BIPARTISAN POLICY CENTER

Restoring America's Future

Bipartisan Policy Center's Debt Reduction Task Force

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INTRODUCTION

The federal budget is on a dangerous, unsustainable path. Even after the economy fully recovers from this deep recession, federal spending is projected to rise substantially faster than revenues and the government will be forced to borrow ever-increasing amounts. Federal debt will rise to unmanageable levels, which will push interest rates up, endanger our prosperity, and make us increasingly vulnerable to the dictates of our creditors, including nations whose interests may differ from ours.

This alarming prospect was created by the actions of both political parties over many years, with strong public approval. Promises to provide benefits and services through Medicare, Medicaid, Social Security and many other spending programs, as well as reductions in taxes, were extremely popular and both parties took credit for them. But now, with an aging population and increasingly expensive health care, federal spending will rise much faster than revenues if those popular policies are not changed. The only hope is for the two parties to come together around a bipartisan plan—which liberals, moderates, and conservatives alike see as fair—and work together to make it a reality.

We offer this plan as proof that a group of Republicans, Democrats, and independents can work together to create a balanced package of spending cuts and revenue increases that solves the debt crisis. Other groups might prefer other combinations of policies to reach the same ends. We created this plan to show that it can be done—and thereby encourage others from both political parties to bring their ideas to a constructive, respectful, and ultimately successful dialogue.

This proposal attacks our debt problem from all sides and, by 2021, reduces and stabilizes the federal debt below 60 percent of GDP. Further, this plan will balance the budget in 2023. To succeed, federal spending is reduced from projected levels of 24 percent of GDP to 21.6 percent by 2021, with revenues at 21.5 percent. This requires taking a hard look at our tax code, health care system, Social Security, and all discretionary spending programs while making fundamental changes to our nation's budget process.

HEALTH CARE

- Incentivize employers and employees to select more cost-effective health plans:

- ✓ Cap the exclusion of employer-provided health benefits in 2018, and then phase it out over 10 years.

- Control Medicare costs in the short term:

  - ✓ Gradually raise Medicare Part B premiums from 25 percent to 35 percent of total program costs (over five years).

  - ✓ Use Medicare's buying power to increase rebates from pharmaceutical companies.

  - ✓ Modernize Medicare's benefits package by providing catastrophic coverage and updating the premium and coinsurance structure. To avoid having the modernized benefit structure become outdated, empower the Independent Payment Advisory Board to recommend changes every two years to parallel developments in the private insurance market.

  - ✓ Bundle Medicare's payments for post-acute care to reduce costs.

- Preserve Medicare for the long term:

  - ✓ Transition Medicare, starting in 2018, to a "premium support" model that limits growth in per-beneficiary federal support (to GDP plus 1 percent, as compared to current projections of GDP plus 1.7 percent). The new system maintains traditional Medicare as the default, but will charge higher premiums if costs rise faster than the established limits. Alternatively, beneficiaries can opt to purchase a private plan on a health insurance exchange. Competition among plans should foster innovation, improve the quality of care, and increase efficiency.

- Control Medicaid costs in the short term:

  - ✓ Remove existing barriers for states seeking to enroll aged Supplemental Security Income (SSI) beneficiaries in managed care plans.

- Control Medicaid costs in the long term:

  - ✓ Beginning in 2018, reduce the amount by which Medicaid is growing faster than the economy (that is, reduce annual per-beneficiary cost growth by 1 percentage point).

- ✓ There are various approaches to achieving these savings. One option would be to reform the shared financing arrangement between the federal and state governments, which has led to gaming of the matching payment system and rising health care costs. Through a federal-state negotiation, allocate program responsibilities between the federal government and the states, so that each will fully finance and administer its selected components of the Medicaid program. This will restore incentives for cost containment, and slow future program spending growth.

- Reform medical malpractice laws:

  - ✓ Cap awards for noneconomic and punitive damages for medical malpractice.

  - ✓ Start large-scale testing of systemic reforms, including safe harbors for practices that conform to accepted guidelines, specialized malpractice courts, and administrative proceedings to resolve disputes.

- Help reduce long-term health care spending to treat obesity-related illnesses—including diabetes, heart disease, cancer, and stroke—by imposing an excise tax on the manufacture and importation of beverages sweetened with sugar or high-fructose corn syrup.

- The Task Force plan accommodates a permanent fix to the sustainable growth rate (SGR) mechanism that currently requires unrealistic automatic cuts in physician payments, which Congress has been annually delaying.

SOCIAL SECURITY

In order to guarantee that Social Security can pay benefits for the next 75 years and beyond:

- Gradually raise the amount of wages subject to payroll taxes (currently $106,800) over the next 38 years to reach the 1977 target of covering 90 percent of all wages.

- Change the calculation of annual cost-of-living adjustments (COLAs) for benefits to more accurately reflect inflation. (This is a technical change that will be applied in all government programs that use COLAs, including the indexation of tax brackets.)

- Slightly reduce the growth in benefits compared to current law for approximately the top 25 percent of beneficiaries.

- Increase the minimum benefit for long-term, lower-wage earners, and protect the most vulnerable elderly with a modest benefit increase. The former is particularly targeted to address the needs of long-time laborers who are unable to remain in the workforce due to the demanding nature of their work.

- Beginning in 2023, index the benefit formula for increases in life expectancy and require the Social Security Administration to ensure that early retirees understand that they are opting for a lower monthly benefit. These changes will increase the incentive to work longer, while not changing either the age of full retirement or the early retirement age from those in current law.

  Cover newly hired state and local government workers under the Social Security system, beginning in 2020, to increase the universality of the program.

DOMESTIC DISCRETIONARY SPENDING

- Freeze domestic (i.e., non-defense) discretionary spending for four years and cap at GDP thereafter.

- Implementing the freeze will require policymakers to terminate ineffective programs and set priorities across the broad range of government programs.

- Enforce the freeze through statutory spending caps, which, if exceeded, trigger automatic across-the-board cuts in all domestic discretionary programs.

OTHER MANDATORY SPENDING

- Reduce farm program spending by eliminating all farm payments to producers with adjusted gross incomes greater than $250,000, imposing limits on direct payments to producers, consolidating and capping 16 conservation programs, and reforming federal crop insurance.

- Reform civilian retirement by calculating benefits based on a retiree’s annual salary from his or her highest five years of government service; and reform the age at which career military can retire to be consistent with federal civilian retirement.

- Achieve other cost savings by raising fees for aviation security, actuarially adjusting flood insurance subsidies for risk, adjusting Pension Benefit Guaranty Corporation fees to better cover unfunded liabilities, and adopting a more accurate inflation measurement to calculate COLAs for all federal programs.

DEFENSE SPENDING

- Freeze non-war defense discretionary spending for five years and cap at GDP thereafter (baseline assumes reduction of troop levels deployed in combat to 45,000 by 2015).

- Among the options for achieving the required savings are streamlining military end strength, prioritizing defense investment, maintaining intelligence capabilities at a reduced cost, reforming military health care, and applying the savings from Secretary Gates' efficiency measures to deficit reduction.

- Implement the freeze through statutory spending caps, enforceable through automatic across-the-board cuts in all defense programs.

TAX REFORM

- Cut tax rates; broaden the tax base; boost incentives to work, save, and invest; and ensure, by 2018, that nearly 90 million households (about half of potential tax filers) no longer have to file tax returns.

    - ✓ Cut individual income tax rates and establish just two rates—15 and 27 percent—replacing the current six rates that go up to 35 percent.

    - ✓ Cut the top corporate tax rate to 27 percent from its current 35 percent, making the United States a more attractive place to invest.

    - ✓ Eliminate most deductions and credits and simplify those that remain while making them better targeted and more effective.

    - ✓ Replace the deductions for mortgage interest and charitable contributions with 15 percent refundable credits that anyone who owns a home or gives to charity can claim.

    - ✓ Restructure provisions that benefit low-income taxpayers and families with children by making them simpler, more progressive, and enabling most recipients to receive them without filing tax returns.

- Establish a new 6.5 percent national Debt Reduction Sales Tax (DRST) that, along with the spending cuts outlined in this plan, will reduce the debt and secure America's economic future. Once debt is stabilized below 60 percent of GDP, the DRST could be slowly phased down so long as debt as a percent of GDP remains on a declining path.

These reforms, taken together, will make the tax system more progressive.

BUDGET PROCESS REFORMS

- Prevent new tax cuts or new entitlement spending from worsening the fiscal situation by enacting a strict, statutory "pay-as-you-go" (PAYGO) requirement:

  - ✓ Require policymakers to fully offset new tax cuts, expansions of existing mandatory spending, or new mandatory spending with increases in revenues or reductions in mandatory spending.

  - ✓ Trigger fully offsetting automatic cuts in predetermined mandatory programs or increases in revenue if policymakers violate the requirement.

- Convert the federal budget process from annual to biennial budgeting.

- If the president and the Congress cannot agree on a comprehensive package of reforms upfront, create a new budget process mechanism—Save-as-you-Go ("SAVEGO")—to mandate specific amounts of annual budget savings in different categories of the budget. Specifically, SAVEGO would create:

  - ✓ Appropriations spending caps for the next 10 years (Congress may choose to subdivide appropriations into separate categories, such as security and non-security).

  - ✓ A SAVEGO rule with required year-by-year amounts of deficit reduction in the rest of the budget (entitlement programs and taxes). We recommend that the Congress create two separate categories: healthcare and other.

In total, "Restoring America's Future" is a moderate balance of spending cuts, tax expenditure cuts, and new revenues.

CONCLUSION

There are no easy answers, no quick fixes. Policymakers cannot solve the debt crisis simply by eliminating congressional earmarks or foreign aid. Nor can policymakers significantly reduce the debt by eliminating "waste, fraud, and abuse."

Nor can policymakers realistically solve the problem simply by cutting domestic discretionary spending. Stabilizing the debt by 2020 through domestic discretionary cuts alone would require eliminating all such spending—everything from law enforcement and border security to education and food and drug inspection.

Nor can policymakers rely on hopes of a strong economy to "grow our way out of the deficit." Just to stabilize the debt at 60 percent of GDP, the economy would have to grow at a sustained rate of more than 6 percent per year for at least the next 10 years. The economy has never grown by more than 4.4 percent in any decade since World War II.

Nor can policymakers solve the problem simply by raising taxes on wealthy Americans. Reducing deficits to manageable levels by the end of the decade though tax increases on the most well-to-do Americans would require raising the top two bracket rates to 86 percent and 91 percent (from the current 33 and 35 percent rates).[3]

This bipartisan, fair, and reasonable plan makes tough choices and requires sacrifice from all. Nothing less has a hope of restoring America's future for our children and grandchildren.

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Percent of GDP	2021	2035
Revenues	21.5	23.1
Spending	21.6	23.7
Deficit (-)	-0.1	-0.7
Debt Held by the Public	59.9	38.2

[3] Rosanne Altshuler, Katherine Lim, and Roberton Williams, "Desperately Seeking Revenue," Tax Policy Center, January 29, 2010, http://www.taxpolicycenter.org/UploadedPDF/412018_seeking_revenue.pdf.