to provide accommodations to workers with disabilities in order to keep them on the job. This policy is assumed to reduce the disability onset rate to halfway between the Social Security Trustees' intermediate and low-cost assumptions; disability recovery rates are assumed to remain unchanged.

Other Spending

Spending for other mandatory programs would be reduced by eliminating farm subsidies, reducing federal pensions, eliminating the refundable portion of the child tax credit, and other cuts. The proposal assumes that these programs would be reduced by 0.3 percent of GDP.

Defense spending levels should be based on the security needs of the country, rather than arbitrary budget targets. Productivity improvements and reductions in outdated, ineffective, and excessively expensive weapons systems can produce greater defense capability for less money and military personnel management and compensation policies can be modified to reduce costs. The proposal assumes that defense spending would rise to 3.8 percent of GDP by 2030 and remain at that level thereafter.

Nondefense discretionary programs would also face budget cuts to keep spending on the baseline path, which reflects implementation of the sequester. Deep reductions would be made in community and regional development, energy and agriculture spending, and other programs and all programs would enjoy cost savings from reductions in federal employee compensation.

REVENUES

Recognizing the costly health and welfare burdens imposed by an aging population, revenue would rise to 21.1 percent of GDP in 2040 under our plan. Although somewhat above the historical average, this level of revenue is below the disturbingly high levels that would result from leaving current policies in place. Holding revenues to this path will require the type of aggressive spending discipline outlined in this proposal. We propose fundamental tax reform to ensure that the additional revenue is raised without harming long-run economic growth.

Replacement of Income and Estate Taxes by Bradford X Tax

A Bradford X Tax would be instituted, along the lines of the Progressive Consumption Tax plan discussed, but not endorsed, by the 2005 Tax Reform Panel. The X tax consists of a flat-rate, firm-level tax on business cash flow and a graduated-rate, household-level tax on wages and fringe benefits. The X tax would replace the individual and corporate income taxes and the estate and gift tax on January 1, 2018, subject to transition rules.

The X tax is a consumption tax because it imposes no marginal tax on new saving and investment at either the firm or the household level. No household-level tax is collected on interest, dividends, capital gains, or other income from savings. Because firms immediately deduct business investments rather than depreciating them over time, there is no net firm-level tax on a marginal new investment; the tax savings from the immediate deduction fully offset the present value of the taxes on the investment's subsequent cash flows.

For married couples, the first \$80,000 of earnings would be taxed at 15 percent, the next \$160,000 of earnings would be taxed at 25 percent, and earnings above \$240,000 would be taxed at 35 percent in 2018. The bracket ranges would be half as large for unmarried taxpayers. The bracket ranges would be adjusted for inflation, using the chained CPI, after 2018. There would be no standard deduction or personal exemptions, but households would be allowed a nonrefundable credit of \$1,000 for each adult and \$500 for each dependent. Households would be allowed a 15 percent refundable credit for charitable contributions above an annual floor of \$500; the Earned Income Tax Credit computed largely under present-law rules, but with permanent extension of the 2009 increases and a doubling of the credit for childless workers; a refundable health insurance credit, as detailed above; a 15 percent credit for interest on a mortgage of up to \$250,000; and deductions for child care costs and large employee business expenses.

Firms' cash flow would be taxed at a flat rate of 37 percent, approximately matching the X tax plus Medicare payroll tax on the earnings of workers in the top bracket. Firms would expense all investment, including equipment, structures, land, and inventories. With minor exceptions, the tax would be real-based and disregard financial transactions. Business tax preferences, except a reformed and permanent research tax credit, would be abolished.

Changes to Payroll Taxes

Employer-provided health insurance and other fringe benefits would be subject to the payroll tax. Workers aged 62 or older would be exempt from payroll taxes. The 0.9-percentage-point increase in the Medicare payroll tax for high earners adopted by PPACA would be eliminated.

Replacement of Energy Subsidies by Carbon Tax; Gasoline Tax Increase

Subsidies for ethanol and other alternative fuels would be abolished (except for some basic research on renewable energy), along with energy tax credits and regulations intended to lower greenhouse gas emissions. A carbon tax would be imposed in 2018 at a level of \$4 per metric ton of CO₂ equivalent, increasing thereafter by inflation (as measured by the chained CPI) plus 2 percent per year. The carbon tax rate is intended to match the *domestic* social cost of carbon. In the absence of an international agreement to curb carbon dioxide emissions, national wellbeing is advanced by basing the tax on the costs that climate change imposes on Americans.

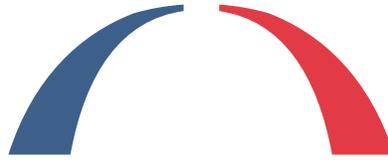
The federal gasoline excise tax would be increased from 18.3 to 30 cents per gallon in 2016 and would be adjusted for inflation (as measured by the chained CPI) in subsequent years. The tax increase would restore solvency to the Highway Trust Fund.

CONCLUSION

Due to transition relief associated with the move to the X tax, our plan initially reduces revenue, and increases debt, relative to current policies, before setting the debt-to-GDP ratio on a declining path. The actual budgetary impact could be even more favorable than shown in the above estimates because they do not account for the increase in GDP likely to result from the move to consumption taxation and the reduction in transfer payments to the elderly.

There are no easy solutions to the country’s fiscal crisis and further delay will only make the decisions harder. Fiscally sound policy will require greater self-reliance, but does not require us to turn our backs on the elderly and the less fortunate. Our proposal narrows the fiscal imbalance, limits the size of government, and adopts a more growth-friendly tax code. Although these policies will require difficult choices, they will ensure a vibrant economy and fiscal stability, now and in the future.

Percentage of GDP	2026	2040
Revenues	19.3	21.2
Spending	21.8	22.5
Deficit (-)/ Surplus (+)	-2.5	-1.4
Debt Held by the Public	76.7	62.7



BIPARTISAN POLICY CENTER

A Bipartisan Approach to America's Fiscal Future

Bipartisan Policy Center

Bill Hoagland, Steve Bell, Shai Akabas, and Brian Collins

INTRODUCTION

The Bipartisan Policy Center (BPC) has long been concerned with the trajectory of our public debt. From the time BPC started the Domenici-Rivlin Debt Reduction Task Force in 2010, BPC's stance has been clear: the U.S. finds itself on an unsustainable fiscal trajectory because the cost of our entitlement programs—especially health and retirement—are not aligned with the revenue brought in by our tax code.

The health of the U.S. economy will be damaged if we do not fundamentally alter the current trajectory of federal debt. Attacking the ever-unpopular waste, fraud, and abuse in government programs will not be enough. The only way to get our fiscal house in order is for federal policymakers to weigh competing priorities and make difficult choices among them. Those difficult choices must include enacting structural reforms that reduce the growth in spending on our federal entitlement programs and significant structural reforms to our federal tax code. Such an agenda—structured in a prudent way that induces strong economic growth, increases revenues, and protects low and middle-income Americans—is what will bring the long-term budget outlook into balance.

Some have pointed to relatively low deficits over the past few years and the savings resulting from the Budget Control Act of 2011 (BCA) as evidence that our nation's fiscal problems are behind us. But they are mistaken—this is just the calm before the storm. Even with relatively slow cost growth in health care over the past few years, the retiring of the baby boomers will put ever-more pressure on Social Security and Medicare; the return to more normal economic times will bring higher interest payments as interest rates return closer to historical averages; and as we have repeatedly indicated, sequestration levels of discretionary spending are too low for our country to fund important investments in the future and protect our country in an increasingly dangerous world.

BPC believes that the plan offered here is one that will help the U.S. maintain international competitiveness, promote a level and fair playing field for all Americans, and ensure our country's fiscal health into the future. It is a balanced plan that reduces projected spending by 7 percent while increasing revenues by 9 percent in 2040. It would reduce debt as a share of the economy in 2040 from a projected 108 percent of GDP to

76 percent. While policymakers may disagree with individual pieces of the plan, BPC believes that the hard choices of the type recommended here are the only way to make sure our country continues to prosper well into the 21st century.

SPENDING

Federal Health Programs

Spending on federal health care programs is expected to grow faster than any other non-interest spending category over the next two decades. While there has been a welcome slowdown in per-capita cost growth, it is questionable whether this slowdown will persist. Policymakers should not assume it will. Because Medicare is the federal government's best lever to encourage system-wide health care improvement, BPC proposes reforms to improve the program and further reduce health care cost growth.

BPC's proposed reforms to Medicare would address many longstanding challenges and build on previous efforts, such as the Medicare Access and CHIP Reauthorization Act (MACRA), enacted in April 2015. Beneficiaries and providers need more choices and better incentives to participate in alternative payment models (APMs), such as BPC's proposal for a new generation of enrollment-based accountable care organizations (ACOs) called Medicare Networks, which would give providers a larger stake in cost, quality outcomes, and patient satisfaction. MACRA was an important start, and BPC proposes to extend differential updates (higher updates for providers that adopt APMs, lower for those that do not) to all Medicare providers. Additionally, BPC proposes beneficiary incentives for enrolling and accessing care from high-performing Medicare Networks, including premium and cost-sharing reductions. BPC also proposes to implement competitively priced Medicare Advantage (MA) benchmarks and better integrate the prescription drug benefit within the MA program.

BPC recommends modernization of the basic Medicare benefit, which is outdated and fails to provide adequate protections for beneficiaries. BPC proposes to establish a single, combined annual deductible of \$500 for Parts A (hospital/facility care) and B (physician/medical care), exempting physician office visits (i.e., beneficiaries could see their doctor for a small copayment even if the deductible is not yet met). Beneficiaries would be protected by a new, annual cost-sharing cap of \$5,400, and coinsurance would be replaced with a simplified copay schedule. First-dollar coverage by Medicare supplemental plans (including Medigap, employer-sponsored plans, and TRICARE-for-Life) would be limited to address incentives for overuse of services and support development of APMs. Specifically, these plans would be prohibited from covering the first \$250 of the proposed combined deductible and would not cover more than half of copayments and coinsurance. MACRA limits first-dollar coverage up to the Part B deductible amount for Medigap only, and it exempts plans sold before 2020.

BPC proposes to expand cost-sharing assistance for low-income beneficiaries—reducing cost sharing by half for beneficiaries between 100 and 135 percent of the Federal Poverty Level (FPL) and reducing cost sharing by 25 percent for those between 135 and 150 percent of FPL—and to reduce subsidies for higher-income beneficiaries. Under current law, most beneficiaries pay Part B and D premiums equal to 25 percent of program costs (about \$105 per month for Part B in 2015) or less, and about 10 percent of beneficiaries pay more, beginning at 35 percent of program costs and rising to 80 percent progressively with income. MACRA will increase premiums further for some beneficiaries who are already paying income-related premiums. Under BPC's proposal, income-related premiums would be expanded to include about 20 percent of Medicare beneficiaries. BPC also proposes a variety of policies that would encourage service delivery in lower-cost settings and encourage the use of low-cost, high-quality drugs.

While needed, BPC does not propose major changes to Medicaid or exchange coverage at this time, but has ongoing efforts in these areas. BPC proposed extending full funding for the State Children’s Health Insurance Program (CHIP) for two years (as passed in MACRA), while addressing coverage gaps, benefit and cost-sharing challenges, and over the long term, eligibility for public and private coverage to allow children and parents to be enrolled in the same insurance plan, eliminating the need for CHIP. BPC is also examining challenges associated with the Affordable Care Act (ACA) and potential policy solutions to be released later this year. Separately, BPC is exploring ways to achieve additional federal savings in Medicare through better integration of health care and Medicaid-covered long-term services and supports for dually eligible beneficiaries and other high-risk individuals. BPC anticipates releasing recommendations that address these two areas in early 2016.

Social Security

BPC’s Social Security proposal includes a balanced set of policies to reduce spending growth and increase revenue (included in the revenue section below). These changes would improve solvency while enhancing the adequacy of the system for those who rely on it most. To achieve cost savings, BPC proposes to index benefits for increases in longevity, base cost-of-living adjustments on the chained CPI, and adjust the benefit formula to modestly reduce benefits for higher-earning beneficiaries. At the same time, BPC proposes to protect long-career, lower-earning workers by increasing the special minimum benefit. BPC also would require participation of all new employees of states and localities.

Discretionary Spending

The levels of annually-appropriated spending allowed under the BCA sequester caps are too low. They do not allow us to adequately fund the readiness of our armed forces or to make important investments in science, health, education, and infrastructure. For that reason, BPC proposes to remove half of the impact of sequestration (relative to the pre-sequester caps set forth in the BCA) for both defense and non-defense discretionary spending by Fiscal Year 2021 and to grow discretionary spending with GDP thereafter. BPC also proposes to reduce the amount of spending on Overseas Contingency Operations to that needed to support 30,000 troops by 2017, in line with dwindling operations. These funds, which are not subject to the BCA caps, should only go to pay for the variable costs of deploying U.S. troops abroad.

Other Mandatory Spending

BPC’s proposal includes the fiscal and macroeconomic effects of reforming America’s immigration system to expand enforcement that reduces future unauthorized immigration, provide legal status for individuals who are already here, and improve the legal immigration system, including pathways for lesser-skilled and high-skilled workers. Additionally, BPC proposes a variety of reforms to federal civilian and military retirement programs, comprehensive reform of government-sponsored enterprises embodied in the Housing Finance Reform and Taxpayer Protection Act of 2014, indexation of federal benefit programs using the chained CPI, and modernization of federal farm programs, including reducing subsidies in the crop insurance program.

REVENUES

BPC’s tax reform plan would radically simplify the current tax code and, by 2040, would increase revenue from 19.5 percent to 21.3 percent of GDP. The plan redesigns the federal income tax system to make it simpler, fairer, more progressive, and more efficient.

The new tax code would include only two income tax brackets, with rates of 15 and 30 percent.¹ These rates would apply to both ordinary and investment income, and the income levels to which the rates apply would

¹ The 30 percent rate would apply approximately to income above \$51,000 for single filers and \$102,000 for couples.

be indexed to the chained CPI.² The corporate tax system would change from one with the highest top rate in the developed world—35 percent—to one with a flat rate of 30 percent. BPC’s plan would eliminate most exemptions, deductions, and credits in the current tax code and replace many of them with a simpler and fairer set of tax credits.

- The constellation of the standard deduction, personal exemption, Earned Income Tax Credit (EITC), child tax credit, and child and dependent care tax credit provide important work supports for low-income Americans. But the rules for these tax breaks are quite complicated, and they are difficult to administer. The plan would retain the child and dependent care credit and replace all four of the other credits with two refundable credits:
 - A refundable per-child tax credit of \$1,600 and;
 - A refundable earnings credit worth 17.5 percent of the first \$20,000 of earnings.
- The current system of itemized deductions, including the mortgage interest and charitable contribution deductions, overwhelmingly benefits higher earners. The plan would eliminate several major deductions, including the deductions for charitable giving, mortgage interest, and state and local taxes and replace them with:
 - A flat 15 percent refundable tax credit for charitable contributions and for up to \$25,000 per year (not indexed) of mortgage interest on a primary residence. (These refundable credits would begin at 20 percent in 2017, and then phase down to 15 percent over five years.)
 - Allow individuals to deduct miscellaneous expenses only if they are in excess of 5 percent of AGI rather than 2 percent under current law and to deduct medical expenses in excess of 10 percent of AGI.
- Under current law, a variable amount of Social Security benefits are taxable (either 0, 50, or 85 percent based on taxable income). BPC’s plan would include 100 percent of Social Security benefits in taxable income, but that would be partially offset by the combination of:
 - A non-refundable credit for Social Security beneficiaries equal to 15 percent of the current standard deduction; and
 - A non-refundable credit equal to 15 percent of an individual’s Social Security benefits.
- Under current law, employer-sponsored health insurance premiums are excluded from the taxable income of employees. ACA’s “Cadillac tax” effectively limits this exclusion by imposing an excise tax of 40 percent on plans that exceed certain limits. But a more direct approach would be superior. The plan would repeal the Cadillac tax and replace it with a limit on the income-tax exclusion for employer-provided health benefits.³ The limit would apply to employer and employee premiums for health, dental, vision, and supplemental indemnity insurance and to contributions to health reimbursement accounts and health savings accounts (flexible spending accounts would be eliminated) at dollar amounts equivalent to the 80th percentile of single and family premiums for employer-sponsored insurance premiums beginning in 2017 (age- and gender-adjusted). The limit would be indexed to per-capita GDP growth through 2024 and to per-capita GDP growth + 0.5 percentage points thereafter.
- Increase the gas tax by 15 cents per gallon and index it to inflation, dedicating the revenue to the Highway Trust Fund.
- Increase taxes on tobacco and alcohol, and introduce a tax on sweetened beverages.

The plan would simplify corporate taxation by establishing a flat rate of 30 percent and repealing a number of tax expenditures that distort incentives for businesses.

Additionally, the plan would adjust payroll taxation to shore up Social Security and Medicare. The taxable maximum would be increased from its current level to 90 percent of covered earnings over 38 years. The plan would also repeal the payroll tax exclusion for cafeteria plans, include newly-hired state and local government

² The first \$1,000 of realized net capital gains or losses would be free of taxation (\$500 for singles and heads of household).

³ The same limit would apply to the deduction for health insurance premiums for the self-employed.

workers, and eliminate a number of payroll tax expenditures that provide incentives for employers to provide non-cash compensation to their employees like transportation, parking, child care, meals and lodging, life insurance, and accident and disability insurance.

BPC’s tax reform plan simplifies the tax code by aligning the top individual, capital gains and dividend tax rates with the significantly-reduced corporate tax rate, while eliminating the alternative minimum tax. Additionally, most individuals will no longer have to file an annual tax return beyond an initial declaration of status because the most commonly taken deductions are either converted into refundable credits, determined solely based on the number of children and earnings, or can be deducted only above a substantial floor. Despite a low top rate of 30 percent, BPC’s tax system will increase progressivity and will raise substantial revenue.

CONCLUSION

U.S. policymaking is often myopic. Elected officials too often focus only on the near term, frequently overlooking what may be best for future generations. But in an environment where growth is stagnating across much of the developed world, we can no longer afford this approach. We must set fiscal policy on a sustainable track—one that is competitive, invests in critical priorities, and preserves U.S. leadership for the next generation.

The package outlined above is a balanced one that makes measured reductions to the growth of projected spending while bringing in additional revenues to support an aging population. It updates entitlement programs, a tax code, and an immigration system that were crafted in the previous century and have not kept up with changing societal and economic dynamics. This agenda would modernize these elements of federal policy in ways that improve their efficiency and result in better outcomes. BPC’s proposed reforms reflect important priorities of both political parties—including equity, competitiveness, investment, and fiscal responsibility—and represent achievable changes to the structures in place today.

Percentage of GDP	2026	2040
Revenues	19.4	21.3
Spending	22.5	24.3
Deficit (-)/ Surplus (+)	-3.1	-3.0
Debt Held by the Public	71.3	75.5

Center for American Progress



Laying the Foundation for Inclusive Prosperity

Center for American Progress

By Harry Stein and Alexandra Thornton

INTRODUCTION

The central challenge of our time is building an economy that works for everyone, not just the wealthy few. The economy is growing, corporate profits have soared, and unemployment is falling. But wages have remained stagnant as the benefits of the recovery have flowed mostly to those at the very top. This is not a new challenge—productivity growth has not translated into consistent wage growth since the 1970s. But while wages remain stagnant, the pillars of middle-class economic security—such as higher education, child care, retirement, health care, and housing—have grown disproportionately expensive and out of reach for American families. The Center for American Progress quantified this phenomenon in a report titled “The Middle-Class Squeeze.”

Fortunately, this is a challenge that the United States can solve. The Center for American Progress recently released the “Report from the Commission on Inclusive Prosperity,” which convened progressive policymakers from the United States, the United Kingdom, and other industrial democracies. This report identified a set of policies to grow the economy by strengthening the middle class and helping more working families achieve middle-class economic security.

Our plan implements an agenda based on the recommendations of the Inclusive Prosperity Commission and other CAP policy development. These policies would create jobs and raise wages, help families afford the pillars of middle-class security, and level the playing field for American workers and businesses. However, this agenda cannot be implemented as long as lawmakers continue to insist on fiscal austerity—a misguided and premature effort to hit arbitrary budget targets that has caused unnecessary economic harm in both the United States and Europe in recent years. A budget that works for all Americans cannot be sustained as long as lawmakers continue to make arbitrary spending cuts and reject any proposal to increase revenue even through reforms that would make the tax code more fair and efficient.

Our plan demonstrates that the United States can afford modern infrastructure, quality education from preschool through college, and a strong safety net to lift up Americans who fall on hard times. Our plan further demonstrates that the United States can sustain fundamental retirement and health care guarantees

for the long term, and that there is no fiscal imperative to cut Social Security. The United States can cultivate an innovative and competitive business environment, where Americans can balance their work and family obligations. In short, the United States can afford to build an economy that works for all.

SPENDING

Building an Economy that Works for All

A healthy budget requires a healthy economy with full employment and rising wages. The centerpiece of our plan is a comprehensive set of policies to create good jobs and lower the barriers that keep people on the sidelines of the economy. Federal budget terminology tends to place these policies in boring-sounding categories called “nondefense discretionary spending” or “other mandatory programs,” but this is exactly where the United States will need to invest to lay the foundation for an economy that works for everyone.

Our plan includes the Inclusive Prosperity Commission’s recommendation to increase federal infrastructure spending by \$100 billion each year for 10 years to create over 1 million jobs. There are more than enough productive uses for this funding, since the American Society of Civil Engineers estimates that bringing American infrastructure into a state of good repair by 2020 will require an additional investment of about \$1.6 trillion.

In addition to infrastructure, our plan doubles federal investment in general science and basic research to create new jobs in cutting-edge fields, and strengthens the American education and workforce development system to make sure Americans can compete for those 21st-century jobs. Our plan implements President Obama’s Preschool for All initiative, provides \$5 billion in annual K-12 education grants for states that increase the rigor of their teacher preparation and development programs, and provides financial support for all students to afford higher education through CAP’s College for All plan. For today’s workers, our plan expands apprenticeships, creates 600,000 summer and year-round jobs for struggling youth, increases in-person career counseling for the long-term unemployed, and improves industry-recognized credentialing programs. Finally, our plan also includes the paid leave benefits provided by the FAMILY Act for caregiving and short-term disability.

Our plan puts Americans directly to work by fully funding the 250,000 national service positions authorized by the Serve America Act, and automatically creates additional positions in times of high long-term unemployment to engage the engine of service when it will deliver the most economic benefit. Additionally, our plan helps struggling workers get a foothold in the labor market with a subsidized jobs program along the lines proposed in CAP’s recent report titled “A Subsidized Jobs Program for the 21st Century.”

The economy works best when everyone can fully participate. In a society as wealthy as ours, hunger should not be preventing children from growing up healthy and achieving their full potential. Our plan reorients federal food subsidies by expanding nutrition assistance for children during summer months when school lunches are unavailable and implementing the farm subsidy reforms recommended by President Obama. Our plan also brings people off the sidelines of our economy by enacting the Smarter Sentencing Act to reform the criminal justice system, which reduces federal spending on incarceration.

Immigration has always been a source of strength for the United States, but a broken immigration system keeps millions of undocumented immigrants on the sidelines, not able to contribute to their full potential. Our plan enacts comprehensive immigration reform, which grows the economy and reduces the deficit.

The nondefense discretionary budget includes many vital programs that have been undermined by recent budget cuts. Our plan prevents further cuts by increasing nondefense discretionary funding to account for

inflation and population growth. After the first 10 years, our plan matches the recommendations CAP made in Solutions Initiative II to ensure stable funding for nondefense discretionary programs.

Social Security

Social Security is the cornerstone of American retirement security, with about 90 percent of elderly Americans, defined as age 65 and above, collecting Social Security in 2012. Also in 2012, Social Security reduced the elderly poverty rate from 44.4 percent to 9.1 percent. Many elderly and disabled Americans still live in poverty, however, so our plan increases the minimum benefit provided by Social Security and Supplemental Security Income.

Our plan prevents a sharp cut to Social Security Disability Insurance by allowing a routine payroll tax reallocation between the retirement and disability trust funds. The scorekeeping rules for the Solutions Initiative assume that Congress will take this action “to keep the program solvent in 2016 if necessary.”

Health Care

Health insurance is vital to middle-class economic security. Our plan protects Medicare by permanently repealing the automatic cuts imposed by sequestration. Our plan also permanently extends the Children’s Health Insurance Program, which would otherwise expire on September 30, 2015. To ensure that health care remains affordable, our plan builds on the cost control policies in the Affordable Care Act by implementing further cost control measures contained in President Obama’s budget and a CAP report titled “The Senior Protection Plan.”

Finally, our plan includes CAP’s “Accountable Care States” proposal to keep health care costs in check for both government and American families. This plan empowers state governments to control health care costs and share the resulting savings with the federal government.

National Defense

Our plan replaces the arbitrary spending caps imposed by sequestration with the funding levels in President Obama’s budget, which includes the recommendations made by military leaders for the next 5 years as part of the Department of Defense Future Years Defense Program. Additionally, our plan phases out the Overseas Contingency Operations budget to prevent it from being used as a slush fund. After the first 5 years, our plan grows the defense budget at the rate of inflation plus 1 percent of GDP to ensure that the military remains prepared to respond to new threats around the world.

REVENUES

How government raises revenues plays a significant role in creating an economy that works for everyone, not just the wealthy few. Our current tax code contains many special tax breaks that enable people with high incomes and accumulated wealth to avoid tax while middle-class working people pay tax on all of their wages. Meanwhile, many businesses and corporations take advantage of tax loopholes and engage creative tax advisers, with the result that some companies pay little or no tax while others pay close to the top tax rate. Another problem with our tax system is that less of our tax revenue today comes from income and estate taxes, which can be tied to the level of income and wealth and historically have offset the burden of payroll and excise taxes on low- and middle-income workers.

If everyone paid their fair share of taxes, that would go a long way toward creating a sound budget plan, while contributing substantially to tax simplicity and creating a level playing field for American workers and businesses.

But, in the long term, closing loopholes will not be enough. Our population is growing and it is aging, which means fewer workers relative to the overall size of the population and more demands on Social Security, Medicare and other safety net programs. The hard truth is that we will need more revenues to sustain our budget in the long term, especially if we want to invest in modern infrastructure, high-quality education, and innovation. We can raise reasonable additional revenues and remain one of the lower-taxed countries among our major competitors. Doing so will also help us maintain our economic strength in an increasingly global and technologically savvy world.

A Fair Tax Code

We have included a number of tax provisions from our earlier Solutions Initiative plans that are aimed at restructuring the tax code for greater fairness and simplicity. As we recognized in our earlier plans, most major tax expenditures are heavily skewed to upper incomes. Thus, a key feature repeated here is to turn the standard and itemized deductions into tax credits so that the tax benefit is the same for most taxpayers.

As before, we have simplified the tax code by making the new standard credit large enough to reduce the number of taxpayers who will need to itemize. Another measure repeated in this plan is a substantially higher child tax credit, as well as a credit for non-child dependents. Together, these credits replace the personal and dependent exemptions in current law and further simplify the tax code for individuals.

To address the fact that wages have not caught up with the economic recovery, we have included a temporary tax credit for the middle class. This will support their wages in the short term and in turn will help grow the economy as they spend those funds.

Affordable child care is a critical element of any pro-family economic agenda, due to the increasing number of families with two working parents. Studies increasingly show that the quality of child care for children under 5 years of age has significant ramifications for success later in life; yet high-quality child care is out of reach for many working families, which ultimately impacts the economy. We believe the most efficient and fair way to deliver high-quality child care to young children is through a tax benefit delivered directly from the government to certified high-quality child care providers. This would be available to all low- and middle-income families, phasing out above \$90,000 of income.

More Revenue in the Long Term

Tax return data shows that the average tax rate paid by individuals with incomes above half a million dollars is relatively flat. Even though individuals with incomes in the top 1 percent and especially the top 0.1 percent have seen their incomes increase dramatically in the recovery, they pay the same top marginal income tax rate of 39.6 percent on all of their wage income above roughly half a million dollars. Our plan would add an additional 5 percent tax on income over \$1 million. Also, because more than 90 percent of the benefits of reduced tax rates on capital gains and dividends accrue to the top 20 percent of taxpayers, our plan would tax dividends as ordinary income, tax capital gains at a top rate of 28 percent, and close the stepped-up basis loophole that currently allows wealthy families to avoid paying any income tax at all on the gain from capital assets they transfer at death.

Many of the above policies would help create jobs and raise wages, address inequality and help families afford the pillars of middle-class security. Our plan also would ask corporations to pay their fair share, primarily through the elimination of corporate loopholes which in turn would help level the playing field for American businesses. It also includes a small tax on financial transactions to discourage high-frequency trading and a tax on large financial institutions—two measures that would increase financial stability and ensure that Wall Street is paying its fair share of taxes. At the same time, we have retained and made permanent corporate tax spending aimed at research and experimentation, as well as innovation that will

help prepare the U.S. economy for a clean energy future.

We believe that the corporate tax code should raise more revenue than it has in recent decades. We envision a higher effective tax rate on corporations, while leaving open the potential for lowering the statutory corporate tax rate through loophole closers and other base-broadening measures. Because we believe that the corporate tax code should be reformed to raise additional revenue over current levels, we have included certain corporate tax measures in our plan as a first step for corporate tax reform. For example, we include the President's proposed changes to the international tax system to address growing concern about tax avoidance by large multinational companies.

Finally, to strengthen Social Security and Medicare for the long term and avoid sharp cuts in benefits due to trust fund exhaustion, we include two measures that would increase revenues going into the trust funds: removing the cap on the employer's share of the Social Security tax and making income in cafeteria plans subject to Social Security and Medicare payroll taxes. And our plan would impose a carbon tax beginning in 2027, in recognition of the fact that climate change poses a serious threat to our economy, as well as the natural environment.

CONCLUSION

Our plan demonstrates that progressive ideas to build an economy that works for everyone, such as the policies advocated by the Inclusive Prosperity Commission, are fiscally responsible. We put an end to misguided short-term austerity and instead focus on the more important goal of growing the economy. Under our plan, the national debt would be on a declining path as a share of GDP, and the budget would gradually reach full balance. When spending and revenue decisions are based on fairness and investment for the long term, the choices become clear.

Percentage of GDP	2026	2040
Revenues	20.8	23.2
Spending	22.8	22.6
Deficit (-)/ Surplus (+)	-2.0	0.6
Debt Held by the Public	66.6	45.8



Investing in America's Economy: A Budget Blueprint for Today and Tomorrow

Economic Policy Institute

Josh Bivens and Thomas Hungerford

INTRODUCTION

The American economy continues to struggle after the end of the Great Recession and five years of historically austere federal spending during an economic recovery. Economic growth is half of what it normally should be after a recession and the labor market still displays signs of significant slack, with little wage growth and a high proportion of long-term unemployed. Even with the large spending cuts enacted in the Budget Control Act of 2011 (BCA) and a rapid decline in projected health care cost growth, the long-term budget outlook shows future deficits large enough to raise the country's debt-to-GDP ratio even if the economy reaches full employment. As a matter of arithmetic, this higher ratio results from increases in revenue relative to GDP that lag federal spending increases, which are in turn driven largely by rapid growth in nationwide health care costs.

Too many policymakers and economic observers treat budgeting as little more than an accounting exercise, in which the goal is simply to make the spending and revenue lines meet. While our budget plan achieves a sustainable debt path, it was crafted with a broader goal in mind: to create a better economy and society.

Our budget proposal starts from a vision shared by most Americans: rising living standards, greater economic opportunity and security, and provision for future generations. To this end, we propose a long-term budget that adheres to our set of guiding principles.

First, America needs to invest in the future by repealing the BCA spending cuts and increasing critical public investments. These investments will not only boost future economic growth by increasing public capital, human capital, and knowledge, but also will create good jobs in the near term to rebuild America's infrastructure.

Second, fiscal policy must address the enormous rise in economic inequality and improve economic opportunity. The tax system has become less progressive over the past 50 years, thus exacerbating income inequality. Our plan restores fairness and progressivity to the tax system by increasing tax rates at the top and on the intergenerational transfer of extreme wealth.

Lastly, the country's social protection system, which helps to soften the sharp edges of our market economy and to maintain public support for the market economy, must be preserved and strengthened. Our budget plan strengthens Social Security's finances, improves unemployment insurance (UI) extended benefits, restores funding for nutrition assistance, and builds on the Affordable Care Act (ACA) to contain long-term health care costs.

In recent years, pundits and policymakers have been far too quick to assume that budget deficits are always and everywhere too large, and that—practically if not rhetorically—job creation has taken a back seat to cutting federal spending. We reject this view and propose a budget that increases spending for critical needs and pays for this increased spending by raising revenue. Ultimately, our budget creates jobs in the near term, fosters future economic growth, and puts the federal budget on a long-term sustainable path.

SPENDING

Our spending policies are designed to promote immediate job creation, strengthen the middle class, expand economic mobility and opportunity, and foster future economic growth. Our plan includes proposals in the following categories:

Medicare, Medicaid, and Other Federal Health Programs

Our plan protects and strengthens the social insurance programs that ensure health coverage for those who are otherwise unable to receive affordable coverage. As the cost of providing health care escalates, however, it is imperative that we slow the rate of rising *national* health care expenditures instead of simply shifting rising costs from the federal government onto households or state governments.

Our budget establishes a public health plan in the ACA Health Insurance Exchanges, which would increase competitive pressures on other health insurers selling policies through the health exchanges.

Using government monopsony (single-buyer) power to contain costs, our plan would negotiate lower Medicare Part D drug prices, encourage bundling payments, accelerate generic drug availability, and finance investments in health information technology and research into comparative effectiveness.

Furthermore, our plan expands the jurisdiction of the Independent Payment Advisory Board (IPAB) to the private sector. This super-charged IPAB, in addition to our other health policies, should sufficiently contain nationwide (and thus government) health care costs. If it does not, we then propose an all-payer IPAB system that caps federal health spending at nominal GDP plus 1.85 percent beyond 2022. Lastly, our plan repeals the sustainable growth rate formula for Medicare physician payments.

Social Security

Social Security has kept more seniors, disabled persons, and children out of poverty than all other social welfare programs combined, and for 75 years it has provided economic support for millions more. As businesses continue to shift risk to individuals by replacing private pensions with tax-preferred personal savings accounts, Social Security is proving an increasingly important pillar of retirement.

However, as income inequality has increased over the past 35 years, a larger share of earnings has not been taxed, thus depriving the Social Security system of revenue. Our plan recognizes the need to shore up Social Security while protecting benefits: the maximum taxable earnings level for payroll tax contributions is increased so that 90 percent of covered earnings are taxable. Furthermore, our plan would expand Social Security coverage to newly hired state and local government workers.

Defense Discretionary

Our plan replaces the frontloaded BCA discretionary spending caps and sequester for defense spending with comparable cuts that are in line with those proposed by the Congressional Progressive Caucus budget. Additionally, we propose a 0.025 percent of GDP increase in defense discretionary spending for research and development.

Nondefense Discretionary

A balanced approach to fiscal sustainability requires boosting employment in the near term and investing in long-term growth. An excessive focus on restraining debt ignores ways in which simple-minded spending cutbacks can shortchange future generations by leaving them with inadequate roads, bridges, schools, knowledge, health, or environmental quality. The current budget trajectory underinvests in physical, human, and environmental capital. Consequently, our budget starts with the repeal of the entire BCA, which applies disproportionate cuts to the non-security discretionary budget, half of which consists of public investment.

Our budget further invests in our nation's infrastructure, education and training, and research and development by financing a permanent increase in public investments of \$300 billion in 2017, which is then indexed to GDP growth in subsequent years. In addition, the Highway Trust Fund is fully funded on a permanent basis. Finally, our proposal substantially increases funding for research and development by the National Institutes of Health (NIH) and the National Aeronautics and Space Administration (NASA).

Other Mandatory

Our budget preserves and strengthens our country's social welfare system. It restores the Supplemental Nutrition Assistance Program benefits that were cut by the 2014 Farm Bill to help feed low-income families and children.

The Earned Income Tax Credit (EITC), which encourages work and reduces poverty, is expanded for childless workers. Additionally, the 2009 expansions of the child tax credit and the EITC, which expire in 2017, are made permanent.

Lastly, our budget improves UI extended benefits by creating a permanent, federally-funded program that provides benefits for up to 52 weeks. This proposal is in line with President Obama's fiscal year 2016 budget proposal.

REVENUES

The current tax code fails along many dimensions. First, tax receipts have been deliberately driven down over the past 15 years to levels that will produce unsustainable budget deficits as far as the eye can see. The Bush tax cuts, for example, are a core reason that sizable structural deficits are projected if fiscal policy remains unchanged. Second, changes in tax policy have exacerbated income inequality, and tax progressivity must be restored to address the large rise in inequality of incomes in recent decades. Third, tax code complexity for both individuals and corporations is such that a tax bill can depend as much on the quality of one's accountant as on the size of one's income.

High-income households and corporations now often pay far less in taxes than what an optimal tax system would collect from them. Under our proposals, higher-income earners and corporations would contribute more.

Individual Income Taxes

The Bush tax cuts were costly and ineffective, and the evidence shows their failure to boost economic growth. The tax system has also become less progressive over time as tax rates have been reduced. Our budget eliminates the reduced tax rates enacted in 2001 for taxpayers in the 25 percent tax bracket and above (the richest 20 percent). Two new tax brackets are added for the highest-income taxpayers: a 43 percent tax bracket on income between \$2 million and \$10 million, and a 47 percent tax bracket on income over \$10 million. Furthermore, our plan taxes income derived from wealth—qualified dividends and capital gains (with a 35 percent exclusion)—as ordinary income rather than at the current reduced rates.

Corporate Income Taxes

The corporate tax code is rife with inefficient and costly special-interest tax breaks. First, our plan starts by adopting the Obama administration’s proposals to eliminate fossil fuel tax subsidies, which are unnecessary and inhibit the transition to a more sustainable economy. Second, our plan eliminates the tax deferral of foreign-source active income and limits the ability of U.S. corporations to expatriate for tax purposes. Third, some inventory methods that are unjustified and unnecessarily complicate the tax code, such as last-in, first-out (LIFO) and lower of cost or market, are repealed. Fourth, debt financing of corporate investment is put on a more equal footing with equity financing by indexing the corporate interest deduction to inflation.

Tax Expenditures

Tax expenditures—special deductions, exclusions, and exemptions that are often characterized as “loopholes”—were added to the tax code for specific economic or social purposes. However, many tax expenditures are ineffective in achieving their stated purpose, and the tax benefits are often skewed toward higher-income taxpayers. Our budget broadens the tax base and increases tax collections by eliminating several unnecessary tax expenditures. Eliminating wasteful tax breaks will further improve tax compliance and administration.

Under the individual income tax, several itemized deductions are eliminated, and the tax benefits of the remaining itemized deductions are capped at 28 percent. The mortgage interest deduction is phased out over a 15-year period, and the deduction for state and local taxes is eliminated. The charitable contributions deduction is limited to donations that exceed 2 percent of adjusted gross income so as not to remove the marginal incentive to contribute to charity. These provisions will only affect taxpayers who itemize deductions—about one-third of all taxpayers, most of whom are higher-income individuals.

Other Revenues

Our plan shifts the burden of taxation away from work and emphasizes corrective taxes, seeking to minimize socially harmful outcomes and activities that produce “negative externalities” because their full social costs are unpaid. These include pollution, alcohol consumption, firearms and ammunition, the diabetes epidemic and other adverse health effects, concentrated wealth, and high degrees of financial leverage. To help mitigate pollution and improve public health, our plan prices carbon emissions (initially set at \$30 per metric ton) and recycles over half of the revenue back to low- and middle-income households through a refundable tax rebate. Our plan also phases in an increase in the motor fuel excise tax, raises alcohol excise taxes, increases the excise tax rate on firearms and ammunition, and enacts a new sweetened-beverage tax. To reduce systemic financial risk, we adopt a leverage tax on “too big to fail” banks.

The estate and gift tax is an effective way to reduce the corrosive effects of concentrated wealth. Our plan reduces the estate tax exemption from the current \$5.4 million to \$2.5 million and increases the top tax rate on these intergenerational transfers of wealth from 40 percent to 50 percent.

CONCLUSION

Our budget blueprint navigates the current economic headwinds by expanding effective job creation measures and reorienting tax policy to help lower- and middle-income families while eliminating many costly, inefficient, and regressive tax provisions. Over the longer term, our plan reverses the decades-long erosion of public investment and declining tax code progressivity by boosting investments in future generations and financing these investments by asking more of those in society who can most afford it. Our plan preserves social insurance benefits and avoids cost-shifting measures that tend to exacerbate rather than address the underlying economic challenges.

The current austerity measures designed to reduce budget deficits have failed to improve the long-term budget outlook, increase economic growth, boost living standards, or provide security for current and future generations. To be successful, deficit reduction must be paired with policies that push the labor market back to full employment and that lay the foundation for long-run economic growth.

Percentage of GDP	2026	2040
Revenues	22.4	23.5
Spending	23.9	25.4
Deficit (-)/ Surplus (+)	-1.5	-1.9
Debt Held by the Public	58.4	54.2

A Note about Scorekeeping

The Peter G. Peterson Foundation's Solutions Initiative III enlisted five independent policy organizations to develop comprehensive plans that met the following criteria:

- Proposed solutions should be sufficiently detailed to allow them to be scored by an independent group against the January 2015 CBO baseline, as updated by CBO in March, extended through FY 2040.
- Each finished budget plan should represent a comprehensive package of specific policy proposals to address the projected long-term fiscal gap. Although the Foundation did not stipulate a required goal or target for these plans, each plan will be evaluated on its impact on projected debt-to-GDP ratios and other related measures over the FY 2017-FY 2040 time period.
- Each of the comprehensive budget plans should be accompanied by a detailed spreadsheet that provides estimates of each plan's projected budgetary impact.

To enable fair and objective comparisons of the plans, the Foundation engaged independent scorekeepers to review the estimates and analyses for each plan. This scorekeeping effort was led by Barry Anderson, former Acting Director at CBO and senior career civil servant at OMB. Eric Toder and Jim Nunns of the Tax Policy Center, a joint venture of the Urban Institute and the Brookings Institution, led the review of the plans' revenue proposals. Bill Menth, former OMB senior analyst, tracked each of the plans specific proposals and performed aggregate comparisons of the plans. Other current and former budget analysts helped review the plans' specific proposals, particularly in the health, Social Security, and defense areas.

The scorekeeping team carefully reviewed each of the spending and revenue proposals submitted by the five organizations. In particular, the scorekeeping team reviewed:

- the sources cited by the organizations to support their estimates;
- the baseline assumptions used by the organizations in measuring the budgetary impact of their proposals;
- estimates produced by existing models developed to score similar proposals;
- comparisons with estimates of similar proposals made by other organizations; and,
- comparisons with similar proposals made by one or more of the other organizations that developed plans in response to the Foundation's Fiscal Solutions III Initiative.

Many of the organizations relied on the scoring of similar proposals produced by CBO, OMB, the Joint Committee on Taxation, and other agencies that have extensive experience in scoring proposals, and this reliance greatly facilitated the review of the scoring of the proposals.

For the past six months, the scorekeeping team has had extensive discussions with each of the organizations. Some of the organizations' original proposals were modified as a result of these discussions. The scorekeeping team recognized that estimating over a 24-year period the year-by-year budgetary impact of proposals—many of which were innovative with few similar proposals having been made previously—is inherently difficult. Nevertheless, despite these difficulties, all of the organizations sought to make their estimates as accurate and consistent with objective scorekeeping principles as possible. As a result of these efforts, the scorekeeping team is satisfied that the organizations' plans can be fairly and objectively compared with each other.

This is not to say that the Foundation, the scorekeeping team or its members, or any of the organizations to which members of the scorekeeping team belong, should be cited as sources of the estimates. The sources of the estimates are the five organizations that developed the proposals. However, the scorekeeping team believes that because of the actions taken by each of the organizations to try to achieve common, comparable estimates of the budgetary impact of their proposals, a fair and objective comparison of the five plans can be made.



For more information, please visit
pgpf.org/solutions-initiative-iii