BIPARTISAN POLICY CENTER

TESTIMONY BY SEN. PETE V. DOMENICI AND DR. ALICE RIVLIN

CO-CHAIRS, BIPARTISAN POLICY CENTER DEBT REDUCTION TASK FORCE

TO

THE JOINT SELECT COMMITTEE ON DEFICIT REDUCTION, U.S. CONGRESS

NOVEMBER 1, 2011

Senator Murray, Representative Hensarling and Members of the Joint Select Committee on Deficit Reduction , thank you for inviting us to testify on the enormous fiscal and economic challenges confronting our nation.

The testimony we have submitted summarizes more than one and a half years of deliberation by nineteen former senior policy makers ranging from former Democratic mayors of large cities to former governors, to former members of presidential cabinets. The Task Force represented a very diverse cross-section of the nation's economic and political interests.

The United States faces two huge challenges: (1) accelerating growth and job creation and (2) reducing future deficits to stabilize the debt so that it is no longer growing faster than the economy. These objectives reinforce each other. Faster growth will reduce deficits, and stabilizing the debt will cut future interest rates, reduce uncertainty and enhance growth. This Committee, with its extraordinary powers, has both the opportunity and the obligation to address both challenges.

The Bipartisan Policy Center's Debt Reduction Task Force urges you put ideology aside, cooperate across partisan lines, and craft a Long term budget plan that will put the country on a path to sustainable prosperity and responsible budgeting. To achieve success, the Committee will have go well beyond the minimum charge of identifying at least $1.2-$1.5 trillion in savings over the next ten years, because even savings of this magnitude would still leave the debt rising faster than economic growth. We believe you should craft a grand bargain involving structural entitlement and tax reform that would save at least $4 trillion over ten years. In order to do so, the Committee should take full advantage of the authority given to it by the Budget Control Act (BCA) in Section 404, and write instructions to compel authorizing committees to produce fundamental tax and entitlement reform and provide for "fast-track" consideration of those reforms.

We believe that a grand bargain would have enormous economic benefits and would also reassure citizens and markets that our political process is functioning in the public interest, not stuck in partisan gridlock or overwhelmed by special interests. Failure to reach agreement (or even settling for the minimal $1.2 trillion savings) would increase the chances of continuing weakness in the economy, high joblessness, and deep distrust of the ability of elected leaders to govern.

The BPC recommends a three-step process in order to spur our economy, achieve savings and stabilize our debt:

- **Step 1** was passage of the BCA, which provided $900 billion in discretionary savings, similar to the amount recommended by the BPC's Task Force.

- **Step 2** – in progress – calls on the Committee to **identify a down-payment of $1.2-$1.5 trillion in net deficit reduction over ten years**, **which should be accompanied by a full payroll tax holiday to spur the economy**. The deficit reduction should utilize the many bipartisan plans that have been released, combining spending cuts from all parts of the budget with revenues. These savings also must be *real* – no budgetary gimmicks. Many of these policies will not be overly popular, but a comprehensive plan – one that addresses every aspect of the budget – is the most politically palatable approach.

- **Step 3** requires the Committee to take full advantage of Section 404 of the BCA and **instruct the relevant authorizing committees to legislate further reform**. The two primary areas of focus should be fundamental, pro-growth *tax reform that raises revenue*, and *structural Medicare reform* to ensure the future sustainability and efficiency of the program, as explained in the Domenici-Rivlin Protect Medicare Act.

Should the Committee fail to reach agreement on major reforms that will encourage growth and stabilize our fiscal situation, you will have missed an historic opportunity to set the country on the right track, and the consequences both to the economy and to public confidence could be dire. A sequester would produce mindless, possibly harmful cuts in spending, and even avoiding the sequester by finding $1.2 trillion would only kick the biggest part of the rising debt problem down the road. We urge you to seize the opportunity to get the job done.

The central elements of any grand bargain to stabilize our debt are clear:

1) Policies to promote growth and create jobs now;
2) Savings from discretionary accounts (which have already been enacted in the Budget Control Act);
3) Fundamental health care reform, especially Medicare; and
4) Fundamental tax reform that raises revenue.

The Bipartisan Policy Center's Debt Reduction Task Force, which we co-chaired, only was able to achieve consensus by addressing all four.

Payroll Tax Holiday

To jumpstart the struggling economy, we recommend enacting a full Social Security payroll tax holiday for both employers and employees for one full year. This immediately will increase consumer spending and business hiring, thereby delivering economic growth and creating jobs. The tax cut will provide financial relief for roughly 160 million American workers, many of whom are having difficulty making ends meet in the aftermath of the worst recession in nearly eighty years. A significant portion of the additional take-home pay will be spent quickly by consumers. Some of the money will undoubtedly go towards paying down debt, but household deleveraging is a necessary precondition for a return to low unemployment and sustained growth. A payroll tax holiday will help people get out of debt faster by adding roughly $3,000 to the average worker's paycheck.

Fundamental Health Care Reform

The fundamental problem to be addressed by this Committee is that federal spending is projected to rise faster than revenues for the foreseeable future leaving a widening gap to be financed by borrowing. The primary drivers of increased spending are the health care programs, including Medicare, Medicaid, and the subsidies to be provided by the Affordable Care Act (ACA). Huge projected increases in the number of older people, combined with persistent increases in health care spending per person account for this upward pressure on spending. Hence, reducing the rate of growth of these programs is essential to any long run debt stabilization plan. (See Chart)

Spending on mandatory healthcare programs is projected to increase from 23 percent of non-interest federal spending in 2011 to 34 percent by 2021.

Rising federal spending on health care is, of course, a part of the more general trend of increasing spending for health care in the economy as a whole. Over time, national health spending has grown about 2 percentage points per year faster than GDP and health care spending nationally is nearly 17 percent of GDP and rising. The objective of reforming federal health programs should not be to shift federal costs onto the private sector, but to use the federal programs to lead the way toward more effective and less wasteful delivery of health care, no matter how that care is paid for.

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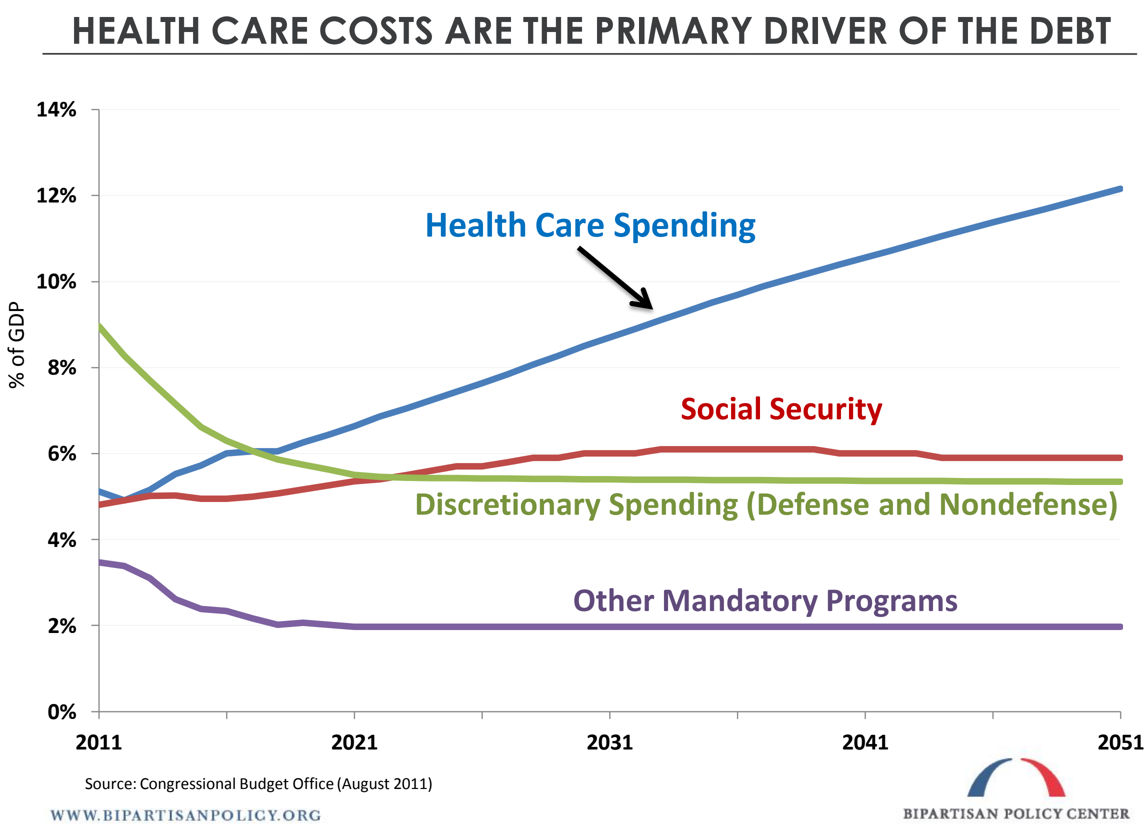

The Task Force plan includes both demand- and supply-side approaches to slowing the growth in overall health spending and federal spending specifically. Some aspects target the health system in general, while others focus specifically on Medicare and Medicaid.

The major demand-side strategy is to cap and then phase out the tax exclusion of employer-sponsored health insurance (ESI) benefits. This policy will result in more cost-conscious choices by purchasers of health insurance.

Also on the demand side is a proposal to modernize patient cost sharing in the Medicare program. The modernized benefit structure will include a combined annual deductible for Parts A and B, and will provide catastrophic coverage – a protection that is sorely lacking today – thereby more closely matching recent trends in private health care plans.

The key supply-side strategy is to reform provider payment incentives. Moving payment away from fee-for-service and toward broader payment units will incentivize providers to seek more efficient delivery systems. Health reform – i.e., the ACA – took some very important steps toward reforming provider payments in Medicare. The Task Force proposes to build on this by bundling payments for post-acute care into the payment for inpatient care. Many other options for supply-side reform have received bipartisan support – this committee would be wise to select from some of those, as well.

For Medicaid, in the short term, the Task Force proposes to remove barriers to greater use of managed care for those dually eligible for Medicare and Medicaid. For the long term, significant changes to the program are needed – both narrowly-targeted and fundamental reform proposals should be given serious consideration.

Although each of these proposals will have beneficial effects for the national healthcare system help control federal costs, much of the long-run savings in the Task Force plan will come from transitioning Medicare from fee-for-service to a defined support option. This new system will marshal both demand- and supply-side leverage to transform the national healthcare infrastructure into a more efficient and effective vehicle. As such, this is the proposal that we primarily will focus on today:

Domenici-Rivlin Protect Medicare Act

Simply put, there can be no lasting solution to the U.S. debt crisis without structural changes in the Medicare program to slow its cost growth. This can be done through our proposal to transition Medicare to a "defined support" plan. Such a system will provide major incentives to increase the efficiency and effectiveness of health care delivery to seniors – without abolishing current Medicare, or forcing any beneficiary to move to a different system – and cap total Medicare spending while protecting low-income seniors.

The Domenici-Rivlin defined support proposal will preserve Medicare for future generations. It will allow beneficiaries who wish to stay in traditional Medicare to do so, but also control program costs by providing them the option of choosing among competing private plans that could save them money. It will restrain the growth in total Medicare spending, while protecting low-income beneficiaries from any increases in their cost. In short, the Domenici-Rivlin plan both will preserve Medicare as a choice and also save money by flattening the now-steeply-rising Medicare cost curve.

The Domenici-Rivlin proposal restructures Medicare to achieve fiscal soundness in three ways:

1) A new federally-run Medicare Exchange will provide beneficiaries with a truly competitive marketplace in which they can choose among private healthcare plans and traditional fee-for-service Medicare (FFS). The private plans will be required to cover at least the same services as FFS Medicare, and their government subsidy will be adjusted up (or down) if they attract patients whose illnesses are more (or less) expensive than

average. The Exchange will provide understandable information about the costs and health outcomes of plans so that beneficiaries can choose plans that are best for them, and will allow beneficiaries, if they are not satisfied, to change plans in an annual open season. This competition will incentivize healthcare plans to innovate in every facet of their operations and benefit designs to keep premiums down and quality of care up.

2) By using competitive bidding, this system will tie the federal contribution to the cost of the 2nd-cheapest approved plan or FFS Medicare in each area, whichever is cheaper. Thus, the government will no longer have to pay extra to private healthcare plans in areas where the public FFS plan provides cheaper coverage, nor will they have to overpay to provide FFS Medicare in areas where approved private plans offer the same care at lower cost.

3) These two cost-control features should flatten the cost curve. However, an additional element will ensure substantial savings. The growth in per-beneficiary federal support will be limited to one percentage point faster than the growth of the economy – "GDP+1%" – compared to the current projection of growth that is 1.7 percentage points faster. If costs rise faster than the established limit, Medicare beneficiaries will have to pay higher premiums. However, individuals whose Part B premiums are paid by Medicaid programs will not be affected. Additionally, to smooth the transition to the defined-support system, current beneficiaries with low incomes will be guaranteed access to traditional Medicare with no additional premiums. This subsidy will phase out at higher income levels.

How the Exchanges Work

In each regional market – be it a metropolitan area, or a large rural area where population density is low – all of the private healthcare plans and traditional FFS Medicare will submit bids (subject to strict quality and coverage standards) to provide the standard Medicare benefit package for Parts A and B to an average-risk beneficiary. The FFS "bid" will be based on average FFS costs for the same type of standardized beneficiary in the bidding area. The amount that the government contributes to premiums in that area will then be based on the 2nd-lowest private bid or FFS Medicare's bid, whichever is lower. This will be referred to as the "benchmark" bid.

Beneficiaries who choose to enroll in a plan that is more expensive than the benchmark – even if that plan is FFS Medicare – will be required to pay the incremental additional cost. A beneficiary who enrolls in the plan with the lowest bid will be rebated the full difference in cost from the benchmark

The Exchange will be federally run, presumably by the Centers for Medicare and Medicaid Services (CMS), require guaranteed issue (under which insurers may not decline any applicant), and enforce guidelines for the structure of the benefit package. CMS also will utilize risk adjustment by distributing the government subsidy among insurers according to the health status of those whom they enroll.

Why is this proposal an improvement over the current Medicare system?

Medicare Advantage already offers private plans to Medicare beneficiaries. However, if a private healthcare plan currently has lower costs than FFS Medicare in its area, it cannot offer a rebate to enrollees as an incentive to sign up. Instead, it must increase benefits – which in and of itself increases Medicare spending. Therefore, beneficiaries in areas with high FFS Medicare costs who enroll in private plans receive a host of free supplementary benefits, financed by the government. There is no policy justification for selectively offering free, government-financed supplementary benefits to beneficiaries in one geographic region but not another.

Instead, the new Medicare Exchange will provide strong incentives for plans to manage care-delivery efficiently and to offer the public evidence that their plans achieve quality outcomes at comparatively low cost – because low-bidding plans would be rewarded with increased enrollment.

The Domenici-Rivlin proposal also guarantees that the federal support per beneficiary will *not* grow faster than GDP+1%, thereby assuring the federal government of budgetary savings. The cap on the growth rate also should increase the pressure on plans to develop more efficient methods of care delivery, and might increase political support – by Medicare beneficiaries, their children, and those approaching Medicare eligibility – for federal policies that promote cost containment in health care. The Affordable Care Act already established a cap on the growth of Medicare; moving to a defined support model creates the incentives to make that cap stick.

In the event that Medicare spending per beneficiary rises at a faster rate, enrollees will have to pay higher premiums to cover the difference.[1] However, individuals whose Part B premiums are paid by Medicaid programs will not be affected. Additionally, to smooth the transition to the defined-support system, current beneficiaries with low incomes will be guaranteed access to traditional Medicare with no additional premiums. The new system also could be structured to provide a higher subsidy to those with lower incomes and a lower subsidy to those with higher incomes.

[1] To promote stability, the proposal calls for employing a five-year historical trend of per-capita GDP rather than measuring the change over a single year.

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Fundamental, Pro-growth Tax Reform

Unfortunately, even if we are able to significantly bend health care's cost curve through the Protect Medicare Act and rein in other spending, the aging of the population and retirement of the baby boom generation is not something that we can control. In order to stabilize the debt, therefore, we must raise more revenue. But, this can be achieved through fundamental tax reform that broadens the base, lowers tax rates, and promotes economic growth.

The Bipartisan Policy Center's Tax Reform Plan represents a radical simplification of the current tax code and raises $2.2 trillion more in revenue than current policy[2] (or, $1.7 trillion less than current law). In fact, to best explain it, forget what you know about the complexities of the current tax system, and start fresh. Outlined below are the core elements of the plan:

- A **two-bracket income tax with rates of 15% and 28%**. Because there is no standard deduction or personal exemptions, the 15% rate applies to your 1st dollar of income.[3]

- The **corporate tax rate will be set at 28%**, instead of the current 35% level.

- Capital gains and dividends will be taxed **as ordinary income** (**with a top rate of 28%**), excluding the first $1,000 of realized net capital gains (or losses).[4]

- To replace the overly-complex Earned Income Tax Credit (EITC) and to help offset the elimination of personal exemptions, the standard deduction and the child credit, the BPC Plan will establish:
  - A flat **refundable per child tax credit of $1,600** (higher than current law); and
  - A **refundable earnings credit** similar in structure to the recent Making Work Pay credit, but substantially higher.

- Instead of the current system of itemized deductions, which disproportionately subsidizes the housing consumption and charitable giving of upper-income taxpayers, the BPC Plan will:
  - Provide a **flat 15% refundable tax credit for charitable contributions** and for up to $25,000 per year, not indexed, **mortgage interest on a primary residence**.
  - Eliminate the deduction for state and local taxes.

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[2] Current policy baseline assumes that all 2001/2003/2010 income and estate tax cuts are extended and that the AMT is indexed to inflation.
[3] The 27% rate applies approximately to income above $51,000 for single filers and $102,000 for couples.
[4] $500 for singles and heads of household

- Provide a flat, **15% refundable tax credit** or a deduction (for those in the higher bracket) **for contributions to retirement saving accounts** up to 20% of earnings or a maximum of $20,000.

- Include 100% of Social Security benefits in taxable income, but:
  - Create a non-refundable credit for Social Security beneficiaries equal to 15% of the current standard deduction; and
  - Create a non-refundable credit equal to 15% of an individual's Social Security benefits.

- Allow deduction of medical expenses in excess of 10% of AGI (as in current law).

- Allow deduction of miscellaneous itemized deductions in excess of 5% of AGI.

The BPC Plan achieves a massive simplification of the tax code by **aligning the top individual, capital gains and dividend tax rates, significantly reducing the corporate tax rate, and eliminating the AMT**. Additionally, **most individuals will no longer have to file an annual tax return**[5] beyond an initial declaration of status because the most commonly taken deductions have either been turned into refundable credits, determined solely based on the number of children and earnings, or can only be deducted above a substantial floor. Despite a low top rate of 28%, the new tax system created under the BPC Plan will be **more progressive than the current system** and **raise the requisite revenue to achieve a sound debt-reduction goal**.

How the Joint Select Committee on Deficit Reduction can reach the grand bargain

To put our country's budget back on a sustainable path, these three elements are essential. However, time is short. With the deadline to report recommendations only three weeks away, writing legislation to fundamentally reform Medicare or the tax code is unrealistic. **Still, this Committee can achieve these objectives**.

Section 404 of the Budget Control Act (BCA) provides this Committee the power to draft legislation that must be voted on by the House and the Senate and, if approved, presented to the president for his signature. Significantly, such legislation could:

- Order the committees with jurisdiction over entitlements and revenues to report legislative language by a specific date next year (for example, April 15, 2012), after the

[5] According to Tax Policy Center projections, only 50% of tax units would be required to file tax returns, as opposed to 88% under the current tax system.

expiration of the Joint Select Committee (JSC) itself, to change their programs to reduce projected federal deficits by an amount certain.

- In that order, the JSC could specify explicitly not only the deficit reduction targets to be met, but also the nature of the structural program changes to be made – and by so doing, enforce what would be a true and binding agreement between the two political parties that had been negotiated within the JSC.

- The legislation developed by the instructed committees would be reported back to the House and Senate Rules Committees (or the Budget Committees) and combined into one bill, which would be scored by the Congressional Budget Office.
- The JSC, further, could order that the legislation reported back by the instructed committees receive "fast-track" treatment in the House and Senate, which could be similar to the fast-track treatment afforded to some other types of legislation, and would be determined by the recommendations of the JSC itself.

- Lastly, the JSC could draft the legislative language so that failure to produce the substantive legislation would trigger a sequestration, either conforming to the instructions given to the committees and in the amount of the deficit reduction targets required by the JSC, or in some new manner that could be specified by the JSC.

In sum, Section 404 of the BCA gives the JSC the power to do much more than just find savings of $1.2 trillion to $1.5 trillion; it also has the power to establish and enforce a process that uses existing congressional committees to change entitlement and tax policies.

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APPENDICES

TESTIMONY BY SEN. PETE V. DOMENICI AND DR. ALICE RIVLIN

CO-CHAIRS, BIPARTISAN POLICY CENTER DEBT REDUCTION TASK FORCE

TO

THE JOINT SELECT COMMITTEE ON DEFICIT REDUCTION, U.S. CONGRESS

NOVEMBER 1, 2011

1. 3-step process, $1.2-1.5 trillion spreadsheet and JSC instructions for authorizing committees: How the super committee could stabilize the debt
2. Background document on savings of $1.2 trillion (Step 2): A $1.2 trillion down payment on deficit reduction
3. Section 404 one-pager: The super committee's "super" authority under the Budget Control Act
4. Domenici-Rivlin Medicare Act: Protecting and reforming Medicare
5. Tax reform summary: Creating a simple, pro-growth tax system
6. Payroll tax holiday brief: Economic growth and the payroll tax holiday

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THE ROAD TO THE GRAND BARGAIN

STEP I	→	STEP II	→	STEP III
DONE • Establish Joint Committee on Deficit Reduction • Cap discretionary spending to save $917 billon		**IN PROCESS** • $1.2-1.5 trillion in additional savings • Mandatory spending restraint • Eliminate some tax expenditures • Grow the economy through the enactment of a full Social Security payroll tax holiday		**THE GOAL** • Issue instructions to committees • Change programs within their jurisdiction to achieve fundamental tax and entitlement reform • Report changes by a date certain • Expedited legislative process

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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 could 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 (One Way to Achieve a Net $1.2 Trillion in Savings for Step 2)

***Indicates that there is more than one option for that policy listed in the background information**

Page	*Medicare Savings*	Approximate Savings (in billions of $)
1	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
3	Reduce Medicare coverage of patients' bad debts	20
3	Accelerate home health savings in the ACA*	9
4	Introduce home health co-payments	40
5	Use Medicare's buying power to increase rebates from pharmaceutical companies	154
8	Bundle Medicare's payments / reform provider payments for post-acute care to reduce costs*	42
10	Better align graduate medical education payments w/ patient care costs*	60
12	Reduce or Eliminate Subsidies to Rural Hospitals in Medicare*	17
14	Increase Part B deductible for new beneficiaries	4
14	Eliminate provider carve-outs from IPAB	--
14	Make reforms to Medicare's Quality Improvement Organizations (QIOs)	3
15	One-year SGR fix	-12
	Total Medicare	**430**
	Medicaid Savings	
16	Eliminate state gaming of Medicaid tax gimmick	26
16	Apply a single blended matching rate to Medicaid, CHIP, and exchanges	21
17	Rebase Medicaid disproportionate share hospital (DSH) allotments in 2021	4
17	Limit Medicaid reimbursement of durable medical equipment (DME) based on Medicare rates	4
17	Shorten exclusivity period for brand name biologic drugs	4
18	Prohibit "pay for delay" agreements to increase the availability of generic drugs and biologics	3
19	Track high prescribers and utilizers of prescription drugs in Medicaid	4
19	Reduce Medicaid fraud	1
	Total Medicaid	**67**

Other Healthcare Savings

21	Limit medical malpractice torts	62
23	Increase TRICARE annual premiums and Rx copayments	22
24	Decrease investment in prevention and public health fund	4
25	Include Social Security benefits in income calculation to determine Exchange subsidy eligibility	15
	Total Other Health Care	**103**
	TOTAL HEALTHCARE	**600**

Other Mandatory Savings

26	Switch to the chained CPI measure of inflation	145
26	Reform civilian retirement	60
28	Reform military retirement	4
29	Reduce farm program spending	35
33	Reform the aviation passenger security fee to more accurately reflect the costs of aviation security	25
34	Adjust Pension Benefit Guarantee Corporation fees to better cover unfunded liabilities	16
36	Actuarially adjust flood insurance subsidies for risk*	12
38	Auction radio spectrum to expand wireless broadband and invest in a broadband network for public safety users	18
39	Index mandatory user fees to inflation	2
39	Restructure the power marketing administrations to charge market rates	2
40	Transfer the Tennessee Valley Authority's electric utility functions and associated assets and liabilities	4
42	Gradually lower the conforming loan limits for Fannie/Freddie	4
43	Increase guarantee fees charged by Fannie/Freddie	27
45	Provide Postal Service Financial Relief and Undertake Reform	19
46	Improve Collection of Pension Information from States and Localities	3
46	Get rid of unneeded Federal real property	4
47	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

48	Switch to the chained CPI measure of inflation	72
49	Eliminate ethanol/biodiesal subsidies	19
52	Cut subsidies for employee parking expenses	38
52	Eliminate the mortgage deduction for 2nd homes/yachts	15
53	Tax carried interest as ordinary income	21
55	Cut subsidies for private-purpose state and local bonds	23
56	Eliminate Hollywood tax breaks	1
57	Timber subsidies	5
58	Remove many energy subsidies (solar, wind, oil and gas, coal)	61
58	Include All Income Earned Abroad by U.S. Citizens in Taxable Income	71
59	Exclusion of Certain Allowances for Federal Employees Abroad	18
60	Eliminate LIFO and LCM Inventory Accounting Methods	100
62	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**

LEGISLATIVE INSTRUCTIONS FOR STEP 3

GENERAL[6]

CBO (with customary input from the Joint Committee on Taxation) is the umpire.[7]

CBO should provide economic analysis of the proposal over at least 20 years.[8]

CBO's static analysis should be the official score.[9]

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.[10]

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.[11]

Each bill from the Committees of jurisdiction will be held at the desk until all are completed.[12]

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[6] These "general" instructions might be added to each Committee's instructions, or put forward in some other way.

[7] 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.

[8] 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.

[9] 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.

[10] 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.

[11] 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.

[12] 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.[13]

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.[14]

The maximum tax rate on individuals and corporations shall be no higher than 28 percent.[15]

MEDICARE POLICY

Beneficiaries (present and future) who wish to enroll in the current conventional Medicare program must have that option.[16]

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[13] 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.

[14] 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.

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

[16] 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 they are forced to switch to current Medicare when they turn 65. With a guarantee of access to conventional

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.[17]

SOCIAL SECURITY POLICY

Separate from the deficit-reduction effort, legislation shall be prepared to achieve 75-year sustainable solvency of Social Security.[18]

All savings from the Social Security legislation shall be credited to the Social Security trust fund.[19]

Medicare, it should be acceptable to other informed beneficiaries. This instruction builds the foundation for all beneficiaries to have the coverage they want.

[17] 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.

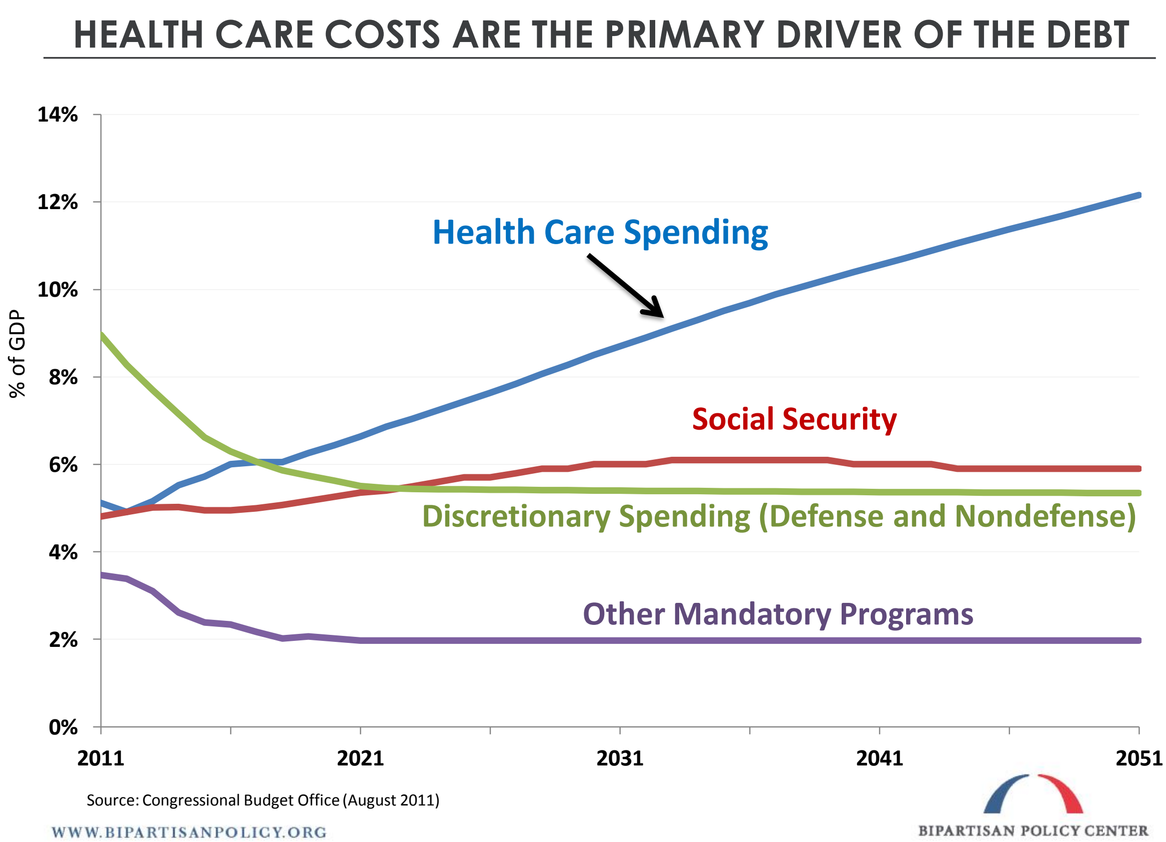
[18] Early repair of Social Security's finances will get the program out of the political line of fire, which all program advocates ought to support. Rhetorically, it must be clear that Social Security will be repaired for its own sake, not to balance the budget (though that of course is a subsidiary 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).

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

Domenici-Rivlin Protect Medicare Act

The principal driver of future federal deficits is the rapidly mounting cost of Medicare. The huge growth in the number of eligible seniors over the coming years is due to both increasing longevity and the retirement of the baby boomers. Then, that beneficiary growth is multiplied by continuing increases in the cost of health care. Without a significant change in this trend, the cost of Medicare will continue to rise faster than the economy can possibly grow. Even if revenues are raised and other spending is restrained (both of which the BPC supports), the exploding cost of Medicare is unsustainable.

Simply put, there can be no lasting solution to the U.S. debt crisis without structural changes in the Medicare program to slow its cost growth. This can be done through our proposal to transition Medicare to a "defined support" plan. Such a system will provide major incentives to increase the efficiency and effectiveness of health care delivery to seniors – without abolishing current Medicare, or forcing any beneficiary to move to a different system – and cap total Medicare spending while protecting low-income seniors.



The Domenici-Rivlin defined support proposal will preserve Medicare for future generations. It will allow beneficiaries who wish to stay in traditional Medicare to do so, but also control program costs by providing them the option of choosing among competing private plans that could save them money. It will restrain the growth in total Medicare spending, while protecting low-income beneficiaries from any increases in their cost. In short, the Domenici-Rivlin plan both will preserve Medicare as a choice and also save money by flattening the now-steeply-rising Medicare cost curve.

The Domenici-Rivlin proposal restructures Medicare to achieve fiscal soundness in three ways:

4) A new federally-run Medicare Exchange will provide beneficiaries with a truly competitive marketplace in which they can choose among private healthcare plans and traditional fee-for-service Medicare (FFS). The private plans will be required to cover at least the same services as FFS Medicare, and their government subsidy will be adjusted up (or down) if they attract patients whose illnesses are more (or less) expensive than average. The Exchange will provide understandable information about the costs and health outcomes of plans so that beneficiaries can choose plans that are best for them, and will allow beneficiaries, if they are not satisfied, to change plans in an annual open season. This competition will incentivize healthcare plans to innovate in every facet of their operations and benefit designs to keep premiums down and quality of care up.

5) By using competitive bidding, this system will tie the federal contribution to the cost of the 2nd-cheapest approved plan (subject to capacity constraints) or FFS Medicare in each area, whichever is cheaper. Thus, the government will no longer have to pay extra to private healthcare plans in areas where the public FFS plan provides cheaper coverage, nor will they have to overpay to provide FFS Medicare in areas where approved private plans offer the same care at lower cost.

6) These two cost-control features should flatten the cost curve. However, an additional element will ensure substantial savings. The growth in per-beneficiary federal support will be limited to one percentage point faster than the growth of the economy – "GDP+1%" – compared to the current projection of growth that is 1.7 percentage points faster. If costs rise faster than the established limit, Medicare beneficiaries will have to pay higher premiums. However, individuals whose Part B premiums are paid by Medicaid programs will not be affected. Additionally, to smooth the transition to the defined-support system, current beneficiaries with low incomes will be guaranteed access to traditional Medicare with no additional premiums. This subsidy will phase out at higher income levels.

How the Exchanges Work

In each regional market – be it a metropolitan area, or a large rural area where population density is low – all of the private healthcare plans and traditional FFS Medicare will submit bids (subject to strict quality and coverage standards) to provide the standard Medicare benefit package for Parts A and B to an average-risk beneficiary. The FFS "bid" will be based on average FFS costs for the same type of standardized beneficiary in the bidding area. The amount that the government contributes to premiums in that area will then be based on the 2nd-lowest private bid or FFS Medicare's bid, whichever is lower. This will be referred to as the "benchmark" bid.

Beneficiaries who choose to enroll in a plan that is more expensive than the benchmark – even if that plan is FFS Medicare – will be required to pay the incremental additional cost. A beneficiary who enrolls in the plan with the lowest bid will be rebated the full difference in cost from the benchmark

The Exchange will be federally run, presumably by the Centers for Medicare and Medicaid Services (CMS), require guaranteed issue (under which insurers may not decline any applicant), and enforce guidelines for the structure of the benefit package. CMS also will utilize risk adjustment by distributing the government subsidy among insurers according to the health status of those whom they enroll.

Why is this proposal an improvement over the current Medicare system?

Medicare Advantage already offers private plans to Medicare beneficiaries. However, if a private healthcare plan currently has lower costs than FFS Medicare in its area, it cannot offer a rebate to enrollees as an incentive to sign up. Instead, it must increase benefits – which in and of itself increases Medicare spending. Therefore, beneficiaries in areas with high FFS Medicare costs who enroll in private plans receive a host of free supplementary benefits, financed by the government. There is no policy justification for selectively offering free, government-financed supplementary benefits to beneficiaries in one geographic region but not another.

Instead, the new Medicare Exchange will provide strong incentives for plans to manage care-delivery efficiently and to offer the public evidence that their plans achieve quality outcomes at comparatively low cost – because low-bidding plans would be rewarded with increased enrollment.

The Domenici-Rivlin proposal also guarantees that the federal support per beneficiary will *not* grow faster than GDP+1%, thereby assuring the federal government of budgetary savings. The cap on the growth rate also should increase the pressure on plans to develop more efficient methods of care delivery, and might increase political support – by Medicare beneficiaries, their children, and those approaching Medicare eligibility – for federal policies that promote cost containment in health care. The Affordable Care Act already established a cap on the growth of Medicare; moving to a defined support model creates the incentives to make that cap stick.

In the event that Medicare spending per beneficiary rises at a faster rate, enrollees will have to pay higher premiums to cover the difference.[20] However, individuals whose Part B premiums are paid by Medicaid programs will not be affected. Additionally, to smooth the transition to the defined-support system, current beneficiaries with low incomes will be guaranteed access to traditional Medicare with no additional premiums. The new system also could be structured to provide a higher subsidy to those with lower incomes and a lower subsidy to those with higher incomes.

Cumulative savings in billions of dollars, 2016 through:				
	2021	**2025**	**2030**	**2040**
Domenici-Rivlin Protect Medicare Act (beginning in 2016)	$241	$569	$1,337	$4,906

[20] To promote stability, the proposal calls for employing a five-year historical trend of per-capita GDP rather than measuring the change over a single year.

Bipartisan Policy Center (BPC) Tax Reform
Quick Summary

The BPC Tax Reform Plan represents a radical simplification of the current tax code and would raise approximately $1.3 trillion less than the system under current law. In fact, to best explain it, forget what you know about the complexities of the current tax system, and start fresh. Outlined below are the core elements of the plan:

- A **two-bracket income tax with rates of 15% and 28%**. Because there is no standard deduction or personal exemptions, the 15% rate applies to your 1st dollar of income.[21]

- The **corporate tax rate will be set at 28%**, instead of the current 35% level.

- Capital gains and dividends will be taxed **as ordinary income** (**with a top rate of 28%**), excluding the first $1,000 of realized net capital gains (or losses).[22]

- To replace the overly-complex Earned Income Tax Credit (EITC) and to help offset the elimination of personal exemptions, the standard deduction and the child credit, the BPC Plan will establish:
  - A flat **refundable per child tax credit of $1,600** (higher than current law); and
  - A **refundable earnings credit**[23] similar in structure to the recent Making Work Pay credit, but substantially higher.

- Instead of the current system of itemized deductions, which disproportionately subsidizes the housing consumption and charitable giving of upper-income taxpayers, the BPC Plan will:
  - Provide a **flat 15% refundable tax credit for charitable contributions** and for up to $25,000 per year, not indexed, **mortgage interest on a primary residence**.
  - Eliminate the deduction for state and local taxes.
  - Provide a flat, **15% refundable tax credit** or a deduction (for those in the higher bracket) **for contributions to retirement saving accounts** up to 20% of earnings or a maximum of $20,000.

[21] The 28% rate applies approximately to income above $51,000 for single filers and $102,000 for couples.
[22] $500 for singles and heads of household
[23] The refundable earnings credit is equal to 17.5% of the first $20,000 of earnings.

- Include 100% of Social Security benefits in taxable income, but:
    - Create a non-refundable credit for Social Security beneficiaries equal to 15% of the current standard deduction; and
    - Create a non-refundable credit equal to 15% of an individual's Social Security benefits.

- Effective in 2015, cap and then phase out over 10 years the tax exclusion for employer-sponsored health insurance benefits.

- Allow deduction of medical expenses in excess of 10% of AGI (as in current law).

- Allow deduction of miscellaneous itemized deductions in excess of 5% of AGI.

The BPC Plan achieves a massive simplification of the tax code by **aligning the top individual, capital gains and dividend tax rates, significantly reducing the corporate tax rate, and eliminating the AMT**. Additionally, **most individuals will no longer have to file an annual tax return**[24] beyond an initial declaration of status because the most commonly taken deductions have either been turned into refundable credits, determined solely based on the number of children and earnings, or can only be deducted above a substantial floor. Despite a low top rate of 28%, the new tax system created under the BPC Plan will be **more progressive than the current system** and **raise the requisite revenue to achieve our debt-reduction goal**.

[24] According to Tax Policy Center projections, only 50% of tax units would be required to file tax returns, as opposed to 88% under the current tax system.

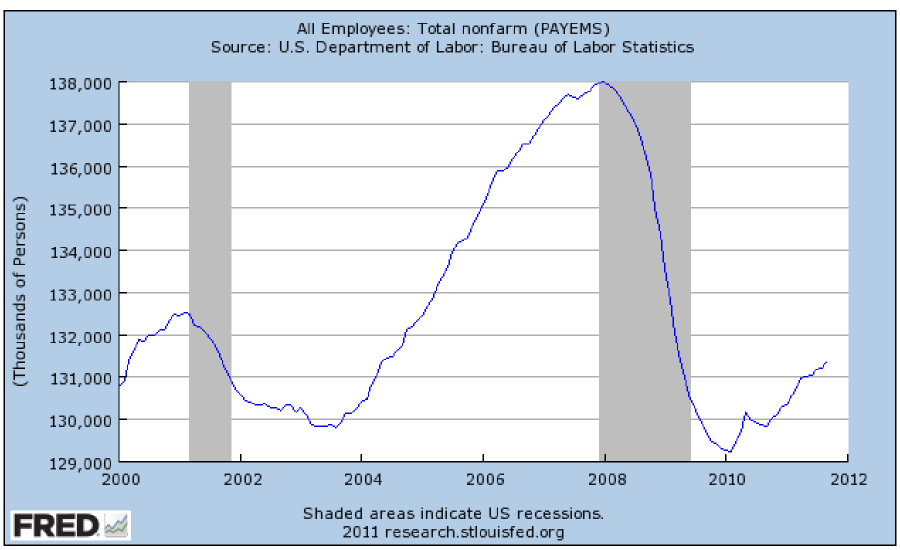
It's Time for a Holiday!

The United States is mired in the slowest recovery from the deepest recession since the Great Depression. Unemployment has hovered around 9 percent for over two years, and there is serious concern about a double dip recession. Any realistic plan to address these problems must garner bipartisan support, and now is the time for action. In order to spur economic growth and business activity, we will need agreement on an effective proposal to boost the flagging economy. The Domenici-Rivlin Task Force's full Social Security payroll tax holiday for calendar year 2012 fits the bill.

The holiday provides much better "bang-for-the-buck" than many other growth measures. It will immediately increase consumer spending and business hiring, thereby providing economic growth and jobs. The tax cut will provide financial relief for roughly 160 million American workers, many of whom are having difficulty making ends meet in the aftermath of the worst recession in nearly a century. A significant portion of the additional take-home pay will be spent quickly by consumers. Some of the money will undoubtedly go towards paying down debt, but household deleveraging is a necessary precondition for a return to low unemployment and sustained growth. A payroll tax holiday will help people get out of debt faster by adding roughly $3,000 to the average worker's paycheck.

The Social Security payroll tax directly funds Social Security. Employees and employers each pay 6.2 percent of salaries – up to a cap of $106,800 per employee – in payroll taxes. Because of this cap, a payroll tax holiday proportionally will direct more money into the pockets of working- and middle-class Americans, those who are most likely to spend it in short order. On the business side, a holiday will reduce the cost of hiring additional workers for every one of America's six million employers, the vast majority of them small business owners.

The Congressional Budget Office (CBO) projects that a full Social Security payroll tax holiday will create between 2.5 and 7 million jobs over two years. With almost 7 million fewer people employed now than before the recession, these jobs are sorely needed. The costs of continued long-term unemployment are steep and likely are already beginning to eat away at our future growth. Long-term unemployment leads to a permanent deterioration of the skills and productivity of our workforce. Therefore, returning unemployed Americans to work as quickly as possible must be a priority.



Temporarily suspending the payroll tax for employees and employers will ***not*** have any net effect on the Social Security Trust Fund. The General Fund of the government will transfer dollar for dollar back to the Trust Fund, such that it is made whole in real time with *no impact* on Social Security's financing.

A payroll tax holiday must be coupled with a strong deficit reduction plan in order to both strengthen the economy and reduce the debt. Restoring the economy to steady growth will help stabilize and reduce the debt, but given the severity of our fiscal imbalance, growth alone is not a panacea. A bold deficit reduction package is necessary, as well.

By providing more money to consumers and business alike right away, however, the payroll tax holiday will help to quickly reignite the struggling economy. It provides more near-term benefits than almost any other proposal in circulation, and will be an effective growth- and job-creator for the United States. That is why the payroll tax holiday is needed now, and should be included in any comprehensive economic recovery plan.

State	# of People Benefiting from Payroll Tax Holiday (millions)	Total Number of Businesses	Total Amount of Payroll Tax Cut (billions of $)	State	# of People Benefiting from Payroll Tax Holiday (millions)	Total Number of Businesses	Total Amount of Payroll Tax Cut (billions of $)
Alabama	2.3	79,812	8.1	**Nebraska**	1	42,302	4.1
Alaska	0.4	16,529	1.7	**Nevada**	1.2	49,956	4.7
Arizona	2.9	109,823	11.6	**New Hampshire**	0.8	32,334	3.5
Arkansas	1.4	52,699	4.7	**New Jersey**	4.7	202,600	23.8
California	16.7	717,133	74.5	**New Mexico**	0.9	37,549	3.5
Colorado	2.5	130,297	9.9	**New York**	10.1	443,992	46.0
Connecticut	2	75,842	9.3	**North Carolina**	4.7	176,196	18.0
Delaware	0.5	20,364	2.3	**North Dakota**	0.4	17,922	1.2
Florida	9	414,799	33.2	**Ohio**	5.7	199,647	20.9
Georgia	4.6	179,576	18.0	**Oklahoma**	1.9	73,310	6.4
Hawaii	0.7	26,360	2.9	**Oregon**	1.9	92,335	7.6
Idaho	0.8	39,368	2.9	**Pennsylvania**	6.7	237,055	27.9
Illinois	6.5	260,225	27.3	**Rhode Island**	0.6	25,818	2.3
Indiana	3.6	115,466	13.4	**South Carolina**	2.2	83,427	8.1
Iowa	1.7	65,015	6.4	**South Dakota**	0.5	21,797	1.7
Kansas	1.6	60,989	5.8	**Tennessee**	3.2	102,398	11.6
Kentucky	2.1	71,510	7.6	**Texas**	11.4	396,412	45.4
Louisiana	2.1	82,301	7.6	**Utah**	1.3	60,271	5.2
Maine	0.8	34,942	2.3	**Vermont**	0.4	19,282	1.7
Maryland	3.1	112,392	15.1	**Virginia**	4.3	154,808	19.2
Massachusetts	3.4	141,843	16.3	**Washington**	3.5	150,991	15.7
Michigan	5.1	182,606	19.8	**West Virginia**	0.9	30,873	2.9
Minnesota	3.1	120,950	13.4	**Wisconsin**	3.2	115,003	12.8
Mississippi	1.4	47,489	4.7	**Wyoming**	0.3	18,104	1.2
Missouri	3.1	120,145	11.1				
Montana	0.6	32,570	1.7	**United States**	158.6	6,095,427	641.0

Sources: **U.S. Census Bureau, Tax Policy Center, and Center on Budget and Policy Priorities**