Hearing before the Economic Policy Subcommittee of the
Senate Committee on Banking, Housing and Urban Affairs

Perspectives on the Economic Implications of the Federal Budget Deficit

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Testimony of Maya MacGuineas
Committee for a Responsible Federal Budget at
The New America Foundation

Chairman Tester, Senator Vitter, Members of the Subcommittee, thank you for inviting me here today to discuss the economic problems presented by our budget deficit.

I am Maya MacGuineas, president of the bipartisan Committee for a Responsible Federal Budget and the director of the Fiscal Policy Program at the New America Foundation. I am also a member of the Peterson-Pew Commission on Budget Reform, which recently released two reports—*Red Ink Rising* and *Getting Back in the Black*, which focus on the need to adopt multi-year debt targets and automatic triggers to help improve the budget process.

Our debt as a share of the economy is now higher than it has ever been in the post-war period, and we are on track to continue adding to it indefinitely. In all likelihood, the debt is already a drag on economic growth, and without changes, it will at some point result in a fiscal crisis.

At the same time, we face serious economic challenges: a slowing economic recovery, unemployment at unacceptably high rates, and a number of persistent problems from a skills shortage, underinvestment in a number of critical areas, and an abysmal, inefficient, and anti-competitive tax code, all of which stand in the way of longer-term growth. So we have our work cut out for us.

The debt owed to the public grew from $9.0 trillion, or 62 percent of GDP, at the end of fiscal year 2010 to $10.1 trillion, or 67 percent of GDP, at the end of fiscal year 2011. Under the Congressional Budget Office's current law baseline, debt is projected to grow to $14.5 trillion by 2021. Interest payments alone would be over $660 billion in 2021.

Yet, these assumptions are likely wildly optimistic. The Committee for a Responsible Federal Budget recently updated its "Realistic Baseline", which includes more realistic assumptions about future tax and spending policies than the current law assumptions CBO is directed to follow.[1] Our baseline shows deficits at nearly $1.1 trillion, or 4.5 percent of GDP, by the end of the ten-year window; public debt growing to $19.4 trillion, or 81 percent of GDP; and interest payments reaching $815 billion in 2021.

[1] The CRFB Realistic Baseline assumes the 2001/2003/2010 tax cuts are fully extended, the AMT continues to be patched, war costs slowly decline, and scheduled reductions to Medicare payments to physicians continue to be waived for remainder of the decade. It does not assume the $1.2 trillion in savings the Joint Select Committee on Deficit Reduction has been charged with.

Fig. 1: CRFB Realistic Baseline

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Ten-Year
Billions of Dollars											
Net Interest	$238	$265	$297	$351	$437	$535	$618	$688	$754	$815	$4,998
Deficits	$978	$829	$663	$636	$747	$753	$791	$902	$992	$1,071	$8,362
Debt	$11,158	$12,097	$12,870	$13,616	$14,461	$15,313	$16,198	$17,188	$18,264	$19,416	N/A
Percent of GDP											
Net Interest	1.5%	1.6%	1.8%	1.9%	2.3%	2.7%	3.0%	3.1%	3.3%	3.4%	2.6%
Deficits	6.2%	5.1%	3.9%	3.5%	3.9%	3.8%	3.8%	4.1%	4.3%	4.5%	4.3%
Debt	71.2%	74.8%	75.8%	75.1%	75.7%	76.5%	77.3%	78.5%	79.9%	81.5%	N/A
Memorandum: CBO Baseline*											
Net Interest	1.5%	1.6%	1.7%	1.9%	2.1%	2.4%	2.6%	2.7%	2.8%	2.8%	2.3%
Deficits	6.2%	3.2%	1.6%	1.1%	1.5%	1.2%	1.0%	1.2%	1.2%	1.2%	1.8%
Debt	71.2%	72.8%	71.6%	68.7%	67.2%	65.8%	64.3%	63.1%	62.0%	61.0%	N/A

*CBO baseline figures refer to current law projections assuming $1.2 trillion in savings related to the Joint Select Committee are put in place.

Under realistic assumptions, debt will continue to grow over the coming ten years, and then continue to rise to over 100 percent of the economy in the late 2020s, to over 200 percent in the 2050s, and eventually to nearly 400 percent by 2080. Obviously, we would experience a fiscal crisis well before it would ever get to these points.

Large deficits and debt have a number of negative effects.

- They harm the economy by diverting capital from productive investments to finance government borrowing, which will inevitably push up interest rates and the cost of capital for families and businesses. A number of academic studies find that high debt levels are already likely negatively impacting the U.S economy.[1]
- From a budgetary perspective, high debt levels lead to higher interest payments which squeeze out other government spending and lead to higher taxes. Higher interest burdens also leave the government more vulnerable to increases in interest rates. The Congressional Budget Office recently found that if interest rates were one percentage higher each year than currently projected, it would lead to $1.3 trillion in additional interest costs over the next decade.[2]
- High debt levels lead to loss of fiscal flexibility. Though the past recession was quite severe, we escaped a far worse outcome due to our ability to borrow to smooth out some of the economic shocks. With our current higher debt levels, we no longer have as much fiscal space to respond to emergencies, and doing so will be much more difficult and costly in the future if the debt trend is not reversed.

[1] See Stephen G. Cecchetti's September 2011 paper: "The Real Effects of Debt." http://www.kc.frb.org/publicat/sympos/2011/2011.Cecchetti.paper.pdf, and Carmen Reinhart and Kenneth Rogoff, "Growth in a Time of Debt." http://www.ycsg.yale.edu/center/forms/growth-debt.pdf.

[2] See the Congressional Budget Office's January 2011 "Budget and Economic Outlook," http://www.cbo.gov/ftpdocs/120xx/doc12039/01-26_FY2011Outlook.pdf.

- From an intergenerational perspective, excessively high deficits and debt reflect the basic policy of our spending, yet refusing to pay for it, and passing the bills along to future generations, along with a lower standard of living than they would otherwise enjoy. This inequity is exacerbated by the fact that the bulk of our government spending goes to consumption—much of it for the elderly—rather than investments, which would at least have the potential to boost longer-term growth.

- The uncertainty that comes from businesses and households knowing the changes will have to be made, but not knowing what they are, makes planning and investing significantly more difficult than if policy changes were already clearly put in place. The lack of certainty is one of the major factors causing businesses to keep their cash on their balance sheets rather than making productive investments that would help create jobs and grow the economy.

- Finally, ultimately, unsustainable levels of debt will lead to some type of a fiscal crisis. Once unimaginable in the United States, we should no longer see ourselves as immune from such a crisis.

The solution to all of the risks of higher debt is a multi-year, comprehensive fiscal plan that would stabilize the debt at a manageable level and set it on a course to decline as a share of GDP. The sooner we enact such a plan, the better.

We should aim to bring the debt down to around 60 or 65 percent of GDP over a decade—still significantly higher than the historic average of below 40 percent, but more manageable—and continue to bring it down to pre-crisis levels over the following decade. All areas of the budget should be on the table.

The debt threat is extremely serious, but it is also an opportunity to restructure our budget and tax system for the 21st century. By shifting our budget from one directed towards consumption to investment, we can lay a new foundation for growth. In order to be competitive down the road, we must strengthen critical investments in human capital, infrastructure, and high value research and development. And our tax system needs to be fundamentally reformed to both help grow the economy and raise more revenues to help close the fiscal gap.

Debt Reduction as an Engine for Economic Growth

It is important to recognize that debt reduction is not at odds with economic growth strategy, but rather, a central part of one. Putting in place a credible multi-year debt stabilization plan immediately has a number of economic advantages.

First, a credible debt reduction package reduces the negative consequences of excessively high debt levels, including pressure on interest rates and payments. The Congressional Budget Office has analyzed the potential impacts of a multi-trillion debt reduction plan over the course of a decade and has found that while it can dampen economic growth in the short-term, the overall size of the economy later in the decade and over the long-term can be notably larger. CBO estimates that by 2021, real GNP could increase by 0.6 to 1.4 percentage points from a $2.4 trillion debt reduction plan, compared to what otherwise would have occurred,[3] The International Monetary Fund has also found that fiscal consolidation in high-debt countries will be beneficial and likely increase output over the long-run.[4] There is also evidence that the announcement itself of a credible, long-term debt reduction can have positive economic effects in the short-term effects by improving confidence and pushing down long-term interest rates. Finally, debt reduction would reduce or eliminate the risk of a fiscal crisis.

Second, a credible, multi-year debt reduction plan can help free up enough fiscal space *upfront* to allow the economic recovery to continue to take hold. Rather than implementing immediate spending cuts and tax hikes, budgetary changes could be phased in more gradually, putting the debt on a glide path to stable and then declining levels. Gradual changes would also allow beneficiaries of our entitlement programs and taxpayers more time to adjust. But, a plan does need to be credible to be effective. Three keys to a credible plan are:

- It must be put in statute, not just promised.
- It must be bipartisan so that there isn't an immediate push by either political party to undo it.
- It must include a well-designed fiscal rule to ensure that savings are realized as promised and that the plan stays on track. Such rules could include spending caps at the levels of an agreed-upon plan, and broad-based automatic triggers that provide savings if policies fall short. The more difficult to override, the better. The Peterson-Pew Commission reports and the Gang of Six plan include a number of budget process reforms that should be integrated into any debt reduction plan to help ensure that stays on track.

Third, a multi-year plan will provide businesses and households more confidence and stability, allowing them to spend, invest and plan in ways that will help the economy.

Fourth, the added pressures on spending will likely lead to better oversight of government programs and reforms or elimination of outdated, ineffective, and redundant spending programs. This is also an important opportunity to transition the U.S. budget from a consumption-oriented budget to an investment-oriented one, which will be critical to long-term economic growth. In so doing, consumption oriented programs would be cut, while spending on many key areas of productive public investments would be increased. Our current incremental approach to deficit reduction is doing just the opposite of thoughtfully reassessing our priorities and their effects on economic growth, and we are instead chipping away at the absolute wrong parts of the budget.

Finally, a comprehensive plan to stabilize the debt, if large enough, will by necessity include reforms to entitlement and the tax system, which if done prudently, will help grow the economy. Examples of such pro-growth structural reforms would include:

[3] See the Congressional Budget Office's July 16, 2010 report: "The Macroeconomic and Budgetary Effects of an Illustrative Policy for Reducing the Federal Budget Deficit." http://www.cbo.gov/ftpdocs/123xx/doc12310/07-14-DeficitReduction_forweb.pdf.

[4] See the October 2010 International Monetary Fund, World Economic Outlook, "Chapter 3: Will It Hurt? Macroeconomic Effects of Fiscal Consolidation." http://www.imf.org/external/pubs/ft/weo/2010/02/pdf/c3.pdf.

- Fundamental tax reform like what the Bowles-Simpson Fiscal Commission proposed, which dramatically reduces tax expenditures, lowers rates – including corporate tax rates, and uses a share of the revenues for deficit reduction.

- Entitlement reform – particularly health and pensions, not only because this is primarily where our fiscal challenges lie, but because fundamental reforms would allow us to more efficiently use our country's resources, and provide better incentives for consumptions, savings and work.

While smaller budget deals are less likely to include fundamental overhauls of major entitlement programs and the tax code, a larger deal would encompass all areas the budget and could reform them in a way to create better growth incentives and reduce the deficit simultaneously.

Our tax code is simply a massive mess. It is littered with over 250 special credits, deductions, exemptions, and exclusions that cost us nearly $1.1 trillion a year. These "tax expenditures" are truly just spending by another name. By reducing, if not eliminating, many of them, we can reduce tax rates to more effectively encourage work and investment, while also helping to reduce deficits. Fundamental tax reform is critical in turning our fiscal situation around and strengthening our economic well-being.

To be large enough in the medium and long-term, and to reassure markets that a plan is serious, entitlement reform and tax reform must be at the center of any fiscal turnaround plan.

While the policy choices involved in tackling our out of control debt are not easy, they are far easier than what we will face if we continue to delay. One thing should be clear: it is preferable to make these difficult budget choices on our own terms then if and when they are forced upon us by credit markets.

As it stands now, the new Joint Select Committee, or Super Committee, is tasked with recommending savings of $1.5 trillion over ten years. This, however, is unlikely to be sufficient to stabilize the debt. Instead, we would urge the Super Committee to 'Go Big" by implementing a larger plan that would be sufficient to stabilize the debt at a manageable level and, in so doing, to tackle the most problematic areas of the budget, including health and retirement entitlements and taxes. Specifically, we urge the Super Committee to:

1. **Go Big.** From a realistic baseline in which current policies are extended, $1.5 trillion is not nearly enough to stabilize the debt. The Super Committee should look at all areas of the budget in order to achieve more savings, with a goal of stabilizing the debt as a share of the economy and then putting it on a downward path.
2. **Go Long.** Any serious fiscal plan must address the long-term drivers of our growing debt. The Super Committee should enact serious reforms to Social Security—which seems to be all but forgotten in this discussion—as well as Medicare, Medicaid, and other federal health spending.
3. **Go Smart.** Without economic growth, it will be difficult if not impossible to get our fiscal situation under control. The Super Committee should pursue pro-growth tax reform which broadens the base and lowers rates, and should reprioritize spending to better encourage short- and long-term growth.
4. **Stay Honest.** The Super Committee must not rely on budget gimmicks to make it appear that they identified savings to meet their target or that the problem was solved, while failing to fix the problem in reality.

5. **Make It Stick.** Once savings have been identified, the Super Committee should put in place an enforcement regime to ensure savings materialize as promised.

Thank you to the Committee for all your work on this and the opportunity to appear here today, and I look forward to your questions.

Appendix 1: Overlapping Policies and Estimated Savings Across Fiscal Plans

Deficit-Reducing Policies	President's Super Committee Submission	House Republican Budget	Bowles-Simpson Fiscal Commission	Domenici-Rivlin (BPC)*	Under Consideration in Debt Limit Discussions+	Lieberman-Coburn Health Proposal
Government-Wide						
Use Chained CPI for All Inflation-Indexed Programs**			**$232 billion** from implementing chained CPI	**$232 billion** from implementing chained CPI	Under discussion by Obama and Boehner	
Health Care						
Reform Medicaid Formula	**$15 billion** from introducing a reduced blended Medicaid rate in 2017	**$770 billion** from block granting Medicaid and indexing to CPI + population	Recommends consideration of block granting to meet long-term health cap	Replaces matching rates with reallocation of federal/state responsibilities beginning in 2018	**$100 billion** from unspecified FMAP changes (with possible increased state flexibility)	
Reduce State Medicaid Gaming	**$26 billion** from reducing Medicaid provider tax threshold		**$51 billion** from phasing out Medicaid provider tax threshold		Under discussion as part of Medicaid reform	
Improve Dual Eligible Care			**$15 billion** from mandating dual eligibles be placed in Medicaid managed care (with Medicare capitated payments)	**$8 billion** from removing barriers for states to place dual eligibles in managed care	**$0-$5 billion** from better care coordination	
Enact Tort Reform		**$62 billion** from aggressive reforms, including caps to non-economic and punitive damages	**$20 billion** from reforms such as collateral source rule changes and consideration of aggressive reforms	**$62 billion** from requiring states to cap non-economic and punitive damages		

Deficit-Reducing Policies	President's Super Committee Submission	House Republican Budget	Bowles-Simpson Fiscal Commission	Domenici-Rivlin (BPC)*	Under Consideration in Debt Limit Discussions+	Lieberman-Coburn Health Proposal
Reduce Medicare Payments for Pharmaceutical Drugs	**$142 billion** from prohibiting pay for delay for generic drugs ($3b), shortening exclusivity for generics ($4b), and drug rebates ($135b)		**$55 billion** by applying Medicaid drug rebates to low income seniors covered by Medicaid and Medicare Part D	About **$160 billion** by expanding Medicaid drug rebates to Medicare Part D	Part D rebates proposed by Dems; other reforms, such as average wholesale price (AWP) rules for Part D drugs and drug reclassifications also considered	
Increase Medicare Cost-Sharing	More than **$1 billion** from increasing the Part B deductible and introducing a home health co-payment for new beneficiaries in 2017		**$65 to $75 billion** from a $550 deductible, 20% co-insurance up to $5,500, 5% co-insurance up to $7,500, and catastrophic cap above that	About **$30 billion** from a $560 deductible, 20% co-insurance up to $5,250 and catastrophic cap above that	Up to **$66 billion** from clinical lab and skilled nursing facilities (SNF) / Home Health co-pays (though money could also come from payment reduction)	**$65 to $75 billion** from a $550 deductible, 20% co-insurance up to $5,500, 5% co-insurance up to $7,500, and catastrophic cap above that
Increase Basic Medicare Premium				About **$240 billion** from raising basic Part B premiums from 25% to 35% of costs (5-year phase-in)		About **$240 billion** from raising basic Part B premiums from 25% to 35% of costs (5-year phase-in)
Increase Medicare Means-Testing	**$20 billion** from increasing means-testing premiums and freezing brackets beginning in 2017				**$38 billion** from freezing premium brackets after 2019 and increasing costs for high-earners	Increases catastrophic cap for high-earners and requires high-earners to pay 100% of premiums

Deficit-Reducing Policies	President's Super Committee Submission	House Republican Budget	Bowles-Simpson Fiscal Commission	Domenici-Rivlin (BPC)*	Under Consideration in Debt Limit Discussions+	Lieberman-Coburn Health Proposal
Restrict Medigap Coverage	Over **$2 billion** from a Medicare Part B surcharge on beneficiaries who purchase Medigap policies with low cost sharing requirements for new beneficiaries beginning in 2017		**$53 billion** from restricting first-dollar coverage of Medigap plans		Up to **$53 billion** from restricting first-dollar coverage of Medigap plans	**$53 billion** from restricting first-dollar coverage of Medigap plans
Enact Medicare Premium Support		Implements premium support for new retirees in 2022, with $8,000 yearly subsidy indexed to inflation	Pilots premium-support in FEHB and recommends consideration of premium support after 2020	Implements premium support in 2018 for current and new retirees, allowing traditional Medicare to compete, indexed to GDP+1%		
Reduce Post-Acute Care Payments	**$42 billion** from reducing payment updates for post-acute care providers and other reforms		**$9 billion** from accelerating home health cuts under PPACA		Up to **$50 billion** from cutting home health and SNF payments (though savings could come from cost-sharing)	**$9 billion** from accelerating home health cuts under PPACA
Raise Medicare Eligibility Age			Recommends consideration of eligibility age increase to meet long-term targets		Raising age from 65 to 67 under discussion by Obama and Boehner	**$124 billion** from raising the eligibility age to 67 between 2014 and 2025

Deficit-Reducing Policies	President's Super Committee Submission	House Republican Budget	Bowles-Simpson Fiscal Commission	Domenici-Rivlin (BPC)*	Under Consideration in Debt Limit Discussions+	Lieberman-Coburn Health Proposal
Reform TRICARE and/or TRICARE for LIFE	**$22 billion** from a TRICARE for Life premium and higher TRICARE drug co-pays		**$43 billion** from applying Medigap restrictions on first dollar coverage to TRICARE for Life		Up to **$17 billion** from increasing drug co-pays under TRICARE	
Reform Federal Employees Health Benefits (FEHB) Program	**$2 billion** from reforming FEHB pharmacy benefit contracting		**$22 billion** from converting FEHB into premium support with fixed contribution amounts and having FEHBP subsidize Medicare premium instead of first dollar coverage		Up to **$11 billion** from allowing FEHB benefit to subsidize Medicare premium instead of first dollar coverage	
Reduce Medicare Bad Debt Payments	**$20** billion from reducing bad debts payment		About **$25 billion** from phasing out payments for bad debts		**$14-$26 billion** from phasing out payments for bad debts	**$25 billion** from phasing out payments for bad debts
Changes in Special Hospital Payment Policies	**$15 billion** from reducing Graduate Medical Education payments and payments to rural hospitals		**$70 billion** from reducing subsidies to hospitals for direct and indirect graduate medical education costs		**$28 billion**, half from graduate (direct and indirect) medical payments and half from rural hospitals	
Reduce Spending from the Affordable Care Act	**$18 billion** from correcting income definition rules for insurance subsidies and reducing spending on the Prevention and Public Health Fund	About **$590 billion** from repealing the coverage and tax provisions of the Affordable Care Act	Calls for reforming or repealing the CLASS Act, which could *cost* up to $87 billion in the first decade but reduce the deficit in future decades		**$10 billion** from not allowing the Prevention and Public Health Fund to grow and repealing Frontier State Adjustments	

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Reform the Sustainable Growth Rate (SGR)	Assumes a permanent freeze to reimbursement rates		**$36 billion** (compared to a 10-year freeze) from a -1% update in 2014 and directing CMS to develop an improved payment formula that encourages care coordination and quality over quantity			Provides 3-year SGR fix to give time for lawmakers to develop new Medicare reimbursement mechanism for physicians

Deficit-Reducing Policies	President's Super Committee Submission	House Republican Budget	Bowles-Simpson Fiscal Commission	Domenici-Rivlin (BPC)	Under Consideration in Debt Limit Discussions
Other Mandatory Spending					
Reduce Farm Subsidies	**$33 billion in net savings** from eliminating direct payments, reducing subsidies for crop insurance, and better targeting of conservation assistance programs, with a portion of the savings used to extend mandatory disaster assistance	**$28 billion** from reductions in direct payments and crop insurance	**$12 billion in net savings** from $18 billion in savings from reductions in direct payments and other subsidies as well as reduction in conservation and market assistance programs), with $6 billion in new spending to extend disaster fund	**$34 billion** from cutting payments to commercial farms, reforming crop insurance, and cutting conservation program spending	**$33 billion** from $31 billion in farm subsidy cuts and $2 billion in cuts to conservation programs
Reform Pension Benefit and Guaranty Corporation (PBGC)	**$16 billion** from increasing PBGC premiums and allowing PBGC to set its own premium rates	**$3 billion** from increasing PBGC premiums	**$10 billion** from allowing PBGC to set its own premium rates	**$5 billion** from increasing PBGC premiums	**$9 billion** from unspecified changes
Auction Spectrum Licenses	**$18 billion** of *net* savings mainly from incentive auctions, with some spending on broadband funding	**$25 billion** mainly from incentive auctions	Less than **$5 billion** from continuing existing auction authority; recommends Congress consider incentive auctions		**$20-$25 billion** in net savings from incentive auctions with a portion of auction proceeds redirected to new spending

Deficit-Reducing Policies	President's Super Committee Submission	House Republican Budget	Bowles-Simpson Fiscal Commission	Domenici-Rivlin (BPC)	Under Consideration in Debt Limit Discussions
Reform Federal Civilian and Military Pension Benefits	Establishes a BRAC-like process to review military retirement benefits, but does not set a savings target or assume any savings	**$1 billion** from eliminating special retirement supplement	Establishes a task force to evaluate federal health and retirement benefits, but makes illustrative suggestions of up to **$27 billion** for pension savings from increasing computation years from 3 to 5 and eliminating COLAs before age 62 with a 1-time catch up	**$9 billion** from using highest 5 years of earnings to calculate civilian benefits and reforming military retirement into one based on FERS	**$47 billion** ($36 billion from civilian and $11 billion from military) including from increasing contributions and benefits changes. Also, chained CPI for COLAs under consideration by Obama and Boehner
Increase Pension Contributions for Federal Employees	**$21 billion** from increasing employee pension contributions from 0.8% to 2%	**$122 billion** from equalizing employer and employee contributions to civilian pensions	Up to **$66 billion** from gradually equalizing employer and employee contributions to civilian pensions#		
Eliminate In-School Interest Subsidies on Student Loans	^	**$46 billion** from eliminating subsidies for undergraduate and graduate students^			Up to **$46 billion**, with the possibility of some of the money going to strengthen Pell Grants
Fannie and Freddie Reform	**$28 billion** from guarantee fees	**$30 billion** from unspecified reforms			**$30-$32 billion** from increasing guarantee fees and other reforms
Aviation Security / FAA Fees	**$26 billion** from increasing aviation security fees and introducing new fees on non-commercial aircraft			**$21 billion** from moving to $5 flat fee per one-way flight for aviation security	Up to **$18 billion** from moving to $5 flat fee for aviation security, and a per flight plan FAA fee

Deficit-Reducing Policies	President's Super Committee Submission	House Republican Budget	Bowles-Simpson Fiscal Commission	Domenici-Rivlin (BPC)	Under Consideration in Debt Limit Discussions
U.S. Postal Service Reforms	**$19 billion** from health benefit reforms, refunding the surplus given to FERS program, giving Postal Service authority to move to five-day delivery, allowing non-postal items to be sold, and allow products to be priced in accordance with costs		Calls for removal of restrictions that prevent Postal Service from taking action to reduce losses, such as five-day delivery and closing down of some offices		**$11-$26 billion** from allowing Postal Service to adjust postal rates, among other changes
Improve Tax Enforcement	Up to **$30 billion** from "cap adjustments" for tax enforcement		Up to **$30 billion** from "cap adjustments" for tax enforcement		
Reduce Food Stamps		**$127 billion** from block granting food stamps at "pre-recession projected levels" in 2015			Republicans proposed **$20 billion** in savings from categorical eligibility, "heat & eat", and job training
Sell Excess Federal Real Property	**$4 billion** from disposing of excess real property		Directs GSA to loosen agency restrictions on selling unused buildings and land		
Reform National Flood Insurance	**$4 billion** from phasing out premium subsidies for certain properties			**About $10 billion** from adjusting insurance subsidies for risk	

Deficit-Reducing Policies	President's Super Committee Submission	House Republican Budget	Bowles-Simpson Fiscal Commission	Domenici-Rivlin (BPC)	Under Consideration in Debt Limit Discussions
Tax Reform					
Reform Employer Health Exclusion	**$410 billion** in additional revenue by limiting itemized deductions for high earners, and then calls for tax expenditure reform. Also implements the "Buffett Rule" in which people with income over $1 million cannot face a lower effective tax rate than people earning less than $1 million	Calls for revenue neutral comprehensive tax reform, which could include elimination of various preferences	Calls for comprehensive reform. Illustrative plan phases out exclusion between 2014 and 2038	Phases out exclusion between 2018 and 2028	
Reform Mortgage Interest Deduction			Calls for comprehensive reform. Illustrative plan replaces deduction with 12% credit up to $500,000, only for primary residences	Replaces deduction with 15% credit up to $500,000 for primary residences only	Elimination of deduction on second homes under discussion by Biden group
Reform Charitable Deduction			Calls for comprehensive reform. Illustrative plan replaces deduction with 12% credit and 2% of AGI floor	Replaces deduction with 15% refundable credit given directly to charitable organization	Democrats proposed limiting itemized deduction for high-earners
Reform State and Local Deduction			Calls for comprehensive reform. Illustrative plan eliminates deduction	Eliminates deduction	
Reform Tax Treatment of Retirement Accounts			Calls for comprehensive reform. Illustrative plan consolidates accounts, caps contributions, and expands savers' credit	Caps contributions and expands saver's credit	

Deficit-Reducing Policies	President's Super Committee Submission	House Republican Budget	Bowles-Simpson Fiscal Commission	Domenici-Rivlin (BPC)	Under Consideration in Debt Limit Discussions
Corporate Tax Reform	**$62 billion** from eliminating various business tax expenditures. Then, calls for corporate tax reform that broadens base and lowers rate	Calls for comprehensive tax reform which targets a rate of 25%	Calls for comprehensive reform. Illustrative plan eliminates corporate all tax expenditures, lowers rate to 28%, and moves to a territorial system	Eliminates most corporate tax expenditures and reduces rate to 27%	White House offered corporate tax reform, including corporate jets and LIFO rules, but offer was rejected
Eliminate Fossil Fuel Tax Preferences	**$4 billion** in budget from reducing various preferences, and calls for tax expenditure reform in framework	Comprehensive tax reform which could include elimination of various preferences	Comprehensive tax reform which could include elimination of various preferences	Eliminates all tax expenditures related to oil and gas	Elimination of domestic manufacturing credit for big five integrated oil companies under discussion

Deficit-Reducing Policies	President's Super Committee Submission	House Republican Budget	Fiscal Commission	Domenici-Rivlin (BPC)	Under Consideration in Debt Limit Discussions
Social Security					
Raise Social Security Retirement Age	Calls for improved WEP/GPO compliance with states and localities, but does not address or mention Social Security reform beyond that. However, the April Budget Framework called for Social Security reform, parallel to deficit reduction, which would strengthen security for low-income earners and the most vulnerable and restore long-term solvency without privatization or reducing the "basic benefit" for current beneficiaries.	Establishes Social Security trigger requiring action by the Administration and Congress in any year in which the Social Security Trustees project the system to be insolvent over the next 75 years. The President would be required, in conjunction with the Social Security Trustees, to put forward a plan to restore solvency, and Congress would be required to consider those recommendations or alternative proposals under an expedited process.	**Closes 18% of 75-year shortfall** from indexing the retirement age to life expectancy, with hardship exemption	**Closes 22% of 75-year shortfall** from indexing benefit formula to account for increases in life expectancy	
Reduce Benefit Formula for Higher Earners			**Closes 29% of 75-year shortfall** from creating bendpoint at median income and reducing PIA factors to 90%|30%|10%| 5%	**Closes 4% of 75-year shortfall** from reducing top PIA factor from 15% to 10%	
Increase Social Security Taxable Maximum			**Closes 35% of 75-year shortfall** from gradually raising the payroll tax cap to cover 90% of wages	**Closes 35% of 75-year shortfall** from gradually raising the payroll tax cap to cover 90% of wages	
Add State and Local Government Workers to Social Security			**Closes 8% of 75-year shortfall** from adding newly hired state and local workers beginning in 2021	**Closes 8% of 75-year shortfall** from adding newly hired state and local workers beginning in 2020	
Apply Chained CPI to Social Security*			**Closes 26% of 75-year shortfall** from using chained CPI to calculate annual COLAs	**Closes 26% of 75-year shortfall** from using chained CPI to calculate annual COLAs	Under consideration by Obama and Boehner

This list is not exhaustive of overlapping policies.

*Estimates for BPC proposals extrapolated out to 2021 and estimated without interaction from premium support or Medicaid overhaul by CRFB staff.

**Switching to the chained CPI would increase revenues by $72 billion, reduce Social Security outlays by $112 billion, and reduce other spending by $48 billion over ten years. To read more, see CRFB's Moment of Truth project policy paper at http://crfb.org/document/measuring-case-chained-cpi.

+ Policies under discussion during debt ceiling debate as defined by memo from Congressman Eric Cantor, unless otherwise noted.

^$18 billion in additional recommended savings already enacted as part of Budget Control Act.

Appendix 2: What We Hope to See from the Super Committee

A Policy Paper by the Committee for a Responsible Federal Budget

http://crfb.org/document/what-we-hope-see-super-committee

THE COMMITTEE FOR A
RESPONSIBLE FEDERAL BUDGET

What We Hope to See from the Super Committee

SEPTEMBER 7, 2011

NOTE: This paper has been updated from the version that was originally published.

The Committee for a Responsible Federal Budget

About

The Committee for a Responsible Federal Budget

The Committee for a Responsible Federal Budget is a bipartisan, non-profit organization committed to educating the public about issues that have significant fiscal policy impact. The Committee is made up of some of the nation's leading budget experts including many of the past Chairmen and Directors of the Budget Committees, the Congressional Budget Office, the Office of Management and Budget, the Government Accountability Office, and the Federal Reserve Board.

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Since 2003, the Committee for a Responsible Federal Budget has been housed at the New America Foundation. New America is an independent, non-partisan, non-profit public policy institute that brings exceptionally promising new voices and new ideas to the fore of our nation's public discourse. Relying on a venture capital approach, the Foundation invests in outstanding individuals and policy ideas that transcend the conventional political spectrum. New America sponsors a wide range of research, published writing, conferences and events on the most important issues of our time.

What We Hope to See from the Super Committee

Introduction

Tomorrow, the Joint Select Committee on Deficit Reduction ("Super Committee") will hold its first meeting as part of a three-month effort to identify $1.5 trillion in deficit reduction over the next decade. Should the Super Committee fail to reach a majority agreement on a plan, or should that plan (or else a balanced budget amendment) not be passed by Congress, a $1.2 trillion across-the-board spending cut will go into effect.

Unfortunately, even if Congress succeeded in adopting a $1.5 trillion deficit reduction plan, it might not be enough to put the budget on a sustainable path. Thus, we urge the Super Committee to:

Go Big. From a realistic baseline in which current policies are extended, $1.5 trillion is not nearly enough to stabilize the debt. The Super Committee should look at all areas of the budget in order to identify savings of two to three times as much, with a goal of stabilizing the debt as a share of the economy and then putting it on a downward path.

Go Long. Any serious fiscal plan must address the long-term drivers of our growing debt. The Super Committee must enact serious reforms to Social Security, Medicare, Medicaid, and other federal health spending.

Go Smart. Without economic growth, it will be difficult if not impossible to get our fiscal situation under control. The Super Committee should pursue pro-growth tax reform which broadens the base and lowers rates, and should reprioritize spending to better encourage short- and long-term growth.

Stay Honest. The Super Committee must not rely on budget gimmicks to make it appear that they identified savings to meet their target or that the problem was solved, while failing to fix the problem in reality.

Make It Stick. Once savings have been identified, the Super Committee should put in place an enforcement regime to ensure savings materialize as promised.

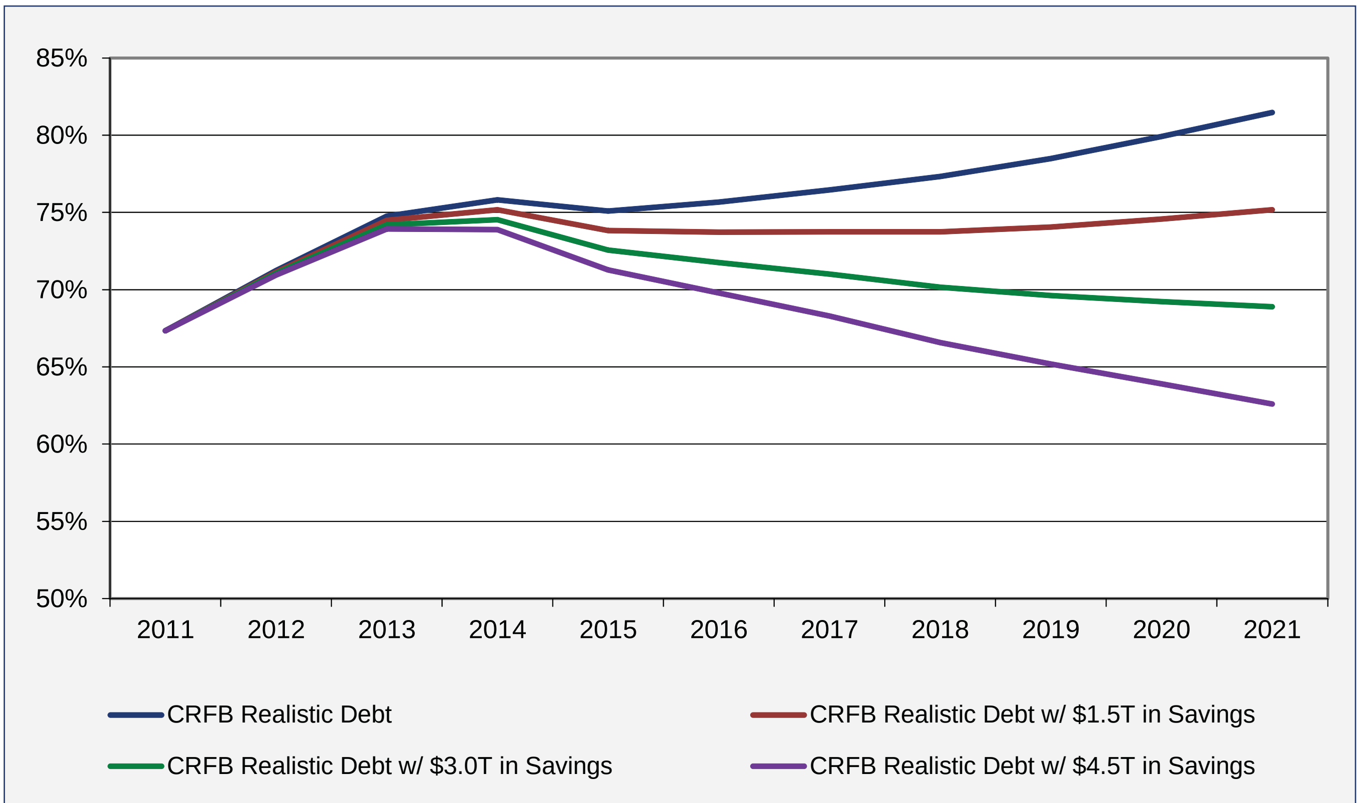
Go Big

The new Super Committee is charged to identify $1.5 trillion in deficit reduction, though $1.2 trillion would be enough to avoid an automatic sequester. While this would represent significant savings, Committee members should be shooting to double or triple this target in order to put the debt on a sustainable course.

Relative to CRFB's Realistic Baseline (see Box 1 for explanation), $1.5 trillion in savings would keep our debt on an upward path – growing from 67 percent of GDP this year to over 75 percent by 2021. By comparison, the Fiscal Commission recommendations would bring the debt down to 65 percent by 2021; the Peterson-Pew Commission on Budget Reform has recommended reducing debt to 60 percent.

Indeed, relative to CRFB's Realistic Baseline, it would take $3 trillion in deficit reduction just to reduce the debt to below 70 percent of GDP by 2021 and put it on a modestly downward path. Identifying an amount of deficit reduction significant enough to put the debt on a downward path will likely require looking at all areas of the budget, including the major entitlements, other mandatory programs, and the discretionary budgets; it will also require looking at ways to generate additional revenues. The Appendix to this paper identifies many policy changes where consensus may be possible.

FIG 1. Debt Paths Under Various Scenarios (Percent of GDP)



Note: For details on CRFB Realistic Baseline, see http://crfb.org/document/analysis-cbos-august-2011-baseline-and-update-crfb-realistic-baseline. Committee savings assumes $1.5 trillion in debt reduction gradually implemented over ten years.

BOX 1. What's in a Baseline?

The Budget Control Act that created the Joint Committee on Deficit Reduction (Super Committee) called for the Congressional Budget Office (CBO) to score its recommendations relative to current law, but allows the Super Committee to present alternative estimates. This means the Super Committee could choose an alternative baseline, which can heavily influence the total and/or relative amount of savings from any one plan.

Relative to current law, which assumes all the 2001/2003/2010 tax cuts expire, the AMT is not patched in the future, and policymakers stop enacting "Doc Fixes," $1.5 trillion would be sufficient to bring the debt down to 60 percent of GDP.

In measuring the magnitude of the problem and whether the Committee has solved it, however, assuming that these policies which have been extended in the past all expire does not provide an accurate picture of the future.

CRFB's Realistic Baseline assumes policymakers continue these policies as they have in the past, and also assumes the wars in Iraq and Afghanistan drawdown as expected. Compared to this baseline, $1.5 trillion would only result in debt levels of 75 percent of GDP as opposed to 81 percent absent those changes. Under a similar baseline – but one in which the upper-income tax cuts were allowed to expire as President Obama has called for – $1.5 trillion would bring the debt to 71 percent of GDP.

FIG 2. Debt Held by the Public in 2021 Under Various Scenarios (Percent of GDP)

Super Committee Savings	Current Law Baseline	CRFB Realistic Baseline Assuming Upper-Income Tax Cuts Expire	CRFB Realistic Baseline (All Tax Cuts Continued)
No Savings	66%	78%	81%
$1.5 trillion	60%	71%	75%
$3.0 trillion	53%	65%	69%
$4.5 trillion	47%	59%	63%

Note: Current policy baseline assumes all 2001/2003/2010 income and estate tax cuts are extended, AMT patches and yearly "doc fixes" continue, and wars are drawn down.

Go Long

No responsible deficit reduction plan can ignore the long-term growth of entitlement spending. It may be possible for the Super Committee to achieve its required savings without serious reforms to Social Security, Medicare, and Medicaid; however, with such a package the Super Committee would fail to meet its mandate to (emphasis added) "significantly improve the short-term and ***long-term*** fiscal imbalance of the federal government."[1]

1 Text from Title IV of Budget Control Act of 2011, P.L. 112-25.

Base on our projections, federal health and retirement spending is slated to grow substantially from below 10 percent of GDP today to 12 percent by 2021, 15 percent by 2035, and 17 percent by 2050. This is due both to population aging (largely because of the retirement of the baby boom population) and to rapid health care cost growth.

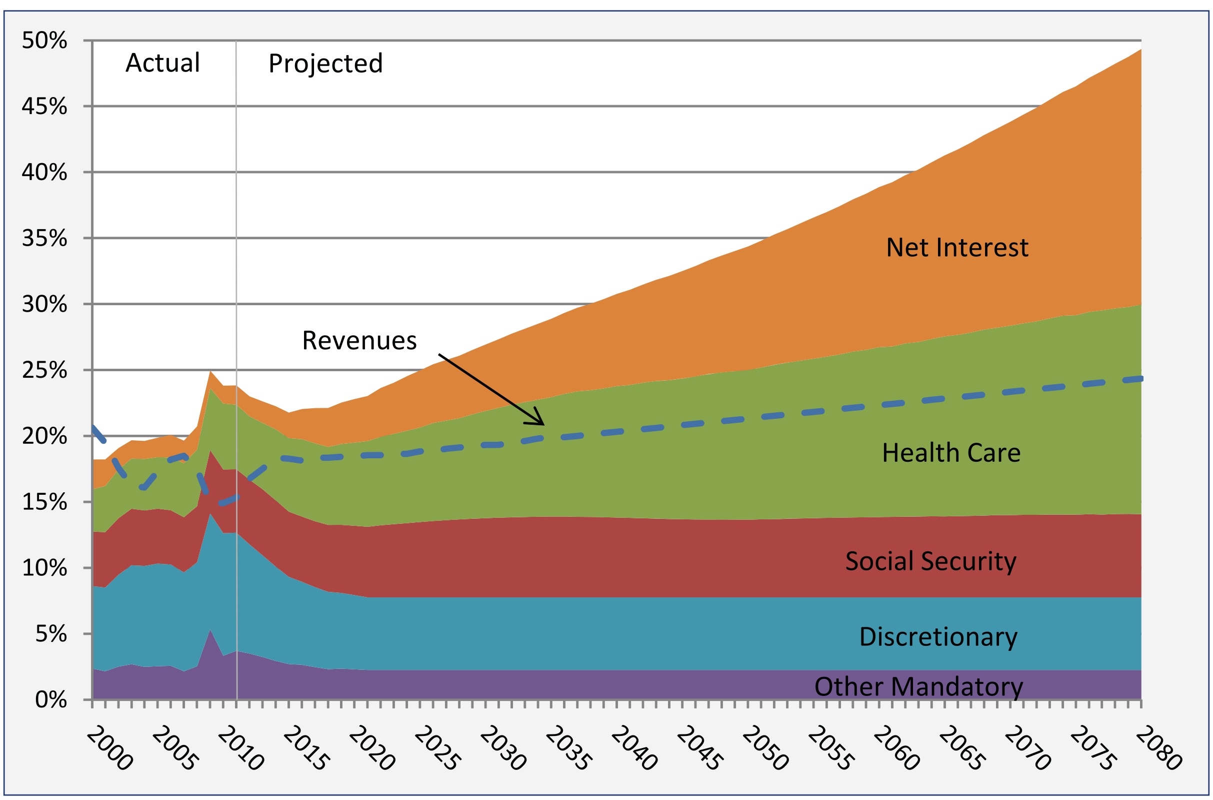
To reassure markets and put our budget on a sustainable path over the long-term, the Super Committee must therefore address the growth of the nation's largest entitlement programs, and give priority to those reforms with the potential to slow long-term growth paths (<u>even if they do not have significant scoreable savings this decade</u>). Reforms to Social Security, Medicare, and Medicaid are central to improving the long-term imbalances.

For Social Security, fixes are well known and developed – and there is no legitimate excuse for continuing to defer action. As the program's own Trustees continue to warn, Social Security is on the path toward insolvency, with cash deficits growing from 0.3 percent of GDP today to 1.4 percent of GDP by 2035. By 2036, according to the latest estimates, the Social Security trust funds will be empty and all beneficiaries will be hit with a 23 percent benefit cut. This can be easily avoided by enacting gradual changes today which phase-in over the coming decades.

Health care spending is more complex, but as the single largest cause of our long-term deficits, it cannot be ignored.

The Super Committee should start by reviewing those proposals which we already know would help to control costs – including changing cost sharing rules, reducing provider payments, increasing premiums, adjusting the Medicare eligibility age, reforming Medicaid rules, enacting malpractice reform, and

FIG 3. Spending by Category (Percent of GDP)



Source: Congressional Budget Office and CRFB calculations.

expanding payment reforms under the health reform law, to name a few. The Super Committee must also seriously consider long-term structural reforms such as moving to a premium support system for Medicare, putting federal health spending on a budget, and/or reforming and strengthening the Independent Payment Advisory Board (IPAB) to better control costs.

The Appendix describes the overlap in recommendations made across multiple deficit reduction plans that could guide the Super Committee's decisions in these areas.

Go Smart

To be successful, a debt reduction plan should not simply pursue savings without consideration of the economic effects. Instead, it should make smart and sensible reforms to the budget and tax code with an eye on enhancing (or at least not impeding) economic growth.

While we will not be able to grow our way out of this problem, higher growth will make the difficult task of fixing the budget much more manageable. According to CBO, growing just 0.1 percent faster than projected each year would generate more than $300 billion in deficit reduction over a decade.

Over the medium and long-run, deficit reduction itself would be pro-growth by increasing the nation's investment capacity; but the composition of the deficit reduction policies will also be critically important.

Super Committee members should therefore recommend reducing lower-priority spending in order to create the fiscal space to maintain or even increase high-priority and pro-growth spending. Over the medium- to long-term, this means moving from a consumption-based budget to one which focuses more on investment.

On the revenue side, the key will be pro-growth tax reform. Fundamental reform, which broadens the base by reducing deductions, credits, exemptions, and other tax expenditures; simplifies the code; and lowers individual and corporate tax rates, has the potential to substantially improve economic growth while also generating additional revenue for deficit reduction. The Joint Committee on Taxation has estimated that income tax reform that wipes out most tax expenditures in order to lower marginal rates, could increase the size of the economy by 1.2 to 1.9 percent of GDP over the medium-term, and more over the long-term.[2]

With a meaningful and credible fiscal plan, deficit reduction can be phased in gradually to give the economy time to recover. Even the announcement of such a plan can have positive effects on business and consumer confidence, particular if the plan is sufficiently large to create certainty over the nation's long-term outlook.

Stay Honest

The formal mission of the Super Committee leaves much room for gimmickry. Though they are tasked with identifying $1.5 trillion in deficit reduction, their mandate does not identify a baseline. This means that the Committee could, for example, claim more than $1.3 trillion in savings from simply taking credit for the

2 Joint Committee on Taxation, "Macroeconomic Analysis Of A Proposal To Broaden The Individual Income Tax Base And Lower Individual Income Tax Rates," December 14, 2006. http://jct.gov/publications.html?func=startdown&id=1186

BOX 2. Baselines and Current Policy Extensions

If the Super Committee members judge their savings against the current law baseline, which assumes that policies set to expire do expire (including the 2001/2003/2010 tax cuts and AMT patches), ideally they should explicitly address expiring provisions. There are a number of ways lawmakers could responsibly address expiring provisions:

- Make specific policy recommendations that supersede expiring provisions, such as fundamental tax reform or Medicare payment formula reforms;
- Make specific policy recommendations about which policies to extend in the context of a sustainable debt path;
- Or, create a clear process for dealing with expiring provisions in the near future, with enforceable limits on the costs of extending those or alternative policies.

If the Super Committee does not address expiring provisions under current law in one of the above manners, the Committee members will inherently be implying that current policies will stay in place. Any projections of the Super Committee's recommendations would then have to be compared to realistic assumptions about likely extensions to policies in place today.

already-planned troop withdrawals in Iraq and Afghanistan.[3]

To be credible, the Super Committee must not inflate their savings or paint an overly optimistic picture of the resulting fiscal path. In fact, rather than focusing on the *amount* of deficit reduction, the Super Committee should put forth recommendations sufficient to put the debt on a stable then declining path under a reasonable set of assumptions. All assumptions in the baseline should be ones policymakers plan to stick to (so for instance, assuming the cuts in Medicare spending from the Sustainable Growth Rate occur and increased revenues from the Alternative Minimum Tax affecting millions more taxpayers should not be acceptable).

Committee members should also avoid other budget gimmicks, such as arbitrary and excessive back-loading of savings, timing gimmicks which push costs beyond the budget window, or unrealistic policy changes which future Congresses are likely to reverse.

Make It Stick

Even once policies are adopted, more will be needed to make sure they are not undone. History shows that having agreed upon deficit reduction measures is no guarantee that they will come to fruition.

Enacted savings could fall off course one of three ways: by lawmakers repealing deficit reducing measures, enacting future spending increases or tax cuts without offsets to give back some of the savings, or by changes in budget projections due to economic or other factors.

To help ensure savings materialize (or at least make it more difficult for lawmakers to undo the savings),

3 By convention, the baseline assumes that spending on Iraq and Afghanistan will continue to grow with inflation. Setting caps on this spending that reflect the already anticipated drawdown would therefore be scored as achieving $1.12 trillion below the baseline – along with another $200 billion in interest savings.

the Peterson-Pew Commission on Budget Reform recommended one approach in that lawmakers should reinforce their agreement by enacting budget rules and procedures to keep the debt on a stable or declining path.[4] Such a process would work both by helping to monitor and facilitate progress on achieving necessary savings, and by putting "triggers" in place to keep the debt on track if policymakers fail to do so.

Other approaches also exist to institute effective budget enforcement and outcomes. Lawmakers could choose to rely on annual savings relative to a particular baseline, aggregate spending targets (as some lawmakers have already proposed), revenue or deficit levels, or other fiscal metrics.

There are many ways to help make debt reduction policies stick, but stronger budget rules and oversight can never compensate for the political will that is needed to enact and adhere to savings in the first place.

* * *

The Super Committee is on a very tight deadline, but its success is imperative. All three major rating agencies have suggested there could be consequences should the Committee deadlock – and more importantly, there may not be many opportunities like the current one to truly bring our debt under control. Right now, all eyes are on this issue, policymakers are invested in this process, and there is a unique fast-track process in place. Waiting until next year will mean addressing the issue in the heat of a Presidential election, and waiting beyond that could not only make things politically more difficult, but could also be too late to reassure markets. The types of structural changes needed to put the budget on a sustainable path just become more and more difficult, both economically and politically, the longer policymakers delay action.

4 Peterson-Pew Commission on Budget Reform, *Getting Back in the Black*, November 2010.