



BIPARTISAN POLICY CENTER

How to “go big” within the Budget Control Act (BCA) Framework

- **STEP #1:** Approximately \$900 billion in domestic and defense discretionary spending cuts over 10 years that were contained in the initial stage of the Budget Control Act.
- **STEP #2:** Approximately \$1.65 trillion in deficit reduction policies over 10 years and a Social Security payroll tax holiday for CY2012 to be proposed by the Joint Select Committee (JSC)
 - The net \$1.2 trillion in savings would consist roughly of:
 1. \$100 billion in further discretionary cuts (half defense, half domestic)
 2. ≈ \$350 billion in other mandatory cuts
 - a. Switch to the chained CPI measure of inflation, civilian and military retirement reforms, cut back on farm subsidies, and increase some fees, among others
 3. ≈ \$600 billion in health care savings
 - a. Update Medicare’s cost-sharing rules, introduce a surcharge for first-dollar Medigap coverage, malpractice reform, among others
 4. ≈ \$450 billion in small tax expenditure cuts / revenue increases
 - a. Switch to the chained CPI measure of inflation, eliminate the mortgage deduction for 2nd homes, remove many energy subsidies, among others
 5. ≈ \$450 Social Security payroll tax holiday (employees: full holiday, employers: full holiday on first \$3 million in payroll and all newly added payroll)
 6. ≈ \$150 billion in interest savings
- **STEP #3:** Using the authority given to the Joint Select Committee in the Budget Control Act, the JSC should write legislation that compels fundamental reform in entitlement spending and in the tax code.
 - Section 404 of the BCA, in combination with other language in the Act, gives the JSC broad powers of an unprecedented nature. It can recommend further sequester action, for example, if it wishes. It can order committees of jurisdiction to make changes in entitlements and taxes and report those changes back in the form of legislative language by a date certain. What we propose, then, is that the work done by the JSC not only meet the mandate of the \$1.2-1.5 trillion in savings in the next decade, but focus on how those changes in law would flow naturally to changes of a more fundamental and far-reaching nature in order to stabilize our national debt as a percentage of GDP.
 - In particular, we recommend that the JSC legislate:
 - A tax reform trigger to force tax reform by a date certain (e.g., April 15, 2012) that the CBO scores as providing net tax relief of no more than \$1.7 trillion against current law through 2021;
 - A health care reform trigger to force additional health care savings to offset a permanent “doc fix” and passage of a premium support system for Medicare by a date certain;
 - And a trigger to force the passage of reforms to make Social Security sustainably solvent.

Net totals for the Budget Control Act (off of current policy baseline):

- Spending Cuts (including interest) ≈ \$2.8 trillion
- Revenues ≈ \$2.2 trillion
- Total Budget Savings ≈ \$5 trillion

BPC'S RECOMMENDATIONS TO THE JOINT SELECT COMMITTEE **(How a Net \$1.2 in Savings can be Achieved for Step 2)**

**Approximate
Savings (in
billions of \$)**

Medicare Savings

Update Medicare's cost-sharing rules, provide catastrophic coverage + introduce a Part B premium surcharge for beneficiaries that purchase near first-dollar Medigap coverage	93
Reduce Medicare coverage of patients' bad debts	20
Accelerate home health savings in the ACA	9
Introduce home health co-payments	40
Use Medicare's buying power to increase rebates from pharmaceutical companies	154
Bundle Medicare's payments / reform provider payments for post-acute care to reduce costs	42
Better align graduate medical education payments w/ patient care costs	60
Reduce or Eliminate Subsidies to Rural Hospitals in Medicare	17
Increase Part B deductible for new beneficiaries	4
Eliminate provider carve-outs from IPAB	--
Make reforms to Medicare's Quality Improvement Organizations (QIOs)	3
One-year SGR fix	-12
Total Medicare	430

Medicaid Savings

Eliminate state gaming of Medicaid tax gimmick	26
Apply a single blended matching rate to Medicaid, CHIP, and exchanges	21
Rebase Medicaid disproportionate share hospital (DSH) allotments in 2021	4
Limit Medicaid reimbursement of durable medical equipment (DME) based on Medicare rates	4
Shorten exclusivity period for brand name biologic drugs	4
Prohibit "pay for delay" agreements to increase the availability of generic drugs and biologics	3
Track high prescribers and utilizers of prescription drugs in Medicaid	4
Reduce Medicaid fraud	1
Total Medicaid	67

Other Healthcare Savings

Limit medical malpractice torts	62
Increase TRICARE annual premiums and Rx copayments	22
Decrease investment in prevention and public health fund	4
Include Social Security benefits in income calculation to determine Exchange subsidy eligibility	15

Total Other Health Care 103

TOTAL HEALTHCARE 600

Other Mandatory Savings

Switch to the chained CPI measure of inflation	145
Reform civilian retirement	60
Reform military retirement	4
Reduce farm program spending	35
Reform the aviation passenger security fee to more accurately reflect the costs of aviation security	25
Adjust Pension Benefit Guarantee Corporation fees to better cover unfunded liabilities	16
Actuarially adjust flood insurance subsidies for risk*	12
Auction radio spectrum to expand wireless broadband and invest in a broadband network for public safety users	18
Index mandatory user fees to inflation	2
Restructure the power marketing administrations to charge market rates	2
Transfer the Tennessee Valley Authority's electric utility functions and associated assets and liabilities	4
Gradually lower the conforming loan limits for Fannie/Freddie	4
Increase guarantee fees charged by Fannie/Freddie	27
Provide Postal Service Financial Relief and Undertake Reform	19
Improve Collection of Pension Information from States and Localities	3
Get rid of unneeded Federal real property	4
Extend unemployment benefits through next year	-30

Total Other Mandatory 350

Discretionary Spending Savings

Nondefense Discretionary	50
Defense Discretionary	50
Budget appropriate amount in a disaster fund	-
Convert to Security/Non-Security breakdown	-

TOTAL DISCRETIONARY 100

Revenue/Tax Expenditure Savings

Switch to the chained CPI measure of inflation	72
Eliminate ethanol/biodiesel subsidies	19
Cut subsidies for employee parking expenses	38
Eliminate the mortgage deduction for 2nd homes/yachts	15
Tax carried interest as ordinary income	21
Cut subsidies for private-purpose state and local bonds	23
Eliminate Hollywood tax breaks	1
Timber subsidies	5
Remove many energy subsidies (solar, wind, oil and gas, coal)	61
Include All Income Earned Abroad by U.S. Citizens in Taxable Income	71
Exclusion of Certain Allowances for Federal Employees Abroad	18
Eliminate LIFO and LCM Inventory Accounting Methods	100
End certain economic development tax breaks	15
1-year AMT offset	-9

TOTAL REVENUES 450

Growth Initiative

Mandate enactment of a full payroll tax holiday for employees and a full payroll tax holiday for employers (for up \$3 million of payroll and all new hires) (BPC) **≈ -450**

TOTAL INTEREST SAVINGS (estimate) 150

TOTAL SAVINGS 1,200



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LEGISLATIVE INSTRUCTIONS

GENERAL¹

CBO (with customary input from the Joint Committee on Taxation) is the umpire.²

CBO should provide economic analysis of the proposal over at least 20 years.³

CBO's static analysis should be the official score.⁴

For informational purposes only, CBO should provide a “dynamic analysis” of the *entire* legislative proposal, according to the procedures it inaugurated in *An Analysis of the President's Budgetary Proposals for Fiscal Year 2004*, March 2003.⁵

For informational purposes only, CBO should provide an alternative analysis of the proposal assuming that the Federal Reserve holds interest rates at their current level beyond the two years specified in its August 9 statement.⁶

Each bill from the Committees of jurisdiction will be held at the desk until all are completed.⁷

¹ These “general” instructions might be added to each Committee’s instructions, or put forward in some other way.

² There should be no estimate-shopping, else all discipline will be lost. CBO’s methodologies and procedures have long standing, and have been accepted on all sides. Anyone who wants to refer arguments and analyses of others to CBO for their consideration is of course free to do so.

³ In the long run, deficit reduction will increase economic growth by increasing national saving – and therefore business investment. If CBO is given only one consensus agreement, this procedural rule will have limited effect. If, however, as part of the process of developing a consensus plan, CBO is presented alternative proposals including some that provide less deficit reduction, this rule will illuminate the long-term consequences.

⁴ This follows long-standing practice. It prohibits supply-side estimates of *either* tax cuts *or* investment spending. Note that a tax proposal that increase revenues beyond expectations will provide additional deficit reduction.

⁵ CBO has used a range of alternative “dynamic” methods to estimate the effects of *complete* packages of proposals. The differences between CBO’s static estimates and the alternative dynamic estimates have been (a) small and (b) roughly equally divided between deficit increases and decreases. Some non-governmental organizations have issued dynamic estimates, but their efforts have widely been regarded as far less rigorous.

⁶ Some on both political extremes argue that deficit reduction harms economic growth, and so is undesirable for the foreseeable future. However, we need a firm commitment to deficit reduction within the foreseeable future. We square this circle if the Federal Reserve maintains low interest rates longer, stimulating economic growth while the budget transits from stimulus to deficit reduction. CBO’s baseline budget forecast has the economy resuming normal growth and the Federal Reserve increasing interest rates as that occurs. If the deficit is reduced but the Federal Reserve follows an unchanged interest rate policy, then growth will suffer. An alternative interest rate forecast can assume the more accommodative policy that the Fed would be likely to follow if there were a firm commitment to deficit reduction.

⁷ This simply dictates that, for example, concessions from one side on Medicare reform cannot become law without compensating concessions from the other side on taxes.

TAX POLICY

The Ways & Means / Finance bill shall not decrease revenues by more than \$1.7 trillion over ten years compared to current law.

Taking into account estimable program changes in Social Security, Medicare and all other benefit programs, the bill shall use refundable tax credits to hold harmless, on average, the households in the lowest 20 percent of the income distribution.⁸

On the same basis and using static estimates, the bill shall decrease the after-tax income in each quintile ranked by gross income by a lesser percentage than for those quintiles with higher incomes.⁹

The maximum tax rate on individuals and corporations shall be no higher than 28 percent.¹⁰

MEDICARE POLICY

Beneficiaries (present and future) who wish to enroll in the current conventional Medicare program must have that option.¹¹

⁸ The proposal of the Bipartisan Policy Center (<http://www.bipartisanpolicy.org/sites/default/files/BPC%20FINAL%20REPORT%20FOR%20PRINTER%2002%2028%2011.pdf>) demonstrates that this is possible.

⁹ In other words, the tax changes should be consistently progressive by income quintile, using the change in after-tax income as the criterion. Specifying the criterion is important, and this one would be the choice of most experts. Although it might seem constructive to reference also smaller upper-income groups such as the top 10 percent, the top 5 percent, the top 1 percent, etc., distributional measures for those groups often have wiggles in them even for sound tax reform proposals. Excessively specific distributional criteria could possibly undermine what could be a fundamentally progressive deficit-reducing tax reform. Note also that the level of the top-bracket rate affects the potential to eliminate or reduce the highly regressive and complicating tax preferences for capital gains and dividends. In 1986, the Congress was willing to eliminate the capital gains exclusion in exchange for a top rate of 28 percent (which had been the capital gains rate since 1979). The higher the top bracket rate, the lower the probability of political acceptance of a lesser preference for capital gains; and the larger the capital gains preference, the less progressive the distributional result of the tax change. In the extreme, the result can be a vicious cycle or “Catch-22” in which progressivity requires a higher top-bracket rate, but the higher top-bracket rate brings on a bigger capital gains preference, and the bigger capital gains preference results in an unacceptable distributional result.

¹⁰ This principle maximizes the chance of achieving a tax reform that is politically acceptable and fair, and that contributes to deficit reduction.

¹¹ The health care of current Medicare beneficiaries must not be interrupted. Future beneficiaries (such as rural residents who have limited choices among providers) who for whatever reason wish to participate in the current program must be allowed to do so. The option of using the current known system will be reassuring to many. But at the same time, the practice of health care in Medicare must change fundamentally to reduce current unsustainable cost growth. The best way to achieve efficiency in Medicare is to give beneficiaries the option of choosing among competing plans that must provide quality care at affordable cost to prosper. This is simply allowing competition to work as it does everywhere else in the economy. It is the Rivlin-Domenici approach. There is nothing else on the table that shows any prospect of success. It will be especially attractive to current workers who have coverage with which they are satisfied, and who might lose that coverage and their ongoing relationships with their providers if

Beneficiaries must have the option of enrolling in a wide range of competing private plans, in addition to the conventional Medicare program.

Medicare policy changes must fully offset a permanent fix to the sustainable growth rate formula within the 10-year window, and must provide increasing annual amounts of savings in later years.¹²

SOCIAL SECURITY POLICY

Separate from the deficit-reduction effort, legislation shall be prepared to achieve 75-year sustainable solvency of Social Security.¹³

All savings from the Social Security legislation shall be credited to the Social Security trust fund.¹⁴

they are forced to switch to current Medicare when they turn 65. With a guarantee of access to conventional Medicare, it should be acceptable to other informed beneficiaries. This instruction builds the foundation for all beneficiaries to have the coverage they want.

¹² This instruction requires the Committees of jurisdiction to find the necessary near-term program savings (as opposed to fundamental reform) to reach the deficit-reduction target. It also sets the general requirement that the savings from longer-term structural reforms must grow over time.

¹³ Early repair of Social Security's finances will get the program out of the political line of fire, which all program advocates ought to support. Rhetorically, it must be clear that Social Security will be repaired for its own sake, not to balance the budget (though that of course is a subsidiary benefit). The sustainable-solvency standard means that the program is to be made sound not only over 75 years, but also in the 75th and subsequent years. That would avoid the uncertainty and political controversy that followed the 1983 legislation, which built up an oversized trust fund but allowed the program's finances to become unstable once the trust fund needed to be drawn down (i.e., now).

¹⁴ This is one more rhetorical way to explain why the program itself is the primary winner if its finances are strengthened.