BIPARTISAN POLICY CENTER

A Bipartisan Approach to America's Fiscal Future

Bipartisan Policy Center

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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

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.

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