A BIPARTISAN PATH FORWARD TO SECURING AMERICA'S FUTURE

April 2013

Moment of Truth
PROJECT

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About the Moment of Truth Project

In its final report, "The Moment of Truth," the President's bipartisan National Commission on Fiscal Responsibility and Reform ("Fiscal Commission") declared that the era of deficit denial is over. Since that report, the debate has transformed from a question of if we will reduce long-term deficits, to a matter of when and how we will do so.

The Moment of Truth project was established to spearhead a sustained, coordinated effort to capitalize and expand on the momentum generated by the Fiscal Commission. Though the Fiscal Commission did not have all the answers, it showed that broad bipartisan support for an ambitious deficit reduction plan is possible – as demonstrated by the bipartisan 11 out of 18 supermajority vote in favor of the plan, which included five Democrats, five Republicans, and one Independent.

The Moment of Truth project has built on this effort, working with Congress, the Administration, and the public at large. The project is co-chaired by Erskine Bowles and Senator Alan Simpson and staffed by several senior members of the Fiscal Commission staff. It focuses primarily on public education, Congressional outreach, and technical and policy analysis.

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The Moment of Truth (MOT) project is a non-profit, non-partisan effort that seeks to foster honest discussion about the nation's fiscal challenges, the difficult choices that must be made to solve them, and the potential for bipartisan compromise that can move the debate forward and set our country on a sustainable path.

Table of Contents

1. Preamble	2
2. Confronting Our Debt Challenge	4
3. The Principles of Principled Compromise	6
4. A Four-Step Process	9
5. A Summary of “Step 3”	10
6. Impact of the Proposal	13
7. Details of the Proposal	16
8. Ensure “Step 4” Savings	38
9. Appendices	41

A BIPARTISAN PATH FORWARD TO SECURING AMERICA'S FUTURE

By Erskine Bowles and Senator Alan Simpson

Preamble

More than two years ago, the National Commission on Fiscal Responsibility and Reform (Fiscal Commission) – a bipartisan group of lawmakers, civic leaders, and fiscal experts – released its final recommendations on how to chart a path forward to meaningful and bipartisan debt reduction. After having the privilege to serve as co-chairs of that commission, both of us – a former Republican Senator from Wyoming and a former chief of staff to Democratic President Bill Clinton – have travelled the country speaking to hundreds of thousands of Americans about our debt challenge. We have met American men and women of all different ages, incomes, backgrounds, and ideologies – and with many different ideas of how to fix our economy. Yet all shared two things in common – a thirst for the truth and a willingness to be part of the solution if everyone is in it together.

Unfortunately, back in Washington, the last two years have been defined by fiscal brinksmanship. Instead of enacting a comprehensive deficit reduction plan, similar to the size and scope of what we or other bipartisan groups and experts recommended, policymakers have jumped from crisis to crisis, waiting until the last moment to do the bare minimum to avoid catastrophe. The focus on elections over solutions and contrast over compromise has left our country with tremendous fiscal uncertainty and no plan to put our debt on a sustainable downward path.

The failure to get our debt under control, reform our tax code, and put our entitlement programs on a fiscally sustainable course is robbing us of the ability to invest in our future and will leave us without the resources we need to meet other challenges facing our nation. Moving forward will be out of our reach as long as we continue to "pass the buck" on the debt crisis. It is critical that leaders in both parties come together to put our fiscal house in order if they have any hope of addressing the other challenges and opportunities that we face as a nation.

To be sure, progress has been made. Out of the debt ceiling agreement in August of 2011 and the fiscal cliff agreement from the beginning of this year, policymakers have enacted as much as $2.7 trillion in deficit reduction, by some measures. Yet for all the unnecessary brinksmanship to achieve these savings,

what we have achieved is woefully insufficient. Reducing discretionary caps to require cuts from future appropriators and raising taxes on the top 1 percent of Americans are the easiest parts of deficit reduction, and the parts least likely to lead to long-term fiscal sustainability.

Despite multiple efforts from Speaker Boehner and President Obama to reach a "grand bargain," the country has still done nothing to make our entitlement programs sustainable for future generations, make our tax code more competitive and pro-growth, or put our debt on a downward path. Instead, we have allowed a "sequestration" to mindlessly cut spending across-the-board in all areas except those contributing to spending growth.

We believe there is a better way, and we believe that getting there is politically achievable. Last December, the negotiating parties were as close as they've ever been on a plan to put our fiscal house in order. Although they were not able to reach agreement at that time, we continue to believe that agreement is possible.

The plan we have put forward here is not our ideal plan, it is not the perfect plan, and it is certainly not the only plan. It is an effort to show both sides that a deal is possible; a deal where neither side compromises their principles but instead relies on principled compromise. Such a deal would invigorate our economy and demonstrate to the public that Washington can solve problems, and leave a better future for our grandchildren.

Confronting Our Debt Challenge

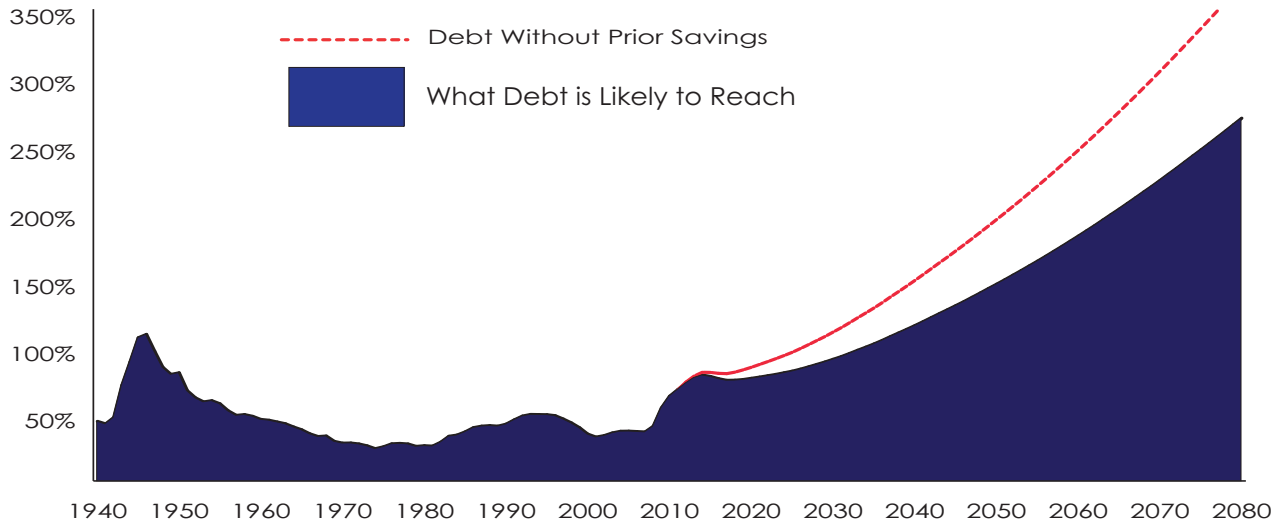
The United States continues to be on an unsustainable fiscal path. Despite the progress over the last couple of years, our national debt continues to rise with no end in sight. Since 2007, our debt has more than doubled as a share the economy – from 36 percent of gross domestic product (GDP), roughly the historical average, to more than 73 percent today.

More troubling, our debt levels will continue to rise even after the economy recovers due to the continued growth in health care spending, the ongoing retirement of the massive Baby Boom population, and rising interest payments on the national debt.

By our estimates, debt will reach 79 percent of GDP a decade from now and exceed 100 percent by 2035 and 200 percent in the 2060s. As debt levels grow, so too will the consequences of this debt burden. Interest rates will likely rise, making it more expensive to buy a home, invest in capital equipment, or start a new business. Economic growth will slow, with government borrowing "crowding out" more productive private investments. And rising government interest payments will leave little room for other government priorities, ranging all the way from defense to education.

Most troublingly, these levels of debt are unsustainable. At some point, if we do not correct this course on our own terms, the markets will do so for us. In the worst-case scenario, investors could rapidly lose confidence in our nation's ability to pay back its debt, leading to a global financial crisis the likes of which has never been seen before. Even absent such a crisis, the decisions necessary to right our fiscal course will become harder over time, requiring more pain with less warning and less time for people to prepare and adjust.

FIG 1. Public Debt Projections (Percent of GDP)



Source: Moment of Truth Project staff.

The so-called "sequestration," which we do not assume will stay in effect in our projections – would improve the debt picture over the next few years but do nothing to change the long-term trajectory. Not only do these mindless cuts have the potential to seriously damage our economy, national security, and domestic programs, but they do almost nothing to address growing entitlement costs and absolutely nothing to help restructure the tax code. Furthermore, sequestration ends in 2021, meaning no deficit reduction would accrue beyond that point.

Although we believe the United States should ultimately balance its budget, the most important measure for sustainability is to put the debt on a downward path relative to the economy. We believe that this will require a *minimum* of $2.4 trillion of deficit reduction over the next decade (relative to our baseline projections) and substantial additional savings over the long-term. A plan that falls short of this level might still stabilize the debt, but would be unlikely to insure against the risk of overly-optimistic projections, offer flexibility in case of new recessions or other crises, or provide the necessary running room to keep the debt shrinking beyond the first decade.

The argument that we should not enact comprehensive deficit reduction until the economy is stronger presents a false choice. Enacting a deficit reduction plan today is not the same thing as implementing immediate austerity. One of the guiding principles of the Fiscal Commission and this plan is that deficit reduction should be phased in gradually to avoid harming the economic recovery. Indeed, one of the reasons to act now in putting a plan in place is to allow time for the changes to be phased in gradually.

Designed properly, a comprehensive deficit reduction framework can promote short- and long-term economic growth by not only avoiding the effects of the sequestration but reducing uncertainty; improving confidence in future economic growth; promoting work, savings, and investment over the long-term; and reducing the likelihood of future debt crises.

On the other hand, continuing to wait to enact a comprehensive deficit reduction plan carries with it no true benefits and substantial economic risk.

The Principles of Principled Compromise

There is no perfect solution to our fiscal problems. However, we believe strongly and sincerely that an agreement on a comprehensive plan to bring our debt under control is possible if both sides are able to put their sacred cows on the table in the spirit of principled compromise. We understand that there will be disagreements about the exact approach to achieve deficit reduction. In our view, however, a reasonable debt reduction plan should at least do the following:

Put the Debt on a Clear Downward Path Relative to the Economy. Debt held by the public currently stands at 73 percent of GDP, about twice the historical average. We need to gradually reduce our debt relative to our economy. To be credible for the long-term, we believe that the *debt must be brought to below 70 percent of GDP* by early next decade, and kept on a downward trajectory thereafter. *Our plan would reduce the debt to 69 percent of GDP by 2023 under our base projections, and as low as 65 percent under more optimistic projections.*

Promote, Don't Disrupt, Economic Growth. The United States must pursue a growth agenda. As the economy recovers, one of the best ways to promote economic growth is to bring our debt under control to encourage private investment and mitigate the risk of a fiscal crisis at some point in the future. However, sharp austerity could have the opposite effect by tempering the still fragile economic recovery. In order to protect the recovery and promote long-term growth, deficit reduction should be phased in gradually and reforms should be designed to strengthen current economic conditions, promote work, encourage innovation, improve productivity, and bolster investment in our future. Encouraging investment also means finding additional savings from wasteful or low-priority spending throughout the budget to make resources available for critical investments in education, high-value research and development, and infrastructure to meet the demands of the future. *Our plan would repeal most of the sequester and phase in changes so that 95 percent of the deficit reduction occurs in 2016 and beyond, when the economy is projected to be much stronger. The plan also includes fundamental tax reform and substantial deficit reduction that, under conservative assumptions, could increase the size of the economy by roughly 2 percent by 2023.*

Protect the Disadvantaged. We must ensure that our nation has a robust, affordable, fair, and sustainable safety net. Benefits should be focused on those who need them the most, and low-income programs should not be cut simply for the sake of deficit reduction. Broad-based entitlement reforms should either include protections for vulnerable populations or be coupled with changes designed to strengthen the safety net for those who rely on it the most. *Our plan would not reduce benefits in any means-tested programs and includes significant protections and enhancements for those of modest income within our policies regarding Medicare cost-sharing, Medicare eligibility age, and chained CPI.*

Reform the Tax Code in a Progressive and Pro-Growth Manner. The current tax code is complicated, confusing, costly, anti-growth, anti-competitive, unfair, and riddled with

well over $1 trillion of tax expenditures – which really are just spending by another name. Tax reform must reduce the size and number of tax expenditures to reduce the budget deficit and lower marginal tax rates for individuals and corporations. At the same time, tax reforms must maintain or improve the progressivity in the tax code and promote economic growth. Tax reform will make the tax code more efficient, effective, and globally competitive. *Our plan puts in place a process for comprehensive tax reform to eliminate or scale back tax expenditures in order to generate nearly $600 billion in revenues for deficit reduction substantially reducing marginal tax rates for individuals, corporations, and small businesses, and moving toward a competitive territorial system while maintaining the progressivity of the tax code.*

Bend the Health Care Cost Curve. Our nation must seek to control its rapidly-growing health care spending while enhancing quality and value. Policymakers should reform federal health spending and tax preferences in order to reduce waste, improve incentives, and deliver care more effectively and efficiently to achieve significant savings in the near-term and control the growth of spending over the long-term. In the long-term, these reforms should be backed up by a cap on the budgetary commitment to health care, limiting per capita growth close to the growth of the economy. *Our plan would reform the Medicare payment system to begin to move away from fee-for-service and reward high-quality low-cost care and overhaul cost-sharing rules so that beneficiaries can play a greater role in promoting cost-control while receiving new protections for catastrophic costs. In addition, our plan would reduce the cost of defensive medicine by reforming our medical malpractice system, give states flexibility and incentives to pursue their own cost-control ideas, and identify a number of savings throughout the Medicare system.*

Get Serious About Population Aging. America is getting older, and the aging of the population represents a significant driver of our growing debt. We need to modernize our tax and entitlement programs to account for this demographic shift and encourage work and savings. *Our plan would gradually increase the Medicare age in combination with a Medicare buy-in with income-related subsidies. It also calls for comprehensive Social Security reform to make that program solvent.*

Cut Spending We Cannot Afford – No Exceptions. We must cut spending and encourage efficiencies in defense, non-defense, and mandatory spending programs, as well as in the tax code. *Our plan identifies savings throughout government, with more than 70 percent of savings from direct spending and nearly 25 percent from spending in the tax code.*

Replace Dumb Cuts with Smart Reforms. The mindless, across-the-board cuts from sequestration would reduce the deficit, but represent the wrong approach to budgeting. These cuts should be replaced with targeted reforms that focus on the drivers of the debt while eliminating redundant, wasteful, ineffective, or unwarranted federal spending while preserving high-value investments. *Our plan repeals most of the sequestration and replaces it with a set of more sensible policy changes. To the extent policymakers can identify additional cuts in low-priority spending beyond those included in our plan, the savings should be used to fund investments in education, high value research and other*

investments necessary to allow our country to remain competitive in a global economy.

Focus on the Long-Term. Looking only to the next decade would be a tragic misstep given the long-term trajectory of the debt. Structural improvements must be enacted to truly tackle the growth of debt over the long-term. Reforms must make Social Security sustainably solvent and limit the growth of all federal health obligations. *Our plan focusses on structural reforms which will pay dividends in future decades and it backs them up with a "Step 4" to make Social Security sustainably solvent and limit the per capita growth of federal health obligations to the growth of the economy.*

Protect the Full Faith and Credit of the U.S. Government. The political fights over the past two years about raising the debt limit have harmed market confidence in our government and created noticeable uncertainty. At the same time, debt cannot continue to grow faster than the economy without risking a fiscal crisis. *Our plan would index the federal debt limit so that no further debt ceiling increases are necessary so long as the debt is not growing faster than the economy and it establishes a debt stabilization mechanism to ensure policymakers act if the debt is projected to begin growing faster than the economy.*

Make America Better Off Tomorrow Than It Is Today. Our generation must take full responsibility for this problem – we created it, Republicans and Democrats alike. It is our responsibility to clean this up. We do not have the time or the luxury of leaving this problem for the next generation to solve. If America is to compete successfully in this global economy, the time for responsible action is now. We can't be the first generation of Americans to leave the country worse off than we found it.

The problem is real, the solutions are painful, and there is no easy way out. What we are calling for is by no means perfect, but it could serve as a mark for real bipartisan negotiations on a plan to reduce the deficit and grow the economy. It is time for our country to put this ultra-partisanship aside and pull together, not apart. We must do it for our grandchildren; we must do it for our children; we must do it for ourselves; we must do it for our country.

A Four-Step Process

Instead of enacting a comprehensive debt reduction plan, policymakers thus far opted to pursue fiscal reforms in steps. The first two steps have been accomplished through various continuing resolutions, the Budget Control Act of 2011, and the American Taxpayer Relief Act enacted in January 2013. We propose two more steps – a "Step 3" focused on additional cuts and reforms and a "Step 4" focused on securing our long-term debt trajectory. The outline below is not meant as a revision to the original Fiscal Commission plan, but rather builds upon where elected leaders were in their negotiations last year.

In "Step 3," we call for an additional **$2.5 trillion** of deficit reduction over the next ten years. Nearly one quarter of those savings come from health care reforms and another quarter from tax reform. The remaining savings come from a combination of mandatory spending cuts, stronger discretionary caps, cross-cutting changes such as adopting the chained CPI, and lower interest payments

In "Step 4", we call for a parallel process to make Social Security sustainably solvent, bring transportation spending and revenues in line, and make further reforms in health care programs if necessary to limit cost growth to about the growth rate of the economy.

FIG 2. Four Steps to Deficit Reduction (2014-2023)

Step 1: Reduce Defense and Non-Defense Discretionary Spending (~$1.85 trillion)
- Enact immediate reductions in discretionary spending levels (Oct 2010-Apr 2011)
- Impose ten-year caps to reduce and limit the growth of discretionary spending (Aug 2011)

Step 2: Increase Revenue Collection and Enact Minor Additional Spending Cuts (~$850 billion)
- Allow the upper-income tax cuts to expire, generally for income above $450,000 (Jan 2013)
- Make minor reductions in discretionary caps and Medicare provider payments (Jan 2013)

Step 3: Enact Serious Tax and Entitlement Reforms and Cut Additional Spending ($2.5 trillion)
- Reduce Medicare and Medicaid spending by improving provider and beneficiary incentives throughout the health care system, reducing provider payments, reforming cost-sharing, increasing premiums for higher earners, adjusting benefits to account for population aging, reducing drug costs, and getting better value for our health care dollars (April-Dec 2013)
- Enact comprehensive, pro-growth tax reform that eliminates or scales back most tax expenditures, with a portion of savings from tax expenditures dedicated to deficit reduction and the additional savings used to reduce rates and simplify the tax code (April-Dec 2013)
- Strengthen limits on discretionary spending (April-Dec 2013)
- Reduce non-health mandatory spending by reforming farm subsidies, modernizing civilian and military health and retirement programs, imposing various user fees, reforming higher education spending, and making other changes (April-Dec 2013)
- Adopt chained CPI for indexing and achieve savings from program integrity (April-Dec 2013)

Step 4: Make Social Security and Highway Programs Solvent and Medicare Sustainable
- Require reforms on a separate track to make Social Security sustainably solvent (2013)
- Require a highway bill to bring transportation spending and revenues in line (2014)
- Require additional reforms of federal health care programs if necessary to limit the growth of the per beneficiary federal health commitment to close to GDP growth (2018)

A Summary of "Step 3"

In "Step 3," we propose roughly $2.5 trillion of new deficit reduction to add to the $2.7 trillion already enacted. Looking both at the total deficit reduction and the additional deficit reduction in this plan, more than 70 percent of the savings would come from lower spending, with less than 30 percent from revenue. "Step 3" of our deficit reduction plan has five major elements. They include:

1. **Tighten and Strengthen Discretionary Caps** to demand additional efficiency from Washington in place of abrupt across-the-board cuts by restoring 70 percent of the sequestration cuts in 2013 and limiting the defense and non-defense spending growth to inflation through 2025.

2. **Reform Federal Health Spending** to reduce subsidies for better-off beneficiaries, reform and reduce provider payments; reduce fraud, abuse, and overpayments at all levels of the health care system; modernize cost-sharing rules with new cost protections; gradually increase the Medicare age with a buy-in at age 65; and re-orient incentives for doctors, hospitals, lawyers, and beneficiaries to improve the delivery of health care and truly "bend the cost curve."

FIG 3. Summary Table of Savings (2014-2023)

	Steps 1, 2, and 3	Enacted Savings (CRs, BCA, ATRA)	"Step 3"
Health Care	$615 billion	$30 billion	$585 billion
Other Mandatory	$255 billion	-$10 billion	$265 billion
Discretionary	~$1.94 trillion	~$1.55 trillion	$385 billion
New Primary Spending	**$2.81 trillion**	**~$1.57 trillion**	**$1.24 trillion**
Upfront Revenue	$690 billion	$690 billion	$0 billion
Tax Reform/Other Revenue	$585 billion	N/A	$585 billion
Revenue Subtotal	**$1.28 trillion**	**$690 billion**	**$585 billion**
Chained CPI	$280 billion	$0 billion	$280 billion
Program Integrity	$50 billion	$0 billion	$50 billion
General Government Sub-total	**$330 billion**	**$0 billion**	**$330 billion**
Interest Savings	**$780 billion**	**$430 billion**	**$350 billion**
Total Savings	**$5.19 trillion**	**$2.69 trillion**	**$2.50 trillion**
Debt (% GDP in 2023)	**69%**	**79%**	**N/A**
Memo:			
Total Spending Savings	$3.76 trillion	$2.00 trillion	$1.76 trillion
Total Revenue Savings	$1.43 trillion	$690 billion	$740 billion

Note: Figures are rounded

3. **Identify Additional Spending Cuts** to reduce various government subsidies, modernize the military and civilian health and retirement systems, improve the financial state of the PBGC, postal service, and Pell Grant program, cut low-priority spending, and impose various user fees.

4. **Enact Comprehensive Tax Reform** that uses a "zero plan" model as a starting point to dramatically reduce the size and number of tax expenditures in the code, sharply reduce rates, improve overall simplicity and move toward a territorial system to promote growth and generate revenue. Tax Reform should be written by the Committees but enforced with an across-the-board tax expenditure limitation.

5. **Implement Government-Wide Reforms** to reduce waste, fraud, and abuse and more accurately measure inflation within the budget and tax code while providing new protections for low-income individuals and the oldest beneficiaries.

Fig 4. Summary Table of "Step Three"

	2014-2023 Savings
Discretionary Caps	**$385 billion**
Reduce defense levels	$220 billion
Reduce non-defense levels	$165 billion
Health Care	**$585 billion**
Enact delivery system and payment reforms	$60 billion
Reform Medicare cost-sharing rules	$90 billion
Enact medical malpractice reform	$20 billion
Increase income-related premiums	$65 billion
Increase the Medicare age with an income-related Medicare buy-in	$35 billion
Reduce and reform post-acute care payments	$70 billion
Reduce various payments to hospitals	$65 billion
Reduce the cost of prescription drugs in Medicare	$90 billion
Reduce Medicare fraud and excessive payments	$25 billion
Reform Medicaid financing by reducing over-payments to states	$65 billion
Other Mandatory	**$265 billion**
Reduce and reform agriculture spending	$40 billion
Reform civilian and military health and retirement programs	$100 billion
Reform higher education programs	$35 billion
Increase or impose user fees	$50 billion
Enact additional savings	$40 billion
Revenues	**$585 billion**
Enact tax reform in 2014 enforced by failsafe trigger	$585 billion
General Government	**$330 billion**
Adopt Chained CPI w/ benefit enhancements for vulnerable populations	$280 billion
Fund program integrity measures	$50 billion
Net Interest	**$350 billion**
Total Savings	**$2.50 trillion**
*Potential Additional Savings from "Step 4"**	*~$350 billion*
Total Savings Including "Step 4"	***~$2.85 trillion***

Note: Savings relative to a current policy baseline explained in Appendix B.
*Assumes roughly $125 billion from reforms to the transportation trust fund, $100 billion from Social Security reforms, $75 billion from the health cap, and additional savings from interest – though actual numbers could differ substantially.

Impact of Proposal

Our proposal is far from perfect. However, we believe this plan would represent a tremendous step forward and, perhaps most importantly, believe it could be enacted into law over the course of this year. This plan would achieve greater deficit reduction than the proposals put forward by either side during the negotiations last year and require both sides take on their sacred cows and politically powerful interests. Based on where the budget negotiations were last December, however, we believe it is within the realm of what is politically possible if both sides are willing to go beyond their comfort zones and reach a principled compromise.

Not only do we believe this plan is politically achievable, but it would also be a real achievement. Taken as a whole, "Step 3" of our plan would:

- Replace the mindless across-the-board sequester cuts specific recommendations to achieve $2.5 trillion in deficit reduction through 2023, with 70 percent of total savings from lower spending.
- Increase total deficit reduction achieved since 2010 to nearly $5.2 trillion through 2023, with over 72 percent from lower spending.
- Reduce the deficit by over $500 billion in 2023 alone, compared to the $60 billion that would be generated by the sequester, reducing deficits to 1.9 percent of GDP in that year.
- Put the debt on a clear downward path relative to the economy, falling to 69 percent by 2023 under our base projections and as low as 65 percent if the wars draw down more quickly and the reforms in the plan produce the increases in economic growth that reports by the Congressional Budget Office and Joint Committee on Taxation suggest are possible.
- Reform the tax code in a way that improves fairness, lowers rates, raises revenue, and promotes more vibrant economic growth.
- Make structural changes to improve the long-term viability of federal health programs, backed up with a cap to ensure per capita health obligations grow no faster than the economy.
- Call for additional reforms to the Social Security, health, and transportation programs in a "Step 4" which could reduce the debt to 67 percent of GDP and the deficit to 1.7 percent by 2023.

Under our plan, using the most recent CBO economic and technical projections and realistic assumptions[1], deficits would fall from 5.4 percent of GDP in 2013 to 1.9 percent of GDP in 2023. By comparison, deficits in 2023 would total 3.9 percent of GDP in our baseline. Spending, meanwhile, would fall from 23.3 percent of GDP in 2013 to 21.6 percent by 2015 and would remain at or below that level through 2023, compared to baseline levels of 23 percent in 2023. And revenue would rise to 19.7 percent of GDP by 2023, compared to 19.1 percent in our baseline.

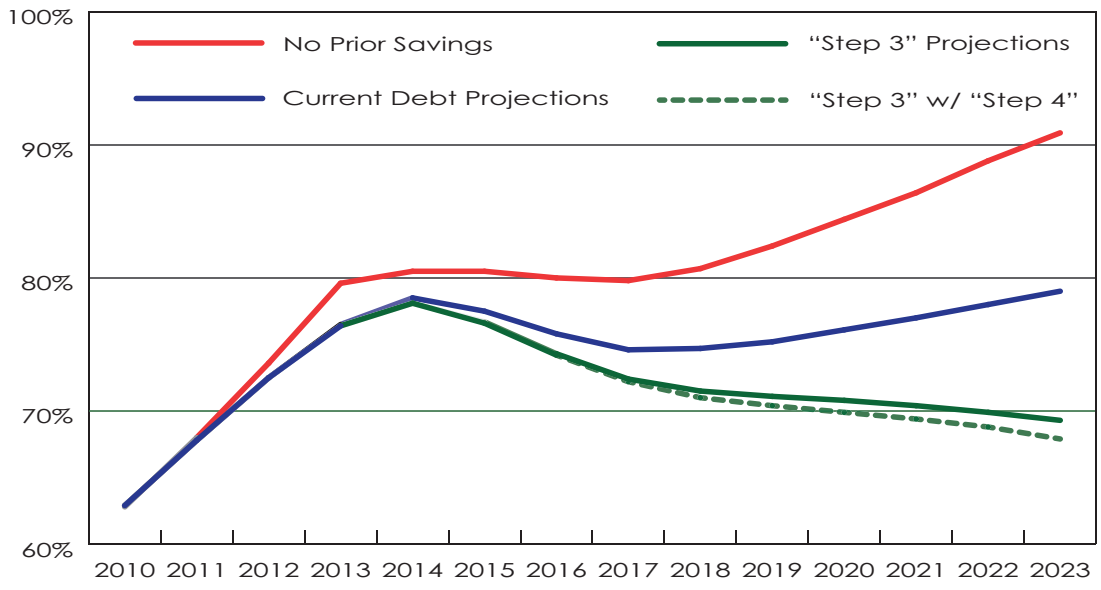
These projections exclude the effect of "Step 4," which could further reduce spending and increase revenues and would likely bring deficits down to 1.7 percent of GDP by 2023 (though most of the effects of "Step 4" would be felt beyond the ten year window). They also exclude potential increases in economic growth, which could further improve deficit projections.

FIG 5. Baseline and Resulting budget projections under the Bipartisan Path Forward (Percent of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Outlays											
"Step 3"	22.3%	22.1%	21.6%	21.3%	21.1%	21.3%	21.4%	21.5%	21.6%	21.6%	21.6%
Baseline	22.4%	22.2%	22.0%	21.7%	21.7%	22.0%	22.2%	22.4%	22.6%	22.9%	23.0%
Revenues											
"Step 3"	16.9%	18.1%	19.3%	19.3%	19.1%	19.1%	19.0%	19.1%	19.3%	19.5%	19.7%
Baseline	16.9%	18.0%	19.1%	19.1%	18.9%	18.8%	18.7%	18.7%	18.8%	19.0%	19.1%
Deficits											
"Step 3"	-5.4%	-4.0%	-2.4%	-1.9%	-2.0%	-2.2%	-2.3%	-2.4%	-2.3%	-2.1%	-1.9%
Baseline	-5.5%	-4.2%	-2.8%	-2.6%	-2.9%	-3.2%	-3.5%	-3.7%	-3.8%	-3.8%	-3.9%
Debt											
"Step 3"	76.4%	78.1%	76.7%	74.3%	72.4%	71.5%	71.1%	70.8%	70.4%	69.9%	69.3%
Baseline	76.5%	78.5%	77.5%	75.8%	74.6%	74.7%	75.2%	76.1%	77.0%	78.0%	79.0%

Most importantly, according to our estimates, "Step 3" alone would be sufficient put the debt on a clear downward path – reducing the debt-to-GDP ratio from above 78 percent of GDP in 2014 to almost 69 percent by 2023 and keep it on a downward trajectory for a number of years thereafter. It would do so without relying on mindless and senseless across-the-board cuts as in the sequestration. If "Step 3" is followed by further measures to address the shortfalls of Social Security and highway funding and restrain the growth of health spending – as we recommend – debt would fall to below 68 percent by 2023 and would remain on a clear downward path for decades to come.

FIG 6. Public Debt Paths under the Proposed Plan (Percent of GDP)



Source: Moment of Truth Staff

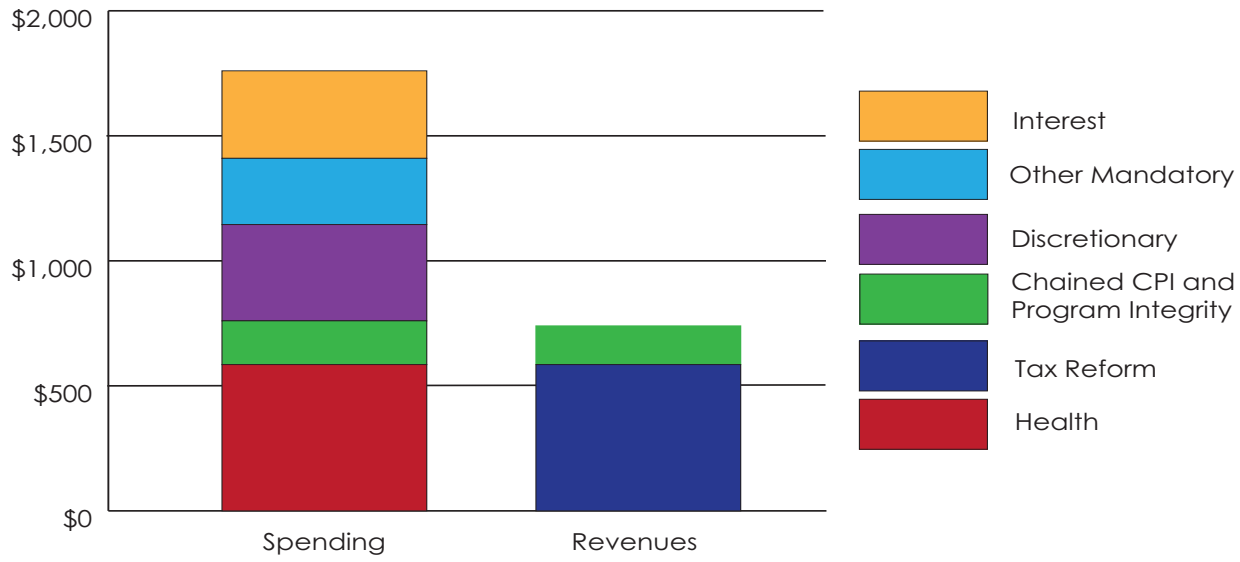
Although we do not account for this in our numbers, analysis by the CBO and JCT of similar proposals suggest that the combination of tax reform and gradual deficit reduction in our plan would promote economic growth both in the short-term and for years to come, thus further reducing the debt as a share of GDP. We also believe it is possible that this country will fully end its engagement in Iraq and Afghanistan at some point in the next few years – though our numbers assume some funds continue to be spent throughout the entire budget window. Accounting for these two effects would reduce debt levels to 65 percent of GDP by 2023, and deficit levels to 1.3 percent (see Appendix E for a more detailed explanation).

At the same time, we set our deficit reduction target and designed the plan to be robust enough to ensure the debt would not increase as a percentage of GDP even if the current economic projections prove to be too optimistic or other factors reduce revenues or increase spending above current projections (see Appendix F for more details).

Some have suggested that the amount of savings that would be achieved under this plan – $5.2 trillion including what has already been enacted, by some measures – "moves the goalposts" from the $4 trillion savings in the Fiscal Commission plan. In reality, the new framework actually calls for fewer savings than the original Commission report; the Fiscal Commission plan would have saved closer to $6.5 trillion if enacted today and measured on a comparable time window.

In developing this plan, we set the goal of reducing the debt as a percentage of GDP rather than on achieving a specific dollar amount of savings. The actual level of debt as a percentage of GDP and its future trend are the most relevant metrics for purposes of determining whether a deficit reduction plan puts the budget on a fiscally and economically sustainable course. There are many different ways to calculate the amount of savings that a plan would achieve, but what matters is the end result of the trajectory of the debt as a percentage of GDP, not how much savings are claimed. That is the metric by which this plan and any deficit reduction plan should be judged.

FIG 7. Ten-Year Savings in the Bipartisan Path Forward (billions)



Details of the Proposal

The "Step 3" plan we have laid out below could be achieved in any number of ways. For example; it could come from an all-encompassing legislative package; it could be enacted through the budget process – beginning with a conference report on the budget resolution; or it could be enacted through expedited procedures and accompanied by triggers where necessary. In any of these cases, there could be a downpayment enacted in the near future with further deficit reduction to follow. We then propose a "Step 4" of additional policies to be considered on a parallel track or in subsequent legislation to ensure the budget remains on a fiscally-sustainable long-term path beyond the ten-year budget window, and that the Social Security, Medicare, and highway programs are financially sound.

In this plan, we have provided suggested savings targets for each area of deficit reduction along with specific policies for achieving those targets. However, in many cases we have left open the precise parameters, which will depend in part on the official budgetary score, and, in some cases, require technical assistance. We have also included alternative methods of achieving savings targets in each area where possible. Policymakers will need to work on a bipartisan basis to decide upon the precise details. To the extent they disagree with any of our specifics, we only ask that they abide by what we call the "Becerra rule"; don't criticize any part of this plan without offering an alternative to achieve at least as much deficit reduction.

I. Discretionary Reforms ($385 billion)

Over the course of Fiscal Year 2011, the United States enacted a series of so-called continuing resolutions (CRs) to reduce annually-appropriated discretionary spending. These reductions culminated in the Budget Control Act of 2011, which put statutory limits or "caps" on both security and non-security spending. The combination of these CRs and caps reduced total discretionary spending by over $1.8 trillion (including interest savings) from 2014 through 2023. And when combined with small additional reductions in the American Tax Relief Act (ATRA), lawmakers set 2013 discretionary spending to levels we recommended in the original Fiscal Commission report – $1.043 trillion.

Although we do believe further savings and efficiencies are warranted over time, policymakers have unfortunately allowed a further $60 billion in cuts to base discretionary spending to take effect in FY2013 through an across-the-board sequestration. The sequester is not only deep and abrupt, but it is mindless and indiscriminate and thus does not allow policymakers or even agencies to prioritize. The continuing resolution enacted in late March made some improvements to this on the margins, but did not fundamentally change the nature of the sequestration.

Continued efficiencies and productivity gains should be expected from our government. However, these efficiencies should come from targeted cuts that protect effective and critical federal programs, *not from the blunt sequestration currently in place*. We therefore propose restoring 70 percent of the 2013 sequestration cuts and asking Congress and the Administration to set priorities in deciding where to restore funding and reallocating the cuts that remain.

Beyond 2013, we would impose defense and non-defense caps through 2025 (as opposed to 2021 under current law) and limit annual spending growth to inflation, as measured by the chained CPI. Using the lower 2013 spending levels as the starting point for discretionary spending limits would generate $385 billion of deficit reduction relative to our baseline, and would do so without resorting to deep immediate across-the-board cuts.

To better ensure spending growth remains under control beyond 2013, we also propose stronger enforcement and new rules to prevent games and gimmicks.

Specifically, we propose the following:

1. **Replace Sequestration with Tight Discretionary Caps Through 2025 ($385 billion through 2023 - $220 billion from Defense, $165 billion from NDD)**

This option would restore 70 percent of the across-the-board discretionary sequestration cuts for 2013 for both the defense and non-defense categories and then establish new caps indexed to inflation through 2025. The practical effect of this policy would be to repeal nearly $50 billion of mindless cuts in 2013, leaving about $20 billion in reductions below the pre-sequester levels[2] in our baseline and limit future spending growth from this reduced level to no greater than the rate of inflation as measured by the prior year's chained CPI.

We propose retaining the firewalls between defense and non-defense put in place by the sequester through 2025 based on the relative split in 2013. By limiting the growth of both sides of the discretionary budget to inflation, our proposal would yield roughly $220 billion of defense savings and $165 billion of non-defense savings from 2014 through 2023. Unlike the sequestration, which cuts spending abruptly and across the board, these savings would come from requiring the appropriators to prioritize and identify efficiencies.

An alternative approach would be to fully repeal the sequester reductions for 2013 and grow spending at a modestly slower rate in future years. However, we would warn against delaying too many years before enacting additional reductions since the farther the delay the less credible those reductions would be.

2. **Establish a 67-Vote Point of Order to Enforce Caps**

The Budget Control Act enforces its discretionary caps through a 60-vote point of order to block attempts to exceed the caps as well as an across-the-board sequester that would go into effect if the caps were violated. Our proposed would instead adopt the recommendation of the so-called "Gang of Six" and strengthen this enforcement by putting in place a 67-vote point of order in the Senate for legislation that increases the discretionary caps or blocks a sequester enforcing discretionary spending caps. Waiving sequestration of caps should also require a stand-alone vote. In the House, this option would require a separate, non-amendable vote for waiving enforcement.

3. Cap Spending on Overseas Contingency Operations

Currently, spending on wars abroad is not limited through the discretionary spending caps. This option would limit spending on Overseas Contingency Operations to the levels assumed in the Congressional Budget Office's (CBO) war drawdown scenario, and allow the President to submit revised limits based on war strategy. This provision would also set a stricter definition of what is allowed to count as OCO spending to prevent Congress and the Administration from shifting funding for items in the base budget to the war supplemental. Since the baseline assumes a drawdown, no savings are counted from this provision. Moreover, any additional "peace dividend" from further reductions in war spending below our drawdown path should be used for deficit reduction and not allowed to offset new spending or tax cuts.

4. Stop the Abuse of Emergency Spending

To provide greater transparency and accountability by preventing Congress from relying on emergency designations to get around fiscal restraints, this option would adopt the policy developed by the so-called "Gang of Six" setting a clear and legal definition of "emergency." The emergency designation would be limited only for urgent costs that cannot be reasonably offset, Congress would be required to designate each emergency provision individually as meeting the definition, instead of through global designations or global waivers. Any emergency spending measure must include a justification for the emergency designation in order to remain in effect, and any points of order raised against emergency designations could not be waived without a two-thirds majority in the Senate.

II. Health Care Reductions and Reforms ($585 billion)

The growing costs of Medicare and Medicaid represent the single greatest threat to our long-term fiscal sustainability, yet over the last two years the federal government has taken almost no action to control them. And while costs do appear to be slowing some on their own, they remain on an unsustainable path even if these trends do continue – and more so if they do not. Indeed, the combination of rising overall health care costs and an aging population means that the costs of these two programs will increase dramatically if changes are not made. To make sufficient progress, we believe at least $585 billion in savings should be enacted through 2023, along with substantially greater savings over the following decade.

The committees of jurisdiction in the House and Senate are probably best equipped to work out many of the details of health reform, particularly with regards to any structural changes that might require transition rules, special exemptions, or intricate changes to the law. However, the basic parameters of the changes that should be enacted are increasingly clear. Reforms must focus on making structural changes in how health care is delivered and paid for to change incentives for providers and beneficiaries and bend the health care cost curve; adjusting benefits to account for an aging population while recognizing growing inequality, reducing payments and overpayments to providers, and reducing various improper or unintended payments.

Structural Reforms to Bend the Health Care Cost Curve

1. Enact Delivery System and Payment Reforms ($60 billion through 2023)

Federal health care programs currently operate under a fee-for-service (FFS) model that only pays health care providers for services rendered, which has helped create a system that favors quantity over quality. With per-capita health spending higher than in any other country and continuing to grow faster than the economy, there is ample room for reforms to improve quality and reduce costs. These reforms could better encourage paying for performance, use competition to drive down costs, or realign incentives to produce savings.

Specifically, we recommend making the following changes:

- **Reforming the SGR to move away from fee for service to a system that encourages coordinated care and quality**
- **Expanding penalties for avoidable complications and readmissions**
- **Expanding payment bundling**
- **Expanding competitive bidding for DME and other devises and services**
- **Encouraging care coordination with alternative benefit packages**
- **Increasing transparency**
- **Giving IPAB and CMS the tools to implement curve-bending reforms**

Reforming the sustainable growth rate (SGR) formula would be an obvious place to start, since Congress regularly waives the current formula designed to contain costs through what is known as "doc fixes." In light of recent Medicare growth trends, the cost of replacing the SGR with a freeze on physician payments has fallen in recent years; it is now roughly $140 billion relative to current law over the next decade (our baseline assumes this cost will occur). While this presents an opportunity for lawmakers to permanently fix the SGR with fewer offsets, they should use this opportunity to reform the way we pay doctors pay for quality instead of quantity of care and encourage care coordination.

In the short-term, we propose a modest reduction in reimbursement rates below a freeze and allowing the Centers on Medicare & Medicaid Services (CMS) to make certain budget-neutral adjustments aimed at improving care quality. Over the medium-term, we recommend directing CMS to develop an improved physician-payment formula that promotes participation in new models like Accountable Care Organizations and patient-centered medical homes, encourages care coordination across multiple providers, prioritizes primary care, and reduces Medicare costs. This requirement would be enforced by the potential reinstatement of a re-based SGR mechanism – if a new payment formula were not implemented – in order to give all parties an incentive to work together on a new payment system and impose budgetary limits on that new system.

Beyond reforming physician payments, we also recommend realigning incentives to **discourage unnecessary hospital readmissions and avoidable complications** known as "never events". The Affordable Care Act took a step toward addressing the readmission issue by creating the Hospital Readmissions Reduction Program. However, many health care experts believe much more can be done to discourage avoidable readmissions by expanding the program to include more medical conditions and higher penalties on more types of providers. The same types of expansions can apply to avoidable complications. In addition to expanding and increasing

penalties, we must recognize the shortcomings of a "one size fits all" model and work to calibrate penalties to adjust for patient demographics, types of condition, and timing of readmission. Penalties could also be decreased for providers who are able to reduce their readmissions or complications over time or those who demonstrate that readmissions are leading to lower mortality rates.

While we work to realign incentives to reduce low-quality care, we should also be increasing high-quantity care. The current fee-for-service system rewards providers for increased volume, even though there is little evidence this results in any quality improvement. **We recommend moving toward a system in which many providers are paid a fixed amount for a bundle of services or all of a patient's care.** Specifically, we recommend expanding the Medicare Acute Care Episode (ACE) demonstration program, which has already shown some signs of success. Over time, we recommend more and more providers be paid through this type of model rather than fee-for-service.

On top of these changes, Medicare should be getting the best price possible for its purchases. Currently, Medicare uses competitive bidding for certain medical equipment and devices and is expanding bidding for equipment, prosthetics, orthotics, and supplies in all regions by 2016. We recommend further **expanding competitive bidding** to lower the cost of medical devices, laboratory tests, radiologic diagnostic services, and various other commodities.

A number of experts have proposed **creating an alternative Medicare benefit package focused on care coordination** in order to drive beneficiaries and providers toward higher value care. For example, a new plan option could merge Medicare Part A, B, and D into a single benefit package, provide care coordination services, and offer lower cost sharing to beneficiaries who use high-value providers and services. Such a plan could also offer coverage above the standard package in order to minimize the need for supplemental plans financed with an additional monthly premium. It could be offered as an additional option alongside traditional Medicare and Medicare Advantage or CMS could contract with a third party for plan Administration. We recommend Congress and the administration consider establishing one or more alternative packages, either as a demonstration project or as alternative options for beneficiaries to choose. Rather than offering this to all beneficiaries, an alternative would be to target certain high-cost populations in particular need of coordinated care.

Patients need to be given more and better information and the price and quality of their health care. The current lack of transparency drives up prices in both the public and private health care markets and reduces competition between providers, particularly under current payment and cost-sharing models. CMS should study new ways to **increase transparency of prices and quality**, and in the meanwhile we recommend prohibiting "gag clauses," which prevent insurers from releasing price information to the consumer; requiring CMS to publicly release Medicare and Medicaid claims and payment data through a searchable database; and mandating public reporting of prices for a basket of routine elective procedures. All of these changes should be made carefully and in a way that protects beneficiaries' privacy and security.

There also may be merit to reforming the Medicare Advantage program by making payments based on a "competitive bidding" system rather than at a fixed rate – if such a system can be designed in a way that CBO estimates overall costs would be reduced without damaging quality.

Finally, existing institutions including **CMS and the Independent Payment Advisory Board (IPAB) need to be given the tools to ensure delivery system reforms are able to move forward.** CMS should be allowed to aggressively implement and expand the various pilot programs and demonstration projects it is currently charged with undertaking, as well as the new ones we have recommended. We recommend allocating additional mandatory funding from Medicare to help them do so, and giving them greater flexibility to improve efficiency by using tools found to be effective in the private sector. At the same time, IPAB should not be restricted through special interest carve-outs, and policymakers should consider giving it expanded authority to change benefit design and reform cost-sharing rules.

The total savings from the policies above would depend on how aggressively they are implemented. The Community Catalyst group estimated that expanding policies discouraging readmissions and avoidable complications could save well over $50 billion alone. And various estimates suggest that reforming the SGR, bundling payments, and expanding competitive bidding of durable medical equipment and other services could save tens of billions more. Many of these other policies we proposed have the potential to result in substantial long-term savings – though, given the uncertainty over how successful they will be, scoring agencies rightfully assume little to no upfront savings for many of these reforms.

To be conservative, we assume a total of $60 billion in combined savings from carefully implementing the policies above. However, we believe that the above reforms and other structural reforms in this plan, as well as other reforms already being implemented in the public and private sector, have the potential to reduce the rate of growth of health care spending by a significantly greater amount. We believe that many of the options above would not only reduce federal health spending, but would lead to structural improvements in the health care system overall, which would substantially slow the growth of health spending in the public and private sector.

The potential for additional deficit reduction beyond the savings we assume could help bring the growth of federal budgetary commitment to health care below the growth-of-GDP-per-capita limit in "Step 4" of our proposal. The limit would be enforced in part through a value-based "withhold mechanism" in which a percentage of provider payments would be withheld and rewarded to providers only if they meet certain savings and quality targets. In addition to providing a mechanism to enforce limits on health spending growth, a value-based withhold also has the potential make delivery system reforms that rely on changes in behavior more likely to succeed, as there would be adverse consequences if the reforms fail to control costs.

2. Reform Medicare Cost-Sharing Rules ($90 billion through 2023)

Provider-side reforms that modernize payment models and realign incentives to encourage cost-control must be coupled by beneficiary-side reforms. Specifically, we recommend:

- **Replacing current Medicare cost-sharing rules with a unified deductible, uniform co-insurance, and out-of-pocket maximum, while varying the deductible and out-of-pocket limit with income**
- **Restricting Medigap plans from covering near-first-dollar costs**
- **Imposing a surcharge on retiree health plans while offering an option for seniors to "cash out" and instead use the value to subsidize their Medicare premium**

Currently, Medicare beneficiaries must navigate a hodge-podge of premiums, deductibles, and co-pays that drive up health costs while offering neither spending predictability nor protection from catastrophic financial risk. These rules, in combination with Medigap and other supplemental plans that provide wrap-around coverage, leave many seniors facing little or no first-dollar costs and therefore encourage overutilization of care. At the same time, seniors are sometimes left on the hook for catastrophic costs they cannot afford.

We recommend replacing current cost-sharing rules with a new simple regime that calls for more "skin in the game" for first-dollar coverage, offers better protections against catastrophic costs, provides important low-income protections, and discourages the use of costly supplemental plans.

The original Fiscal Commission report called for a reform to cost-sharing rules that would offer a single unified deductible of $550 for Medicare Part A and Part B, a universal co-insurance of 20 percent up to $5,500 in out-of-pocket costs, and a smaller co-insurance rate of 5 percent of costs up to $7,500 – after which Medicare would cover all expenses. This approach could substantially slow health care cost growth by reducing overutilization and would provide important protections to seniors.

Yet while many vulnerable seniors would be better off over their lifetimes under such an approach, most would face increased costs in a given year (though those below the poverty line would be protected under current law by Medicaid). To address this concern, health economist Jonathan Gruber recently proposed a cost-sharing regime that would base out-of-pocket costs on income level while also offering a lower deductible for beneficiaries with incomes below 200 percent of the poverty line.

We propose a modified version of Gruber's plan, one that includes a similar income-adjusted out-of-pocket maximum and a lower deductible for low-income beneficiaries but also retains the 5 percent co-insurance above the first out-of-pocket threshold as in the original Fiscal Commission plan. We also recommend giving the Center for Medicare and Medicaid Services (CMS) the authority to make certain value-based adjustments to coinsurance rates for certain very high or very low-value procedures – so long as the changes were made on a neutral basis.

While the exact parameters would need to be worked out with CMS and CBO, we believe this reform should be designed to hold average out-of-pocket costs (including premiums) constant so that seniors are no worse off in a given year on average, and that they have more protection from risk over their lifetime (particularly at lower income levels). Designed properly, this proposal would not only improve Medicare's value for beneficiaries, but would strengthen the financial state of Medicare by reducing overutilization of care.

As an alternative to our approach, our stair-step co-insurance could be replaced with a single co-insurance and a single (but still income-related) out-of-pocket limit – perhaps at the $6,250 level set for private insurance plans in the Affordable Care Act. In place of income-relating the cost-sharing rules themselves, policymakers could also consider a uniform set of cost-sharing rules with low-income subsidies available, as is currently the case in Medicare Part D.

To complement reforms to the cost-sharing system, we also propose measures to reduce the use of wrap-around coverage that covers all or most of the Medicare cost-sharing requirements. Many seniors either purchase (in the case of "Medigap") or receive (in the case of retiree health plans provided by employers and the federal government) supplemental insurance, which masks the costs of health care and prevents Medicare

cost-sharing from successfully deterring overutilization of care. In addition to driving up the cost of health care, Medigap plans also turn out to be a bad deal for most seniors; some studies suggest that about 80 percent of policyholders in a given year have *higher* out-of-pocket costs as a result of the Medigap premium.

To appropriately address this concern, we would restrict Medigap plans so that they are no longer able to provide first dollar coverage within the Medicare deductible and can cover no more than half of the base Medicare co-insurance. This change should go into effect as soon as administrable and should also apply to TRICARE for Life plans, which effectively provide Medigap to military retirees (savings from the TRICARE plans are captured in the "other mandatory" section). In the interim, there should be a surcharge applied to the Part B premium for beneficiaries with Medigap policies that reflects the externality of increased Medicare costs due to the effect of Medigap policies.

As an alternative, policymakers could choose to apply the limitations on first-dollar coverage to new Medigap policies only and apply a surcharge to existing plans. They could also rely solely on a surcharge for new and current plans. However, relying on a surcharge to discourage the purchase of Medigap policies and offset the externality cost of Medigap plans would have the effect of increasing costs for some seniors relative to the approach of restricting Medigap plans.

Although we do no support applying the same restrictions to retiree health plans, which seniors have generally paid for over their working lives, those plans nonetheless impose a cost on the Medicare program. To address this, we recommend imposing a premium surcharge applied to the Part B premium for beneficiaries who have retiree health plans that offer wrap-around coverage while giving employees the opportunity to "cash out" the value of their health plan in the form of a Part B premium subsidy if they so choose. (A similar cash out would be mandated for Federal Employee Health Benefits plans, as explained in our "other mandatory" section.)

3. Enact Medicare Malpractice Reform ($20 billion through 2023)

The current medical malpractice system adds substantially to the cost of health care, including by increasing the cost of defensive medicine. According to the Congressional Budget Office, aggressive tort reform that caps non-economic damages at $250,000 and punitive damages at $500,000, along with other changes, would reduce national health expenditures by 0.5 percent. Short of statutory caps, there are a number of policies which – when taken together – could help reduce the costs associated with the current tort system. We recommend implementing the following reforms: 1) instituting a statute of limitations for malpractice claims; 2) replacing "joint and several liability" with a "fair-share rule" so defendants are only responsible for their share of the responsibility for injury; 3) placing sliding-scale limits on lawyer contingency fees; 4) creating provider safe harbor for certain FDA-approved products; 5) allowing the consideration of collateral source income (for example, life insurance payouts) to be considered in deciding damages; 6) instituting evidence-based clinical practice guidelines and a safe harbor for physicians who follow them; 7) expanding federal support for disclose-and-offer programs; and 8) applying a health court model to malpractice claims in the Federal Claims Court.

4. Encourage State Innovation to Reduce Costs

As the federal government works to contain health care costs, states should be given the power to do the same. We recommend a new waiver program to increase flexibility for states that are serious about controlling health care cost growth. Specifically, our proposal would establish presumptive eligibility criteria for up to 10 states over the next decade. These eligible states would be required to proactively seek out the waiver and to meet certain objective threshold criteria, including: improved quality, efficiency, and cost of care, as well as not increasing the uninsured population. Applications would be evaluated and overseen by the Medicaid Center for Innovation.

CMS should be required to fast-track state Medicaid waivers that offer demonstrable promise in improving care and returning savings, such as Oregon's demonstration program to reduce the state's Medicaid expenditure growth in return for a global payment with flexibility to pursue efforts that improve delivery of care. As states determine their participation under the Affordable Care Act's Medicaid expansion, fast-tracking qualified proposals could provide needed flexibility to encourage innovation and reduce spending growth. This could extend to reforms that seek to advance care coordination between states and the federal government for dual-eligible beneficiaries, such as placing them into managed care plans. Waivers could additionally be granted to states interested in better coordinating their Medicaid programs with other federal or state programs, such as the health exchanges or Supplemental Security Income for the disabled.

Such waivers could also enable states to share in Medicaid savings if they lower per capita health care cost growth by both public and private payers to a certain target, such as GDP growth. Savings to the federal government would depend on the amount shared with the state, but could be enhanced by state efforts to constrain health care cost growth in the private market. Bonus payments could be included for states that meet various performance targets on cost, quality, and access.

In addition to these reforms, we recommend giving states the option of accepting a single "blended rate" for all services – rather than separate federal matching rates for separate parts of the Medicaid (and CHIP) program – if the Secretary of Health and Human Services determines this rate would not increase federal costs.

We assume no savings from these provisions, but believe they could pay substantial dividends over the long-term.

Benefit Adjustment to Account for an Aging Population and Growing Inequality

5. Expand Income Relating of Medicare Premiums ($65 billion through 2023)

Given growing Medicare costs, we believe that wealthier seniors will need to begin paying for a larger share of their Medicare benefits.

Currently, most seniors pay Medicare Part B and D premiums equal to about one quarter of average costs, with the exception being very low-income seniors who pay no premiums and the top 5 percent of seniors who currently pay income-related premiums ranging from 35 to 80 percent. The thresholds above which the income-related premiums apply are currently frozen through 2019, after which they are indexed to inflation.

We recommend increasing existing income related premiums by 15 percent so that the 35 percent premium increases to 40.25 percent, the 50 percent premium to 57.5 percent, and so on. In addition, we would create a new lower income related premium beginning at a threshold so that close to 15 percent of the senior population would be subject to income related premiums and then freeze these thresholds through 2030.

6. Increase the Medicare Age with an Income-Related Buy-In at Age 65 ($35 billion through 2023)

Though excess health care cost growth is the primary driver of growing federal health spending over the very long-run, population aging represents the main driver of that spending over the next 25 years and a substantial contributor in subsequent decades. In order to both accommodate the aging population and to modestly offset its effects on the size of the labor force, we recommend gradually increasing the eligibility age beginning in 2017, accompanied with an income-related buy-in, which would allow those age 65 and up to purchase Medicare with subsidies for the bottom half of the income spectrum.

In our view, raising the Medicare age will help to adjust the program for increases in life expectancy while encouraging some seniors who are able to work longer. Prior to the Affordable Care Act (ACA), raising the age would also have substantially increased the number of uninsured Americans. However, after the ACA's implementation, seniors in the bottom half of the income spectrum will generally be eligible for Medicaid or insurance subsidies – and even higher-earning seniors will have protections that were previously unavailable. We suggest increasing the Medicare age by one month per year beginning in 2017 until it reaches age 66, and then by two months per year until it reaches the Social Security normal retirement age, to which it should then be locked. At this rate the Medicare age would reach 67 by the mid 2030's.

The objection to raising the Medicare age is primarily based on three concerns: that some seniors would be left uninsured, that others would see their costs increase, and that *national health expenditures* would go up as seniors move out of Medicare and into to higher cost insurance options. Our proposal would address all three of these concerns with a Medicare buy-in program that would continue to make Medicare benefits available to those above age 65 but below the new Medicare age with an income-related premium.

Under our proposal, the federal government would cover the entire additional cost for beneficiaries making below 100 percent of the poverty level in order to prevent coverage drops for those in states that do not expand their Medicaid eligibility in response to the Affordable Care Act, and to avoid placing additional burden onto the states that do. The highest earners, conversely, would pay a premium equal to the average cost of benefits for that population.[3]

Beneficiaries with incomes between 100 and 400 percent of the poverty level would pay premiums equal to a percentage of the actuarial value of the plan on a sliding scale basis, with some phase-up of premiums beyond 400 percent to avoid a premium cliff.[4]

Note that our recommendations are similar to those put forward by Robert Berenson, John Holahan, and Stephen Zuckerman of the Urban Institute. Although savings within the ten year window would be small, we believe that implementing this policy properly will substantially reduce long-term federal health spending while encouraging work, increasing economic growth, and having only a modest effect on national health spending. In addition, this policy would be highly progressive because of the subsidies. In fact, it would likely reduce the out-of-pocket costs for most of those making less than 300 percent of poverty.

Rather than requiring beneficiaries to pay 100 percent of their Medicare costs (pre-subsidy) before the new Medicare age, an alternative approach would be to allow individuals to begin benefiting from Medicare as early as age 65 with an actuarially-increased premium for their 65th and future years, which would be similar in approach to actuarial reductions for those who collect Social Security prior to the full retirement age. In this case, low-income subsidies could be offered on a sliding scale to avoid unaffordable premium increases.

Provider Payment Reductions and Reforms

7. Reduce and Reform Post-Acute Care Payments ($70 billion through 2023)

MedPAC and other outside experts have recommended substantial reductions in payments to post-acute care facilities – such as skilled nursing facilities and home health providers – to bring them in better line with actual costs and value. We recommend adopting the President's policy of reducing the annual growth in payments to skilled nursing facilities, inpatient rehabilitation facilities, long-term care hospitals, and home health facilities. Other options for achieving savings include instituting value-based purchasing for home health and skilled nursing facilities, equalizing payments between rehabilitation services provided in different settings, and restoring the "75 percent rule" for impatient rehab facilities.

8. Reduce Various Payments to Hospitals ($65 billion through 2023)

A number of bipartisan and nonpartisan proposals have found several areas in which Medicare payments to hospitals could be reduced without harming quality of or access to care. We recommend phasing out all reimbursements for bad debts, reducing subsidies for graduate medical payments to better align with patient care costs, and reducing enhanced payments for rural hospitals.

The exact mix of savings could vary, as the above options are dialable depending on the precise details and phase-in periods. Phasing out bad debts would save $35 billion and the other policies could easily save $10 to $20 billion each.

9. Reduce the Costs of Prescription Drugs in Medicare ($90 billion through 2023)

Rising prescription drugs prices represent an increasing cost not only for individuals but also for the Medicare Part D program. In fact, Part D spending is the fastest growing portion of Medicare. CBO estimates annual spending growth to average above 10 percent over the next ten years, and over 6.5 percent a year per beneficiary.[5] A study commissioned by the Department of Veterans Affairs found that the Department can purchase drugs at prices 40 percent below those paid by Medicare Part D plans because of the more restrictive formularies and other negotiating tools used by VA that are not available to Part D plans.[6] While dramatically changing Part D to reflect the VA program may not be realistic, we do believe that changes in how the government pays for drugs under Part D can help reduce that difference.

Currently, Medicaid requires drug companies to pay "rebates" equal to at least 23.1 percent of the average manufacturer price (AMP), and more for drugs with rapid cost growth. Drugs purchased by dual eligibles – those who participate both in Medicaid and Medicare Part D – do not benefit from such a rebate. Prior to the implementation of Medicare Part D in 2006, these dually eligible beneficiaries would have received prescription drugs through Medicaid. Instead, Medicare Part D plans now negotiate with manufacturers on

plan-specific rebates on a case-by-case basis.

We recommend restoring drug rebates for those on Medicaid by requiring them for dual eligibles who receive drug coverage through Medicare Part D. Manufacturers of these drugs would be responsible for the same 23.1 above AMP rebate as in Medicaid, with the same additional rebate for price increases that exceeded the rate of inflation. Research suggests that these dual-eligible beneficiaries are among the most costly beneficiaries in Medicare, comprising one fifth of Medicare enrollees, but accounting for nearly one third of its spending. Dual eligibles also disproportionately use "protected classes" of drugs in the Part D program, a classification which limits the ability for prescription drug plans to negotiate lower prices with manufacturers. Unlike other proposals, this recommendation would not extend rebates to new classes of beneficiaries who were not subject to rebates prior to implementation of Part D.

In addition to these rebates, we recommend prohibiting the practice of "pay for delay" – whereby name-brand drug manufacturers pay generic companies to delay introduction of their drugs into the market – and encouraging faster introduction of generic drugs more generally.

Together, these policies would save about $90 billion over ten years. However, policymakers could scale back or even avoid these particular rebates through other policies such as modifying cost-sharing in the low income subsidy (LIS) program to encourage the use of generic drugs, establishing rebates for physician-administered Part B drugs, expanding the existing rebates in Medicaid, allowing safe re-importation of certain drugs from Canada, and/or requiring rebates for single source drugs covered under Part D.

Improper and Unintended Payment Reductions

10. Reduce Fraud, Abuse, and Excessive Payments within Medicare ($25 billion through 2023)

As we implement changes throughout Medicare, it is unacceptable to allow Medicare to continue to pay for unprovided care or unearned benefits, or to pay more for services than what is warranted.

Regarding excessive payments, we recommend giving the Secretary of Health and Human Services the authority to better align clinical lab payments with the private sector and to reclassify certain payments to hospital outpatient evaluation and management visits so they are treated the same as similar visits to a physician's office. Each of these policies could achieve $5 to $10 billion in savings over ten years.

To address the fraud and abuse side, we propose taking a multi-faceted approach to reduce these payments within Medicare and throughout the health care system.

We recommend starting with these steps: validating physician orders for high-cost and high-fraud services, given the IRS the authority to penalize Medicare providers with delinquent debt, requiring prior authorization for advanced imaging, and recouping erroneous payments to Medicare Advantage. Double bonus payments to Medicare Advantage plans should also be eliminated. CMS should be given authority to recover funds when payment adjustments intended to be neutral end up costing the federal government money. And physician self-referrals should be further restricted and better monitored, including narrowing the "ancillary service exception."

On top of these changes, we recommend adopting the reforms in the Coburn-Carper FAST Act, which is

intended to reduce waste, fraud, and abuse throughout the health system.

11. Reform Medicaid Financing by Reducing Overpayments to States ($65 billion through 2023)

Many states finance a portion of their Medicaid spending by imposing taxes on the very same health care providers who are paid by the Medicaid program, increasing payments to those providers by the same amount as the tax, and then using that additional "spending" to increase their federal match. Although this practice is limited to 6 percent of providers' revenue, it still represents a significant cost increase to the federal government. We recommend very gradually phasing down and then phasing out the current limit in order to close this loophole.

There are several other functions and areas in which the federal government may be overpaying states. A modest amount of savings could be generated by closing the "cost allocation" loophole through which states claim reimbursement for Medicaid administrative costs that were already accounted for in state funding under the TANF block grant formula. Additional savings can be achieved by reducing payments for Medicaid Durable Medical Equipment and permanently re-base Medicaid Disproportionate Share Hospital (DSH) payments so that the policy in place today continues beyond 2022, and policymakers can no long use the savings from extending this policy to justify new spending.

If policymakers wanted to allow States to continue some level of the provider tax – for example by reducing the threshold from 6 percent to 4 percent of provider revenue – there are a number of alternatives to reduce so-called "creative financing." For example, policymakers could crack down on the use of so-called intra-governmental transfers (IGTs), including those in which states artificially inflate payments to government (often local government) run medical facilities and then later recover the excess funds. Matches for administrative costs could also be capped or equalized to generate savings.

III. Other Mandatory Savings ($265 billion)

Outside of the major entitlement programs, a number of "other mandatory" programs continue to make up a substantial part of the overall federal budget. These include civilian and military retirement, income support programs, veterans' benefits, agricultural subsidies, student loans, and others.

These mandatory programs are not projected to be the main drivers of rising deficits over the next ten years, but they nevertheless should be part of a comprehensive plan to correct our fiscal path. This is especially true because mandatory spending is not subject to the scrutiny of the annual appropriations process – so poorly directed spending can continue for years with minimal oversight.

Ultimately, many of these other mandatory programs are highly specialized and should be dealt with by the committees of jurisdiction. Other savings have been proposed year-after-year by Members of both parties and could be enacted into law almost immediately. Below, we propose five broad categories of savings, along with specific changes that could achieve these savings.

In general, we believe all reforms should be focused on ending wasteful and low-priority spending, reducing (or charging for) government subsidies, looking to the private sector for innovative cost-saving techniques, and running government more efficiently. Policymakers should avoid cutting pro-growth investments and – most importantly – should protect the most vulnerable.

1. Enact a Farm Bill to Reduce Agriculture Subsidies ($40 billion through 2023)

There is broad agreement among economists on the long-term benefits of reducing agriculture subsidies. Members of both parties – from President Obama to House Budget Committee Chairman Ryan – have proposed substantial reductions in farm subsidies, as have the Agriculture Committees. Ultimately, a new long-term farm bill should be enacted that dramatically restructures agricultural support programs with significantly lower spending levels. Pending enactment of a comprehensive farm bill, the baseline for agricultural support programs should be reduced by $40 billion through 2023 through across-the-board reductions to direct payments and other subsidies. The farm bill should restructure and better target agricultural support programs within this reduced baseline spending level.

We believe the farm bill itself should eliminate direct payments, which would generate up to $50 billion in savings. An additional $30 billion in savings could be generated from reductions in countercyclical payments, crop insurance subsidies, and spending on conservation programs. Roughly half of these funds could be used to implement new programs focused on protecting farmers from the risks of disaster, supply shortages, and price swings, with the remaining savings dedicated to deficit reduction.

Any farm bill should focus on reducing and reforming agricultural subsidies and should not generate its savings by reducing food stamp benefits from those who count on them most. A small amount of savings, however, could be generated by reducing fraud in the program, including ending a practice whereby states offer citizens a single dollar of heating assistance in order to ensure automatic qualification for food stamps. This provision would generate less than $5 billion, which could be used to reduce the deficit, finance targeted enhancements to the food stamps program, or both. Any additional changes to the food stamp program should be enacted only on a neutral basis in an effort to improve the program.

2. Reform Federal Workforce Health and Retirement Programs ($100 billion through 2023)

Military and civilian pensions are both out of line with pension benefits available to the average worker in the private sector, and in some cases, out of line with each other across different categories of federal employment. The same is true for retiree health benefits, which not only tend to offer generous coverage at no cost to beneficiaries but actually drive up Medicare costs by insulating beneficiaries from Medicare cost-sharing rules.

On the retirement side, we recommend gradually increasing federal civilian pension contributions so that new federal employees ultimately pay about one-half the cost of their pensions and existing federal employees pay one-quarter. We also recommend that civilian and military pension benefits be calculated based on the "high 5" years of wages rather than "high 3." Finally, we recommend reducing the cost-of-living adjustment for military and civilian workers who retire before age 62, with a full catch-up once they reach age 62. Together, these changes should save about $60 billion over ten years.

On the health side, we recommend transforming the Federal Employees Health Benefits (FEHB) program into a premium support program, in part to evaluate whether such a model might be effective in controlling costs in other programs. For those on Medicare, we would require that the federal FEHB subsidy be used not to purchase "wrap around coverage" but to cover a portion of the Medicare premium for federal retirees. This reform would reduce overutilization of care while actually lowering out of pocket costs for most federal retirees. In addition, we recommend applying our Medigap restrictions (see previous section) to TRICARE for Life – the Medigap program for military retirees – in order to encourage better use of care by military retirees. Together, these policies should generate in excess of $40 billion in savings over ten years.

A number of alternatives exist to the options above. As an example, new and existing employees could be required to contribute the same amount toward their pensions, and both the level and phase-in could be calibrated and dialed as desired. Savings from health spending could come from an enrollment fee established for TRICARE for Life or via a Part B premium surcharge similar to what we propose for retiree health plans applied to Tricare for Life beneficiaries. Co-payments could also be increased for prescription drugs for non-military TRICARE beneficiaries.

On the military retirement side, policymakers should ultimately consider more structural reforms to move away from a system that offers no benefit for those who retire after nineteen years and encourages good officers to leave only after twenty.

3. Reform Higher Education Programs ($35 billion through 2023)

The federal government currently subsidizes college education through a complicated hodge-podge of loans (at least four different types), grants to individuals (at least four different types), grants to institutions, tax exclusions, credits, deductions, and regulations. Many of these subsidies are not well targeted, either in terms of encouraging higher education or helping those most in need. Meanwhile, in order to maintain the current award level while accommodating increased number of eligible students, the Pell Grant program faces a roughly $50 billion funding gap through 2023, and temporarily-low subsidized interest rates are scheduled to abruptly double in the summer of 2013. By reforming student loan programs, it would be possible to reduce the deficit, provide a "soft landing" for interest rates, and dramatically reduce the Pell funding gap – the remainder of which could be closed through reforms to the Pell program itself.

About $55 billion of savings could be generated by eliminating the in-school interest subsidy which allows undergraduate students to defer accrual of interest on their loans under after they graduate. This subsidy is neither well-targeted to those who need it nor effective in encouraging higher education, and eliminating it would provide funds for a substantial improvement in the Pell Grants program while retaining important student loan protections such as income-based repayment assistance and the grace period before loan repayment must begin.

Another $15 to $20 billion could be generated through a number of more targeted changes such as adopting the President's proposal to reform Perkins loans, lowering Guaranty Agency Compensation Rehabilitation loans, repealing Grad PLUS loans, equalizing loans for dependent and independent students, creating a two-tiered income-based repayment system, and reducing or discontinuing funding for underperforming for-profit schools.

These reforms would produce enough savings to generate substantial deficit reduction while helping to provide permanent fixes to funding issues for the Pell Grant and student loan programs. Absent a permanent solution to the Pell shortfall, the costs of maintaining the current award level and covering the increased number of students eligible for assistance will place growing pressure on the limited discretionary budget. By providing mandatory funding to cover much of the projected shortfall in the Pell Grant program, this option would limit the pressure on the Appropriations Committee to make deeper cuts in other discretionary programs beyond those required by the spending limits to cover the increased costs of maintaining the current Pell Grant award and accommodating increased numbers of eligible students.

In addition to addressing the Pell Grants shortfall, we also recommend avoiding the abrupt increase in student loan interest rates scheduled for this summer, a change that would increase interest rates to 6.8 percent from the current 3.4 percent. To address this problem permanently rather than on an annual basis, we recommend linking subsidized loan interest rates to interest rates in the economy as a whole, thus replacing the immediate 3.4 percent increase in interest rates with a much more gradual increase. Our proposal would not only avoid a steep hike and rationalize the loan system, but it could also contribute further to deficit reduction once the economy and interest rates return to normal.

Funding the Pell Grant shortfall and replacing the abrupt increase in student loan interest rates with a more rational policy would both provide greater certainty for families who rely on these programs to pay for their education and eliminate the pressure for emergency spending and supplemental appropriations and other ad hoc temporary solutions in the future.

To the extent policymakers are interested in pursuing a more modest reform to in-school interest subsidies, the savings could be made up with more aggressive Pell or interest rate reforms or by leaving a small portion of the Pell shortfall to be filled through the appropriations process.

4. Charge User Fees for Various Government Subsidies ($50 billion through 2023)

The federal government subsidizes a large number of industries or individuals either through direct payments, discounted services, or direct provision of various activities. In some cases, it would be sensible for the government to reduce its role and leave more to the private sector. In other cases, however, the government could charge (or increase) user fees in order to recoup its costs.

About $15 billion in savings could be generated by making permanent current Fannie/Freddie Mortgage Guarantee fees and US Customs Merchandizing fees, in addition to indexing existing fixed-dollar user fees to inflation.

An additional $20 billion or more of savings could be generated to help fund Federal Aviation Administration (FAA) and Transportation Security Administration (TSA) spending by reforming and increasing TSA fees and establishing a surcharge for air traffic control services.

The remaining funds could come from a combination of reforms and surcharges on various subsidized public utilities, receipt sharing for energy minerals, fees for health and food inspection, assessments on nuclear utilities, and other user fee changes.

The exact combination of these fees could be adjusted in any number of ways, and a number of smaller additional user fees could also be charged or increased elsewhere in government.

5. Enact Additional Mandatory Savings ($40 billion through 2023)

Beyond reducing various subsidies, increasing a diverse group of user fees, and reforming health and retirement programs, there are a number of long-standing proposals to reduce mandatory spending. Some of these proposals would also restore the financial integrity of various programs.

For instance, as much as $30 billion in savings could be generated by improving the financial integrity of the Pension Benefit Guarantee Corporation (PGBC) and United States Postal Service (USPS) and giving these institutions increased flexibility to make the changes necessary to remain solvent.

Additional money could come from eliminating various government benefits for millionaires; selling unneeded federal real property; allowing more federal-state information sharing to reduce fraud; eliminating the penny and dollar bill in place of the dollar coin; reducing outdated and unnecessary spending such as subsidies for abandoned mines and mandatory R&D payments for fossil fuels; disallowing disability insurance beneficiaries from also collecting unemployment benefits; reforming federal oil, gas, and coal management; and making other changes.

IV. Tax Reform ($585 billion)

America's tax code is in desperate need of reform. It is complicated, confusing, costly, anti-growth, anti-competitive, unfair, and riddled with well over $1 trillion per year of tax expenditures – which really are just spending by another name. This convoluted system discourages work and investment, presents individuals and businesses with perverse economic incentives, and raises insufficient revenue to finance our spending. The American Tax Relief Act (ATRA) raised $675 billion in new revenue through 2023 – but it did nothing to reform or improve the structure of the tax code.

This year should be the year of tax reform, the year that the Department of Treasury, Senate Finance Committee, and House Ways & Means Committee work together on replacing our 20th century tax code with a tax code for the 21st century. Although we have offered our own visions of what tax reform should look like, we strongly believe the precise details of tax reform should be left to the committees of jurisdiction, which have the technical expertise to do so. However, we believe that any tax reform should be based on the following set of principles:

- **Lower rates, broaden the base, and reduce the deficit.** The current tax code is riddled with well over $1 trillion per year of tax expenditures – backdoor spending hidden in the tax code. Tax reform must reduce the size and number of these tax expenditures in order to reduce the budget deficit *and* lower marginal tax rates for individuals, corporations, and small businesses. Looking beyond tax expenditures, reform should also carefully evaluate structural components of the tax code to ensure we are taxing in the fairest, simplest, and most pro-growth manner. If effectively designed, such a reform would simplify the code, improve fairness, reduce the tax gap, and, reduce the cost and burden of tax preparation and compliance, and spur economic growth.

- **Start from zero.** Eliminating tax preferences will be painful – both politically and, at least at first, substantively. To help prevent interest groups from taking options off of the table, policymakers should begin tax reform with the "zero plan" under the premise that all tax expenditures are eliminated. Both the 2010 Fiscal Commission and 2005 Tax Panel found that doing so could reduce the top rate to 23 percent while still reducing the deficit. From that point, policymakers should be allowed to add back tax preferences as desired – but any preference that is restored must be paid for with higher rates or other reforms.

- **Maintain or increase progressivity of the tax code.** Though reducing the deficit will require shared sacrifice, those of us who are best off will need to contribute the most. Tax reform must continue to protect those who are most vulnerable and eliminate tax loopholes favoring those who need them least.

- **Move to a territorial tax system.** The way the United States currently taxes international income encourages companies to keep their money abroad and puts us at a competitive disadvantage with our trading partners. Tax reform should rectify this by moving to a competitive territorial system in which companies are not punished for bringing their money back home. Such a system should include strong protections to avoid gaming and abuse.

- **Promote economic growth and competitiveness.** Above all, America must have a tax code that rewards work, promotes innovation and makes the United States the best place to start and build a business. Our corporate and individual tax codes must promote – and not stifle – economic growth.

Although the Finance and Ways & Means Committees should begin with the "zero plan," we recognize that they will wish to add back a number of tax preferences. Doing so, of course, will result in substantially higher rates than the 23 percent top rate, which could be achieved through a pure zero plan. In the past, both the Simpson-Bowles Fiscal Commission and the Domenici-Rivlin Deficit Reduction Task Force put forward tax reform plans with a top rate of 28 percent – the same tax rate that resulted from the 1986 bipartisan tax reform.

Importantly, even achieving a rate of 28 percent would still require making many tough choices to eliminate or dramatically scale back many popular tax breaks in the current tax code. Both of the plans outlined above would have no deduction for state and local taxes, tax capital gains as ordinary income, eliminate step-up basis of capital gains at death, eliminate various tax exclusions for current and former members of the military and those on workers' compensation benefits, and dramatically scale down preferences for housing, health care, and charitable giving.

In our view these changes are worth making in the context of comprehensive rate-reducing reforms.[7] However, the reforms outlined above to generate savings to pay for lower rates and reduce the deficit will by no means be easy. To the extent the Finance and Ways and Means Committees are unable or unwilling to make these changes, they will need to either identify other sources of revenue or else pay for additional add-backs with higher rates.

As a simple example, if one were to take the Fiscal Commission illustrative plan and "add back" the deduction for state and local income and property taxes, offsetting the cost of that change alone would require increasing rates by between one and two percentage points. And as another example on the corporate side, it would require a one to one and a half percentage point increase to retain the current tax break offered to manufacturers (the domestic production activities deduction).

FIG 8. Tax Reform Under Various Plans

Area	Simpson-Bowles Illustrative Plan	Domenici-Rivlin 2.0
Individual Tax Rates	12% | 22% | 28%	15% | 28%
Corporate Tax Rate	28% (flat rate)	28% (flat rate)
Standard Deduction	Increased 10%	Replaced with work and family credits
Personal Exemptions	Retained	
Child Tax Credit & EITC	Retained	
AMT	Repealed	Repealed
Mortgage Interest Deduction	Converted to 12% credit; capped at $500K mortgage (no 2nd homes or equity)	Converted to 15% credit; limited to $25K of interest (no 2nd homes)
Charitable Deduction	Converted to 12% credit; 2% of AGI floor	Converted to 15% credit
Employer Health Exclusion	Capped, phased out by 2038	Capped, phased out by 2025
State & Local Tax Deduction	Eliminated	Eliminated
Misc. Itemized Deductions	Eliminated	Floor increased to 5% of AGI
Muni Bond Exclusion	Phased out for new bonds	Private Activity bonds repealed
Retirement Savings	Consolidated and capped at $20K or 20% of AGI	Consolidated and capped at $20K or 20% of AGI
Capital Gains and Dividends	Taxed as ordinary income (top rate 28%)	Taxed as ordinary income w/ $1000 exclusion (top rate 28%)
Step-up Basis for Cap Gains	Eliminated	Eliminated
Accelerated Depreciation	Replaced w/ economic depreciation	Retained
International Tax Reform	Territorial System	Current System
Other Tax Expenditures	Most other individual and corporate TEs eliminated	Most other individual and corporate TEs eliminated.

Adding back tax expenditures should also be done in a way that maintains the progressivity of the tax code. Retaining all current preferences for capital gains and dividends (including step up basis at death) would likely require an increase in the top rate of approximately four point (or perhaps a three percent increase in the top rate and a one percent increase in the middle rate) in order to offset the cost while remaining distributionally neutral.

It is important that the revenue targets be enforced to maintain pressure on policymakers to follow through on tax reform and ensure that the revenues are achieved regardless. We recommend enforcing the revenue targets with a failsafe that applies a broad limitation on tax expenditures. One approach to limiting tax expenditures would be establishing a limit on the value of deductions and exclusions. We estimate roughly that a 27 percent limitation on value of all itemized deductions, exclusions for health care, foreign-earned income, interest on bonds as well as certain above-the-line deductions and the standard deduction would raise about $575 billion over ten years with all the revenue coming from families earning more than $150,000 of annual income and most from families earning more than $250,000.

An alternative approach could be a failsafe based on the so- called "50-50" plan recently proposed by Charles Krauthammer in which the overall value of tax expenditures for an individual would be capped with the revenue gains divided equally between rate reduction and deficit reduction. Krauthammer specifically points to the cap designed by Martin Feldstein, Maya MacGuineas, and Daniel Feenberg, which would limit the amount by which individuals could use various preferences to reduce their taxes to two percent of income. This limit could be adjusted in a number of ways (many which Feldstein and MacGuineas have suggested) – for example by setting the limit at a dollar amount rather than percent of income or phasing in the limit with AGI growth – to meet the revenue target and achieve desired progressivity requirements. It could also be adjusted to allow a partial deduction of charitable giving above the credit so as to avoid eliminating the marginal incentive to give.

Either approach could be complemented with specific tax changes such as getting rid of the mortgage deduction for second homes and equity, repealing various loopholes (for example, those for carried interest and S-Corp reasonable compensation), repealing the preference for private activity bonds, removing exclusions for foreign earned income, and freezing limits on retirement accounts, among others.

V. General Government Reforms ($330 billion)

In many areas, the current budget process falls short and is in need of reform. A number of changes could be made to better enforce deficit savings, better ensure debt remains on a downward path, better account for our obligations, and more efficiently keep the budget process moving. In addition, there are several cross-cutting reforms that could be enacted and applied to all areas in which the government is raising less revenue or spending more money than what it intends. We believe that more funding should be dedicated to reducing fraud as well as limiting over- and under-payments on both the tax and spending sides of the ledger. As a part of that, the government should rely on the most accurate measure of inflation available for indexing various programs and provisions.

1. Switch to the Chained CPI with Low-Income Enhancements ($280 billion through 2023)

Most economists and experts across the ideological spectrum agree that the current measure of inflation, used for indexing federal spending programs and parts of the tax code, actually overstates inflation. To improve the technical accuracy of keeping up with inflation and to reduce the deficit, we recommend relying on the chained CPI throughout government programs in which we currently use the CPI-U or CPI-W.

We do not support exempting any area of government from improvements to the way we measure inflation. However, we do recognize that past overpayments have provided important help to certain low-income and elderly individuals for whom the existing program does not provide sufficient protections. To ensure they continue to receive the support they need, we recommend setting aside $60 billion of the $340 billion in gross savings generated by switching to chained CPI for specific policy enhancements that are targeted to these populations. Among these enhancements, beneficiaries of Social Security, Supplemental Security Income (SSI), and veterans benefits should receive a flat dollar (and therefore highly progressive) benefit bump-up once they have been in the program for 20 years. In addition, within the SSI program we recommend indexing the $20 income disregard and asset limits to inflation (as measured by the chained CPI). Further enhancements

could be provided on a budget neutral basis, such as a modest increase in the basic food stamp benefit.

Note that our low-income protections are consistent (and perhaps modestly larger) in size with those proposed by the President in his recent budget. The difference in total savings ($230 billion versus $280 billion) stem from the fact that the President proposes beginning to use the more accurate measure of inflation for indexation in 2015 while we propose beginning the more accurate indexation in 2014.

2. Provide Funding to Enforce Program Integrity Efforts ($50 billion through 2023)

To ensure funding is provided for anti-fraud efforts within the Department of Health and Human Services, the Department of Labor, Social Security, the IRS, and many other programs and agencies, we recommend dedicating mandatory funding toward program integrity within those departments. This funding typically has a very high return and could produce substantial revenue and budgetary savings without raising taxes or cutting benefits. We conservatively estimate that the additional program integrity funding would produce net savings of $50 billion, of which $30 billion would be from increased tax collections – reducing the "tax gap" – and $20 billion would be from savings from reducing improper payments and overpayments in Social Security, SSI, Unemployment Insurance, and Medicare and Medicaid.

3. Establish 67 Vote Point of Order Against Legislation Allowing Spending above Limits or Reversing Deficit Reduction in the Proposal

In order to ensure that the deficit reduction promised in this proposal is achieved, we recommend establishing a new point of order against any legislation that would undo any of the deficit reduction in this legislation or allow spending above the limits in this plan. Unlike most existing points of order, this one could only be waived only by 67 votes in the Senate and by a separate vote devoted solely to that subject in the House. Specifically, we would establish a point of order against legislation that would:

- Waive, suspend or otherwise block sequestration for exceeding the discretionary spending limits established in this bill
- Exclude the costs of legislation repealing or scaling back any of the entitlement savings or increased revenues in the plan without replacing the savings from the PAYGO scorecard
- Waive, block, or delay implementation of the tax reform trigger if Congress has not enacted tax reform legislation meeting the revenue targets

4. Index the Debt Limit

The political fights over the past two years about raising the debt limit harmed market confidence in our government and created economically-damaging uncertainty. At the same time, we understand why those policymakers frustrated with our inability to control the debt have viewed the debt ceiling increase as a vehicle for deficit reduction legislation.

Our plan would put the debt on a clear downward path relative to the economy, which most economists view as the key indicated of sustainability. Given this, we recommend indexing the debt ceiling – ultimately to the growth in gross domestic product (GDP) – so that further increases will not be necessary so long as the debt remains on a downward path as a percentage of GDP. This policy would make the need to increase the

debt limit a more meaningful indication of fiscal stewardship, because it would only be necessary to enact an increase in the debt limit if policymakers have failed to keep the debt on a stable or declining path.

5. Establish a Debt Stabilization Process

We believe additional enforcement may be necessary to ensure that the debt-to-GDP ratio is stabilized this decade and remains stable in future years. Specifically, we recommend a backstop to ensure that beyond 2015 the debt-to-GDP ratio is on a stable or downward path. This process would work by requiring all Presidential budgets and budget resolutions to propose a stable or declining debt path as a percentage of GDP and requiring the President to submit and Congress to consider legislation putting debt on a downward path as a percentage of GDP if it is projected to be growing. Such legislation would earn fast-track status to encourage its enactment.

The requirement to enact policies to put the debt on a clear downward path as a percentage of GDP would be enforced by a restriction on the consideration of any legislation affecting revenues, mandatory spending, or discretionary spending caps. In addition, the failure of Congress and the President to enact policies to put the debt back on a stable path would require enactment of legislation increasing the debt limit that would highlight the failure to ensure the debt remains stable.

Importantly, this requirement would be suspended in bad economic times, such as if nominal GDP grew by less than one percent in the prior year or Congress enacted a joint resolution stating that stabilization legislation would cause or exacerbate an economic downturn.

Ensure "Step 4" Savings

Our "Step 3" proposal would substantially improve our debt situation, but further actions would be necessary to ensure sustainability over the long run. Although our plan would improve the financial state of the Social Security program, that program would still be insolvent over the next 75 years. And although our plan would make substantial progress to slow the growth of health care costs, it would not guarantee that cost growth is limited to GDP growth per beneficiary. Finally, the current highway bill will expire after 2014 and faces more than a $125 billion shortfall through 2023.

To address these ongoing concerns, the reforms in "Step 3" should be accompanied by measures to ensure a "Step 4":

1. Establish a Fast-Track Process for Social Security Reform

The Social Security is on a path to insolvency; the Disability Insurance program's trust fund is slated to run out of money in 2016 and the unified Social Security trust fund by 2033. At that point, the system will only be able to pay three-quarters of benefits – meaning an immediate 25 percent cut for all beneficiaries regardless of age, income, health, or time on the program (though enacting the proposal in "Step 3" to provide more accurate cost of living adjustments would reduce that cut to 20 percent).

The President and Committees must work together to make Social Security sustainably solvent through a combination of reforms that could include[8]:

- Adjust the program to encourage work and account for an aging population
- Slow the growth of benefits for higher earners
- Increase contributions from those who can best afford them
- Make the system universal by eliminating remaining exemptions from the payroll tax
- Strengthen benefits for low-income and vulnerable populations
- Improve the integrity of the disability program

Appendix A includes a description of the Social Security reform plan included in the Fiscal Commission report.

In order to facilitate action on Social Security reform legislation, we recommend adopting the proposal put forward by Senator Dick Durbin to create a bipartisan Commission modeled after the Fiscal Commission (the Simpson-Bowles Commission), composed of Members of Congress from both parties and outside experts appointed by the President that would develop legislative recommendations to make the Social Security system sustainably solvent by the end of the year. If a supermajority of the Commission agreed on the panel's recommendations, the House and Senate would be required to give them an up or down vote on the recommendations.

Because the success of a bipartisan commission is uncertain, we also recommend a fall back mechanism based on the proposal suggested by House Budget Committee Chairman Paul Ryan in which the Social Security Trustees would be required to submit recommendations to achieve sustainable solvency to the President whenever the Trustees report projects that the Social Security trust fund will not be sustainably solvent.

The Trustees would submit their recommendations to the President, who could submit those recommendations or alternative recommendations of his own to Congress for consideration under a fast track process. Congress would be required to vote on the proposal submitted by the President, but could vote on alternative proposals developed by the majority and minority of the Committee of jurisdiction to achieve sustainable solvency as well.

2. Cap the Growth of the Per Beneficiary Net Federal Commitment to Health Care to Growth to GDP after 2018

Although we are hopeful the health reforms in this package will be sufficient to slow health care cost growth, we believe in a trust-but-verify approach. Should the federal budgetary commitment (spending plus tax preferences) continue to grow faster than the economy on a per beneficiary basis, policymakers should consider additional reforms including options ranging from premium support to move to an all-payer system.

Absent reforms, caps would be enforced through an equally-divided combination of the following:

- Reductions in Medicare provider payments implemented through a "value based withhold"
- Across-the-board increases in Medicare premiums
- A reduction in the value of the employer health exclusion which treats some percentage of the exclusion as ordinary income for income tax purposes

To achieve the "value based withholding" savings, CMS would need to develop a value-based withhold mechanism. Jonathan Skinner, James Weinstein, and Elliot Fisher at the Dartmouth Institute for Health Policy and Clinical Practice have proposed such a model in which a portion of payments to providers are initially withheld and provided to providers only if certain targets for quality and cost control are met. If the targets are not achieved, Medicare would keep the withheld amount to meet the savings target. Unlike strictly cutting payments across-the-board for all providers, this mechanism would target high-cost providers. Implementing a value based withhold beginning in 2018 will allow time for the delivery system reforms in the plan to take effect and hopefully begin to reduce costs by improving efficiency in the health care system.

If the delivery reforms succeed in achieving that goal, the growth of health spending would be lower than currently projected and the GDP per capita limit could be met without further action. However, this mechanism will ensure that health care costs do not continue to consume a rapidly growing portion of the federal budget if the reforms fail to produce the hoped-for savings through efficiencies or other factors cause per capita health care costs to grow faster than GDP.

3. Establish a Fast-Track Process to Pass a "Highway Bill" that Brings Spending and Revenues in Line

The current highway bill is scheduled to expire after 2014, and was funded in part through temporary savings that will run dry around the same time. Policymakers must make the transportation trust funds solvent for at least a decade through some combination of spending and revenue changes. As an example, an 11- or 12- cent gasoline tax increase would be sufficient. Any reforms should represent structural changes to the funding our outlay streams – not one-time transfers or budget gimmicks.

Appendices

Appendix A

An Illustrative Social Security Reform Plan

In addition to a "Step 3" of deficit reduction, our plan calls for a "Step 4" which would include – among other changes – comprehensive Social Security reform. Under current law, the Social Security trust funds are expected to be exhausted by 2033, at which point benefits would be cut across-the-board by 25 percent. Although "Step 3" would improve the financial status of the trust fund somewhat – primarily by using an improved measure of inflation – it would none-the-less leave the program with a large shortfall.

Our proposal suggests setting up a bipartisan commission meet in order to recommend a full Social Security reform package. Such a package must make the program sustainably solvent while protecting or enhancing benefits for those who count on the program most. Fortunately, they will not be starting from scratch. The Fiscal Commission included a reform plan which could serve as a starting point for reform.

FIG 9. Fiscal Commisssion Social Security Plan

	75-Year	75th Year
Gradually phase in progressive changes to benefit formula, modifying PIA factors to 90% | 30% | 10% | 5% by 2050	45%	51%
Offer minimum benefit of 125% of poverty for an individual with 25 years of work; index minimum benefit level to wage growth	-5%	-6%
Index normal retirement age (NRA) and earliest eligibility age to longevity so that they grow about 1 month every two years; include a "hardship exemption"	18%	30%
Provide benefit enhancement of 5% of the average benefit (spread out over 5 years) for individuals who have been eligible for benefits for 20 years	-8%	-6%
Gradually increase taxable maximum to cover 90% of earnings by 2050	35%	22%
Apply refined cost of living measure (chained-CPI) to COLA	26%	17%
Cover newly hired state and local workers after 2020	8%	0%
Share of Existing Shortfall Closed (OLD PROJECTIONS)	**112%**	**102%**

As shown above, the Fiscal Commission plan would have modified the benefit formula to make it more progressive, indexed the retirement ages to longevity (with a hardship exemption), established a new "minimum benefit," increased the taxable maximum, and made other changes and improvements.

Although the original Fiscal Commission plan would increase benefits for many low-income workers and reduce poverty among seniors, subsequent analysis of the original plan found that it would result in a slight reduction in scheduled benefits for the median retiree in the bottom quintile, primarily because a number of

future retirees with short or intermittent work histories would not be adequately protected by the minimum benefit, which was targeted toward full-career workers.

Upon learning of this unintended consequence, we committed to working to eliminate the benefit reduction in the bottom quintile, and have identified two modifications that, when combined, would do so. The first modification would make the progressive formula change even more progressive by increasing the bottom replacement factor from 90 percent to 95 percent and establishing the 10 percent bendpoint at the 40th percentile (the FC report put it at the 50th percentile). The second would phase up the minimum benefit more rapidly for retirees with less work history –from 0 to 110 percent of poverty between 10 and 20 years of work history and then to 125 percent for 30 years and 140 percent for 40 years -- and crediting workers for quarters of coverage toward the minimum benefits in years with less than four quarters of coverage. With the appropriate design details, these two changes would be roughly cost-neutral but would offer far more robust benefits for those in the bottom quintile and far better poverty protections than was available either in our original plan or the current system.[9]

Unfortunately, since the Fiscal Commission proposal was released, the 75-year actuarial shortfall has increased substantially – from 1.92 percent of taxable payroll back in 2010 to 2.67 percent today. In addition, at the time of the Fiscal Commission report in late 2010, the disability program was projected to be 8 years from insolvency, but now it is just 3 years away. To address these changes, we believe the Fiscal Commission proposal must be modified further to add new Social Security Disability Insurance reforms and include additional cost-savings.

We believe a fundamental overhaul of the Social Security Disability Insurance program is necessary; policy makers should carefully review options to modernize the programs objectives, rules, and eligibility criteria in a way that provides support to those who need it without creating disincentives to work and without erecting barriers to work. In the meanwhile, a number of changes could be made to begin to improve the financial state of the disability programs including changes designed to improve program integrity, reduce administrative costs, and encourage work among those who are able.[10]

To close the remaining solvency gap we suggest policy makers focus on two areas – dependent benefits and the payroll tax base. Currently, spouses are able to collect half of a primary earner's benefit as an alternative to collecting on their own record. Though these dependent benefits provide an important stream of income to many in need, they are poorly targeted and are based neither on need (adequacy) nor on work history and contributions (equity). This benefit could be changed in a number of ways, including by capping spousal benefits for higher earners and eliminating certain outdated auxiliary benefits and provisions such as the obscure Retirement Insurance Benefit limitation (RIB-LIM) for widow(er)s benefit. Ideally, enough savings could be generated to also increase benefits for low-income widow(er)s.

Finally, policymakers should look to mimic some of what we have recommended in individual tax reform by broadening the payroll tax base. One option would be to eliminate the deductibility of so-called "cafeteria plans" to put them on the same footing as 401ks, but policymakers could also look to certain types of income currently exempt from the payroll tax.

Appendix B

The Baseline Used for the Bipartisan Path Forward

Any set of budget projections must first make certain assumptions about the future paths for spending, tax revenues, and the overall economy – even before the budget effects of any new proposals are incorporated. This is what organizations like the Congressional Budget Office and Office of Management and Budget, along with other organizations and experts, refer to as a budget "baseline." Most baselines produce budget projections that extend ten years into the future, although both CBO and OMB at times publish longer-term budget projections.

CBO's official baseline is a "current law" baseline that assumes future spending and revenue paths will result largely from laws as currently written – with the implementation of policies or policy expirations taking place as scheduled in law (or as called for given existing baseline conventions). Other baselines, often referred to as "current policy" or alternative baselines, attempt to construct a more realistic set of projections assuming lawmakers will continue certain practices of waiving certain policies set to take place or extending other policies set to expire.

In the Bipartisan Path Forward, Moment of Truth Project staff calculated the budget impacts of the recommendations off of a realistic baseline constructed by the Committee for a Responsible Federal Budget in February of 2013, which is similar in concept to what was used in past negotiations between Speaker Boehner and President Obama. CRFB's Realistic Baseline begins with CBO's current law projections, but incorporates the following assumptions:

- A repeal of the $1.2 trillion sequester
- An extension of the 2009 refundable tax credit expansions beyond 2017
- A repeal of the Sustainable Growth Rate, which mandates a 25 percent reduction to Medicare physician payments (the repeal is often referred to as the "doc fix")
- A drawdown of war spending more in line with current timetables (current law convention assumes current spending levels grow with inflation)
- A correction of the current law projections of disaster relief that removes the assumption that temporary spending on Hurricane Sandy will be repeated annually and adjusted for inflation
- An adjustment for timing shifts of payments which push payments normally made in one year into preceding years

FIG 10. Bridge from CBO Current Deficits to CRFB Realisitc Baseline Deficits (Billions)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2014-2023
Current Law Deficits (CBO)	**-$845**	**-$616**	**-$430**	**-$476**	**-$535**	**-$605**	**-$710**	**-$798**	**-$854**	**-$957**	**-$978**	**$6,958**
Repeal Sequester	-$42	-$89	-$99	-$103	-$104	-$104	-$104	-$104	-$104	-$94	-$89	-$995
Extend Refund-able Credits	$0	$0	$0	$0	$0	-$3	-$31	-$32	-$32	-$33	-$33	-$164
Extend Doc Fix	$0	-$14	-$16	-$13	-$12	-$12	-$13	-$14	-$14	-$15	-$16	-$138
Reduce Troops in Afghanistan	$0	$16	$37	$51	$60	$64	$67	$69	$71	$73	$74	$582
Do Not Continue Emergency Sandy Past 2013	$0	$2	$9	$18	$26	$33	$38	$41	$43	$45	$47	$302
Adjust for Timing Shifts	$0	$0	$0	$32	$1	-$33	$0	$0	$0	$45	$2	$47
Net Interest	$0	-$1	-$1	-$4	-$7	-$10	-$13	-$16	-$19	-$21	-$24	-$108
CRFB Realistic Deficit	**-$887**	**-$701**	**-$500**	**-$495**	**-$572**	**-$671**	**-$766**	**-$854**	**-$908**	**-$957**	**-$1,016**	**-$7,441**

FIG 11. CRFB Realistic Baseline Budget Projections

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Nominal Dollars(Billions)											
Spending	$3,595	$3,703	$3,873	$4,086	$4,337	$4,606	$4,858	$5,124	$5394	$5,681	$5,968
Revenues	$2,708	$3,003	$3,373	$3,591	$3,765	$3,934	$4,092	$4,270	$4,486	$4,724	$4,951
Deficits	-$887	-$701	-$500	-$495	-$572	-$671	-$766	-$854	-$908	-$957	-$1,016
Debt	$12,271	$13,064	$13,660	$14,241	$14,895	$15,635	$16,468	$17,388	$18,362	$19,388	$20,468
Percent of GDP											
Spending	22.4%	22.2%	22.0%	21.7%	21.7%	22.0%	22.2%	22.4%	22.6%	22.9%	23.0%
Revenues	16.9%	18.0%	19.1%	19.1%	18.9%	18.8%	18.7%	18.7%	18.8%	19.0%	19.1%
Deficits	*-5.5%*	*-4.2%*	*-2.8%*	*-2.6%*	*-2.9%*	*-3.2%*	*-3.5%*	*-3.7%*	*-3.8%*	*-3.8%*	*-3.9%*
Debt	*76.5%*	*78.5%*	*77.5%*	*75.8%*	*74.6%*	*74.7%*	*75.2%*	*76.1%*	*77.0%*	*78.0%*	*79.0%*

Appendix C

Savings in the Bipartisan Path Forward Compared to CBO'S Current Law Baseline

Although we measure the savings in our plan relative to a "realistic baseline," a Congressional Budget Office estimate would project such a plan relative to current law. Below, we show the ten-year savings of the plan against both baselines.

FIG 12. SAVINGS COMPARED TO CRFB REALISTIC BASELINE AND CBO CURRENT LAW BASELINE

	CRFB Realistic Baseline	Current Law
War and Sandy Drawdowns	$0 billion	$885 billion
Sequester	$0 billion	-$995 billion
Health Care	$585 billion	$445 billion
Other Mandatory	$265 billion	$265 billion
Discretionary	$385 billion	$385 billion
New Primary Spending	**$1.24 trillion**	**$985 billion**
Tax Reform/Other Revenue	$585 billion	$420 billion
Revenue Subtotal	**$585 billion**	**$420 billion**
Chained CPI	$280 billion	$280 billion
Program Integrity	$50 billion	$50 billion
General Government Subtotal	**$330 billion**	**$330 billion**
Interest Savings	**$350 billion**	**$235 billion**
Total New Savings	**$2.50 trillion**	**$1.97 trillion**
Memo:		
Total Spending Provisions	$1.76 trillion	$1.40 trillion
Total Revenue Provisions	$740 billion	$575 billion

Note: Figures are rounded and may not add exactly in totals.

Appendix D

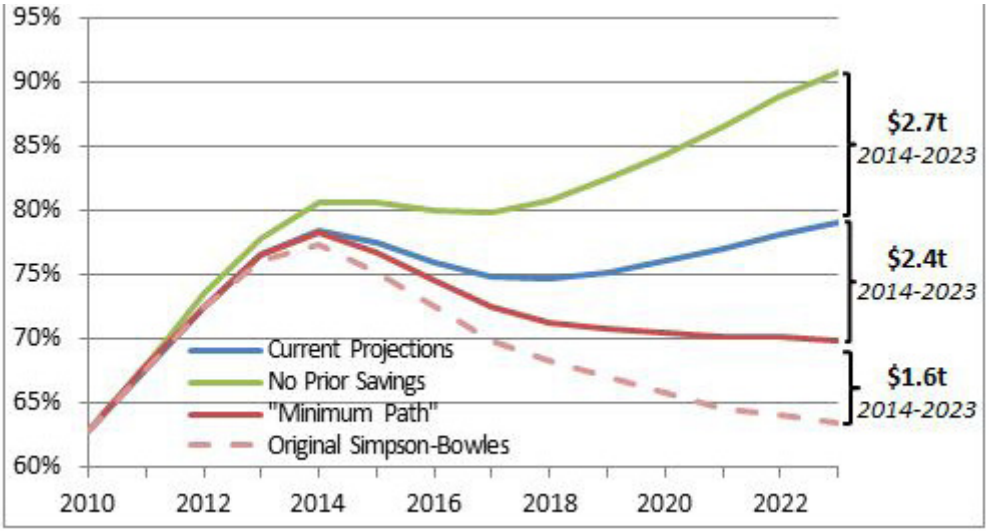
The Minimum Additional Deficit Reduction Needed to Put Debt on a Downward Path

While the deficit reduction enacted to date since FY2011, totaling nearly $2.7 trillion over ten years by some measures, represents notable progress, our debt problems remain far from solved. Debt as a percent of GDP is currently on an upward path, on course to exceed 100 percent in the mid-2030s and 200 percent in the 2060s. Some commentators have called for only stabilizing the debt as a share of the economy later this decade, or even worse, no further savings. Others have pointed to the $4 trillion in savings called for in the December 2010 Fiscal Commission report as the appropriate target for deficit reduction. However, if enacted today, the Fiscal Commission plan would save closer to $6.5 trillion under the new time window. These commentators miss the mark by proposing stable or rising debt paths which come with major risks, including:

- No Room for Error if economic projections are too rosy or policymakers enact future deficit increasing policies.
- No Long-Term Sustainability since $1.5 trillion in savings this decade would highly unlikely keep debt stable in future decades.
- Slower Economic Growth due to higher interest rates "crowding out" investment.
- No Fiscal Flexibility in the case of natural disasters, security needs, or an economic downturn.

Instead of settling for stability, the focus of a deficit reduction plan should be on putting public debt on a clear downward path as a share of the economy – the metric used by economists and budget experts. To achieve this, we need a minimum of $2.4 trillion in additional deficit reduction through 2023. So far, we have only enacted roughly half of the minimum necessary savings over the next decade and a far smaller share of the necessary long-term savings.

FIG 13. DEBT PROJECTIONS UNDER VARIOUS SCENARIOS (PERCENT OF GDP)



Although a minimum of $2.4 trillion in additional savings are needed to put debt on a downward path, the Bipartisan Path Forward calls for an additional $2.5 trillion in savings over the next ten years – hopefully bringing debt to even lower levels and protecting against additional changes in budget or economic projections.

Appendix E

Alternative Debt Projections for the Bipartisan Path Forward

By our estimates, "Step 3" of the Bipartisan Path Forward will reduce the debt to GDP from above 78 percent in 2014 to almost 69 percent by 2023. These projections are based on so-called "current policy" assumptions based on data from the Congressional Budget Office (CBO) and rely on scoring with no macro-economic feedback – consistent with the methodology used by the CBO, the Joint Committee on Taxation (JCT), and the Office of Management and Budget (OMB). We support these projection methods as appropriately conservative.

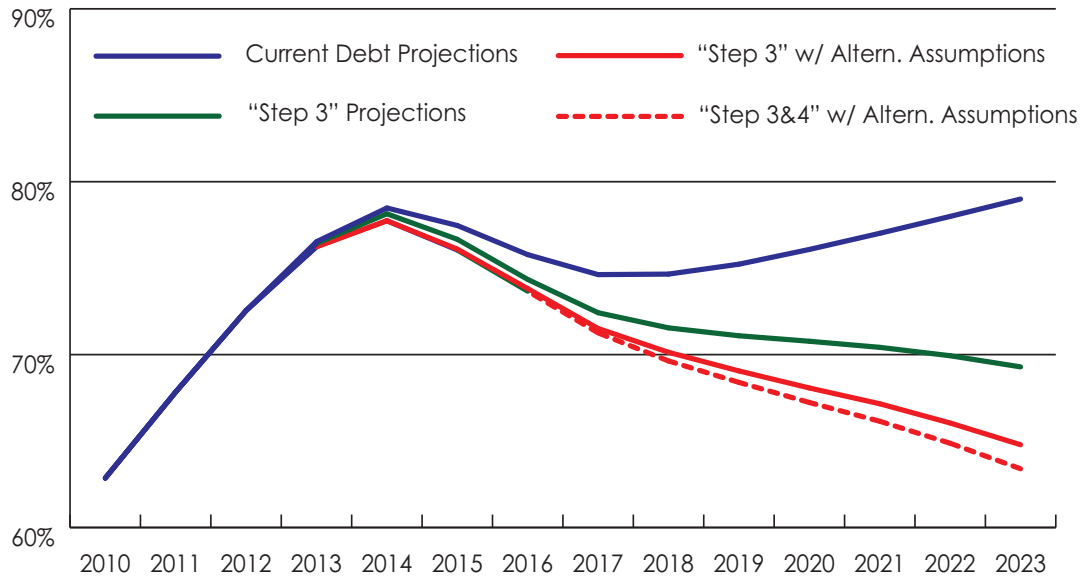
However, we do believe it is possible that actual debt levels could be much lower for two primary reasons. First, the withdrawal from Iraq and Afghanistan appears more rapid than in our assumptions, which assume that 45,000 troops remain in Iraq and Afghanistan on a permanent basis. Secondly, we believe our plan would produce faster economic growth. Although we do not believe such deficit reduction as the result of "dynamic scoring" should be counted in budgetary estimates, additional estimates about the potential macroeconomic impacts can at times provide useful information. The below analysis seeks to demonstrate what some of the macroeconomic impacts could be, along with other assumptions to produce an optimistic scenario for the Bipartisan Path Forward.

First, we adjust our assumptions for spending on Iraq and Afghanistan downward by about $385 billion to reflect war spending levels in the Senate budget resolution. This change alone brings the debt to below 68 percent of GDP by 2023.

Second, we incorporate conservative assumptions about faster economic growth as a result of the overall deficit reduction levels and as a result of the tax reform recommendations in our plan. To calculate the effects from deficit reduction, we compare our plan to the illustrative $2.3 trillion deficit reduction plan analyzed by CBO. Given the very similar amounts of deficit reduction relative to current law under our plan and CBO's illustrative scenario, we assume the same 0.5 percent increase in GDP by 2023. Because our plan actually increases current law deficits in 2013 and 2014, however, we assume a larger economy in those years and a smaller economy in 2016 and 2017.

To calculate the effect of tax reform, we look at two generic base-broadening, rate-lowering analyses from JCT – one on the individual code and the other on the corporate code. Taken together, these plans would increase the size of the economy by 1.2 to 2.0 percent in the second half of the decade. To be conservative and reflect the chance the tax reform may be less bold and pro-growth than these models, we assume only a one percent average increase in the economy in the second half of the decade.

FIG 14. Debt Projections (percent of GDP)



As a result of this faster growth, revenue would likely increase by roughly $375 billion over the next ten years. In combination with the faster war drawdown, lower interest payments, and a larger GDP denominator, this would reduce the debt-to-GDP ratio to below 65 percent in 2023 and the deficit to below 1.3 percent of GDP.

Appendix F

Testing the Bipartisan Path Forward's Savings Against Worse Budget Projections

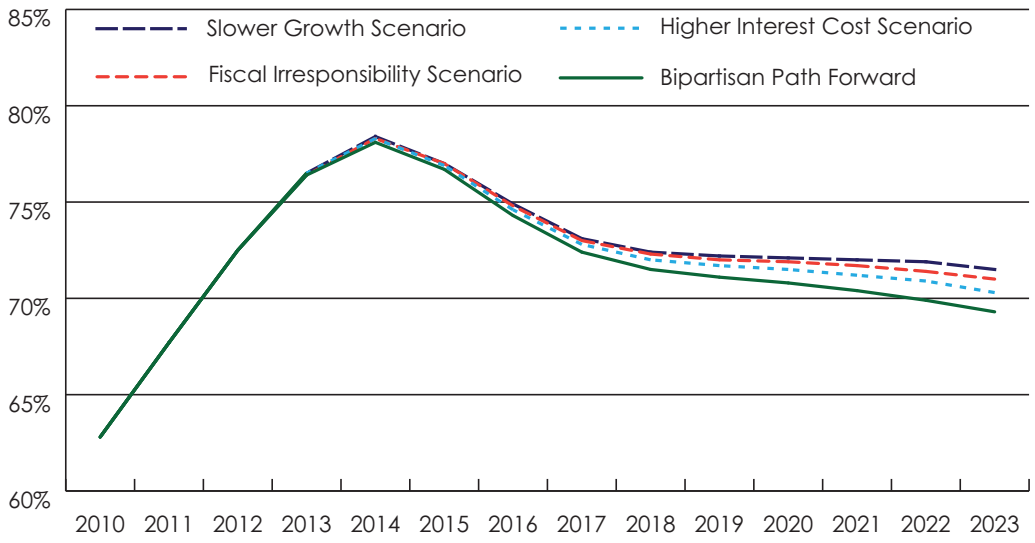
Producing a sustainable debt path requires putting the debt on a clear downward path relative to the economy, both this decade and over the long-term. To achieve this goal, "Step 3" of the Bipartisan Path Forward calls for $2.5 trillion in deficit reduction over the next ten years, which would reduce the debt from a peak of 78 percent in 2014 down to nearly 69 percent by 2023.

However, to ensure that $2.5 trillion in deficit reduction would be sufficient to put debt on a downward debt path in case budget or economic projections change, Moment of Truth Project staff tested the proposed savings against three scenarios:

- **A slower growth scenario** where the same amount of ten-year savings is achieved, but economic growth is 0.1 percentage points slower each year.
- **A higher interest rate scenario** where yearly federal interest payments are 5 percent higher than projected.
- **A fiscal irresponsibility scenario** that assumes policymakers enact roughly $450 billion of deficit-financed measures over the next decade – the equivalent of continuing various expiring tax provisions ("tax extenders") through 2023 outside of the deficit reduction package.

Under all three scenarios, the Bipartisan Path Forward would still produce a declining debt path at the end of the decade, with debt falling to 71.5 percent of GDP by 2023 under the slower growth scenario, 70.3 percent under the higher interest costs scenario, and 71.0 percent under the fiscal irresponsibility scenario. Assuming any two of these scenarios in tandem, meanwhile, would produce a roughly stable debt path later this decade.

FIG 15. Debt Projections under Several Pessimistic Assumptions (Percent of GDP)



Appendix G

Long-Term Analysis

One of the central principles we put forward in this proposal is that any responsible deficit reduction plan should focus on the long-term. Accordingly, it is important to look beyond just the next ten years, when health care costs and retirement costs are on pace to be much higher than today.

To estimate the potential impacts of the Bipartisan Path Forward over the long-term, staff of the Moment of Truth Project estimated the effects of the "Step 3" recommendations in isolation along with its combined impact with "Step 4" savings. Under both approaches, staff estimated the impacts against two scenarios: one in which discretionary and other mandatory spending grow with GDP (Scenario 1) and one in which those categories of spending grow with inflation and population (Scenario 2).

In developing these long-term projections, it should be stressed that the estimates are very rough indicators of the proposal's potential impact, given the outdated nature of CBO's long-term projections, the lack of availability of long-term scores for most policies, and the inherent uncertainty of projecting beyond a ten year budget window.

To calculate long-term savings, most policies were assumed to grow at the same rate as the programs they were deducted from. Specific policies known to have additional long-term savings – for example the increase in the Medicare age which would reach 67 by 2035 – were extrapolated forward on an independent basis using a variety of methodologies depending on the details available. Revenue levels were assumed to grow based on the "real bracket creep" likely to occur after implementation of the chained CPI, with an added assumption that they not exceed 21 percent of GDP. Finally, interest payments were calculated based on prior year's debt levels.

Though these projections are by their nature very rough, under both scenarios including and excluding "Step 4" projections suggest debt would continue to fall relative to the economy through at least 2040.

FIG 16. LONG-TERM PROJECTIONS FOR "STEP 3" (PERCENT OF GDP)

		Outlays	Revenues	Deficits	Debt
2013	"Step 3" Scenarios 1 & 2	22.3%	16.9%	-5.4%	76%
2023	"Step 3" Scenarios 1 & 2	21.6%	19.7%	-1.9%	69%
2030	"Step 3" Scenario 1	22.6%	20.5%	-2.1%	64%
	"Step 3" Scenario 2	22.0%	20.5%	-1.5%	63%
2035	"Step 3" Scenario 1	22.8%	21.0%	-1.8%	61%
	"Step 3" Scenario 2	21.6%	21.0%	-0.6%	55%
2040	"Step 3" Scenario 1	23.0%	21.0%	-2.0%	58%
	"Step 3" Scenario 2	21.0%	21.0%	0%	46%

Scenario 1 assumes baseline discretionary and other mandatory spending grow at the rate of GDP over the long-term.
Scenario 2 assumes baseline discretionary and other mandatory spending grow at the rate of inflation and population growth over the long-term.

Under Scenario 1, "Step 3" outlays would grow from 21.6 percent of GDP in 2023 to 23.0 percent by 2040, with revenues rising from 19.7 percent of GDP in 2023 to 21 percent by 2040. Deficits under this scenario would hold at about 2 percent of GDP over the next quarter century. As a result, debt would decline from 76 percent in 2013 to 69 percent in 2023 and to 58 percent of GDP by 2040.

Under Scenario 2, which assumes mandatory and discretionary spending grow with inflation plus population, "Step 3" would bring the budget into balance by 2040 with spending and revenue levels converging at 21 percent of GDP and debt declining to 46 percent of GDP.

FIG 17. Long-term Projections for "Step 3" and "Step 4" (percent of GDP)

		Outlays	Revenues	Deficits	Debt
2013	"Step 3 & 4" Scenarios 1 & 2	22.3%	16.9%	-5.4%	76%
2023	"Step 3 & 4" Scenarios 1 & 2	21.4%	19.8%	-1.7%	68%
2030	"Step 3 & 4" Scenario 1	22.2%	20.7%	-1.5%	61%
	"Step 3 & 4" Scenario 2	21.6%	20.7%	-0.9%	59%
2035	"Step 3 & 4" Scenario 1	22.2%	21.0%	-1.2%	55%
	"Step 3 & 4" Scenario 2	21.0%	21.0%	0.0%	49%
2040	"Step 3 & 4" Scenario 1	22.1%	21.0%	-1.1%	50%
	"Step 3 & 4" Scenario 2	20.2%	21.0%	0.8%	38%

Assuming lawmakers go beyond "Step 3" and enact the final "Step 4" of the recommendations – including reforms to make Social Security sustainably solvent, to limit the per capita growth of federal health care costs to the rate of GDP per capita, and to make the highway trust fund solvent – then deficit and debt projections would continue to improve.[11] Under Scenario 1, outlays would level off around 22 percent by 2040, with revenue at 21 percent, and deficits falling to 1.1 percent of GDP. As a result, debt levels would fall from 68 percent of GDP at the end of this decade to 50 percent by 2040.

Under Scenario 2's more favorable projections, the combined effect of "Step 3 and Step 4" would push bring the budget to balance (at 21 percent of GDP) by 2035, and result in a modest surplus by 2040 with spending declining to 20.2 percent of GDP. The debt, under this scenario, would fall below 40 percent of GDP by 2040.

Appendix H

Summary Tables

Figure 18. Bridge from Current Law to CRFB Realistic Baseline Projections (Billions)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2014-2023
CBO Current Law Deficits	**-616**	**-430**	**-476**	**-535**	**-605**	**-710**	**-798**	**-854**	**-957**	**-978**	**-6,958**
Repeal sequester	-89	-99	-103	-104	-105	-104	-104	-104	-94	-89	-995
Extend refundable tax credits	0	0	0	0	-3	-31	-32	-32	-33	-33	-164
Extend annual doc fixes	-14	-16	-13	-12	-12	-13	-14	-14	-15	-16	-138
Drawdown war spending	16	37	51	60	64	67	69	71	73	74	582
Do not continue emergency Sandy aid past 2013	2	9	18	26	33	38	41	43	45	47	302
Adjust for Timing Shifts	0	0	32	1	-33	0	0	0	45	2	47
Deficits under CRFB Realistic Baseline	**701**	**500**	**495**	**572**	**671**	**766**	**854**	**908**	**957**	**1,016**	**7,441**

Fig 19. Baseline and Bipartisan Path Forward Projections (Billions and Percent of GDP)

CRFB Realistic Baseline Projections	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2013-2022
Revenues	3,003	3,373	3,591	3,765	3,934	4,092	4,270	4,486	4,724	4,951	40,190
Primary Spending	3,459	3,600	3,759	3,918	4,078	4,252	4,442	4,645	4,865	5,087	42,106
Net Interest	244	273	327	419	527	606	683	749	816	881	5,525
Total Spending	3,703	3,873	4,086	4,337	4,606	4,858	5,124	5,394	5,681	5,968	47,630
Deficit (-) or Surplus	-701	-500	-495	-572	-671	-766	-854	-908	-957	-1,016	-7,441
Debt Held by the Public	13,064	13,660	14,241	14,895	15,635	16,468	17,388	18,362	19,388	20,468	n.a.
Revenues	18.0%	19.1%	19.1%	18.9%	18.8%	18.7%	18.7%	18.8%	19.0%	19.1%	18.8%
Primary Spending	20.8%	20.4%	20.0%	19.6%	19.5%	19.4%	19.4%	19.5%	19.6%	19.6%	19.7%
Net Interest	1.5%	1.5%	1.7%	2.1%	2.5%	2.8%	3.0%	3.1%	3.3%	3.4%	2.6%
Total Spending	22.2%	22.0%	21.7%	21.7%	22.0%	22.2%	22.4%	22.6%	22.9%	23.0%	22.3%
Deficit (-) or Surplus	-4.2%	-2.8%	-2.6%	-2.9%	-3.2%	-3.5%	-3.7%	-3.8%	-3.8%	-3.9%	-3.5%
Debt Held by the Public	78.5%	77.5%	75.8%	74.6%	74.7%	75.2%	76.1%	77.0%	78.0%	79.0%	n.a.

Bipartisan Path Forward	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2013-2022
Revenues	3,019	3,402	3,635	3,816	3,994	4,167	4,362	4,590	4,848	5,095	40,929
Primary Spending	3,436	3,544	3,679	3,809	3,949	4,104	4,270	4,450	4,635	4,816	40,692
Net Interest	244	272	322	408	506	575	639	690	739	783	5,177
Total Spending	3,680	3,817	4,001	4,218	4,455	4,678	4,908	5,140	5,374	5,599	45,869
Deficit (-) or Surplus	-661	-415	-366	-401	-460	-512	-547	-549	-526	-504	-4,941
Debt Held by the Public	13,007	13,517	13,970	14,453	14,982	15,560	16,173	16,788	17,383	17,951	n.a.
Revenues	18.1%	19.3%	19.3%	19.1%	19.1%	19.0%	19.1%	19.3%	19.5%	19.7%	19.2%
Primary Spending	20.6%	20.1%	19.6%	19.1%	18.9%	18.7%	18.7%	18.7%	18.6%	18.6%	19.1%
Net Interest	1.5%	1.5%	1.7%	2.0%	2.4%	2.6%	2.8%	2.9%	3.0%	3.0%	2.4%
Total Spending	22.1%	21.6%	21.3%	21.1%	21.3%	21.4%	21.5%	21.6%	21.6%	21.6%	21.5%
Deficit (-) or Surplus	-4.0%	-2.4%	-1.9%	-2.0%	-2.2%	-2.3%	-2.4%	-2.3%	-2.1%	-1.9%	-2.3%
Debt Held by the Public	78.1%	76.7%	74.3%	72.4%	71.5%	71.1%	70.8%	70.4%	69.9%	69.3%	n.a.
Memorandum:											
Gross Domestic Product	16,646	17,632	18,792	19,959	20,943	21,890	22,854	23,842	24,858	25,910	213,326

Fig 20. Effects of "Step 3" on Realistic Baseline Deficits (Billions and Percent of GDP)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2014-2023
Realistic Baseline Deficits	**701**	**500**	**495**	**572**	**671**	**766**	**854**	**908**	**957**	**1,016**	**7,441**
Tax Reform	-15	-25	-36	-41	-48	-59	-72	-81	-96	-112	-585
Discretionary	-15	-24	-29	-34	-38	-41	-45	-47	-52	-60	-385
Health Care	-9	-23	-35	-45	-50	-56	-70	-82	-96	-118	-585
Other Mandatory Spending	3	-3	-7	-18	-26	-32	-35	-40	-51	-57	-266
Cross-Cutting Reforms	-4	-9	-17	-22	-28	-35	-42	-50	-58	-67	-332
Net interest	0	-1	-4	-11	-22	-31	-44	-59	-77	-98	-347
Total Deficit Reduction in "Step 3"	**-41**	**-85**	**-129**	**-171**	**-211**	**-255**	**-307**	**-359**	**-431**	**-512**	**-2,501**
Deficits under "Step 3"	**661**	**415**	**366**	**401**	**460**	**512**	**547**	**549**	**526**	**504**	**4,941**
Memorandum:											
Potential Deficit Reduction with "Step 4"	*41*	*94*	*148*	*193*	*266*	*295*	*356*	*409*	*481*	*582*	*2,864*
Potential Deficits under "Step 4"	*661*	*406*	*347*	*379*	*406*	*472*	*499*	*499*	*476*	*434*	*4,578*
Realistic Baseline Deficits	4.2%	2.8%	2.6%	2.9%	3.2%	3.5%	3.7%	3.8%	3.8%	3.9%	3.5%
Tax Reform	-0.1%	-0.1%	-0.2%	-0.2%	-0.2%	-0.3%	-0.3%	-0.3%	-0.4%	-0.4%	-0.3%
Discretionary	-0.1%	-0.1%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%
Health Care	-0.1%	-0.1%	-0.2%	-0.2%	-0.2%	-0.3%	-0.3%	-0.3%	-0.4%	-0.5%	-0.3%
Other Mandatory Spending	0.0%	0.0%	0.0%	-0.1%	-0.1%	-0.1%	-0.2%	-0.2%	-0.2%	-0.2%	-0.1%
Cross-Cutting Reforms	0.0%	-0.1%	-0.1%	-0.1%	-0.1%	-0.2%	-0.2%	-0.2%	-0.2%	-0.3%	-0.2%
Net interest	0.0%	0.0%	0.0%	-0.1%	-0.1%	-0.1%	-0.2%	-0.2%	-0.3%	-0.4%	-0.2%
Total Deficit Reduction in "Step 3"	**-0.2%**	**-0.5%**	**-0.7%**	**-0.9%**	**-1.0%**	**-1.2%**	**-1.3%**	**-1.5%**	**-1.7%**	**-2.0%**	**-1.2%**
Deficits under "Step 3"	**4.0%**	**2.4%**	**1.9%**	**2.0%**	**2.2%**	**2.3%**	**2.4%**	**2.3%**	**2.1%**	**1.9%**	**2.3%**
Memorandum:											
Potential Deficit Reduction with "Step 4"	*-0.2%*	*-0.5%*	*-0.8%*	*-1.0%*	*-1.3%*	*-1.3%*	*-1.6%*	*-1.7%*	*-1.9%*	*-2.2%*	*-1.3%*
Potential Deficits under "Step 4"	*-4.0%*	*-2.3%*	*-1.8%*	*-1.9%*	*-1.9%*	*-2.2%*	*-2.2%*	*-2.1%*	*-1.9%*	*-1.7%*	*-2.2%*
Gross Domestic Product	*16,646*	*17,632*	*18,792*	*19,959*	*20,943*	*21,890*	*22,854*	*23,842*	*24,858*	*25,910*	*213,326*

Fig 21. Detailed Effects of "Step 3" on Deficits (Billions)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2014-2023
Realistic Baseline Deficits	**-701**	**-500**	**-495**	**-572**	**-671**	**-766**	**-854**	**-908**	**-957**	**-1,016**	**-7,441**
Effect of "Step 3" of the Bipartisan Path Forward											
Revenues											
Tax Reform	15	25	36	41	48	59	72	81	96	112	585
Chained CPI (revenues)	1	3	6	8	9	13	16	19	23	26	124
Program Integrity (revenues)	0	2	2	2	3	3	4	4	5	5	30
Total Effect on Revenues	17	29	44	51	60	75	91	104	124	144	739
Outlays											
Discretionary											
Defense	-10	-15	-17	-20	-22	-23	-25	-27	-30	-34	-222
Non-Defense	-6	-10	-12	-14	-16	-18	-19	-20	-22	-26	-163
Subtotal	-15	-24	-29	-34	-38	-41	-45	-47	-52	-60	-385
Health Care											
Enact delivery system and payment reforms	0	-2	-3	-4	-5	-5	-6	-9	-11	-14	-59
Reform Medicare cost-sharing rules	-2	-4	-8	-9	-10	-10	-11	-12	-12	-13	-90
Enact medical malpractice reform	0	-1	-1	-2	-2	-2	-3	-3	-3	-3	-20
Increase income-related premuims	-1	-2	-2	-3	-3	-4	-8	-11	-13	-17	-65
Increase the Medicare age with an income-related Medicare buy-in	0	0	0	-1	-2	-3	-5	-6	-8	-10	-35
Reduce and reform post-acute care payments	-1	-2	-3	-5	-6	-7	-9	-11	-13	-15	-71
Reduce various payments to hospitals	-2	-4	-5	-5	-6	-7	-8	-9	-10	-11	-65
Reduce the cost of prescription drugs in Medicare	-3	-7	-8	-9	-9	-9	-10	-11	-12	-13	-90
Reduce Medicare fraud and excessive payments	0	-1	-2	-2	-2	-2	-3	-4	-4	-5	-26
Reform Medicaid financing by reducing over-payments to states	0	-1	-3	-4	-6	-7	-8	-9	-11	-16	-65
Subtotal	-9	-23	-35	-45	-50	-56	-70	-82	-96	-118	-585
Other Mandatory Spending											
Reduce and reform agriculture spending	-3	-4	-4	-4	-4	-4	-4	-4	-4	-4	-40
Reform civilian and military health and retirement programs	-1	-3	-5	-7	-9	-11	-13	-15	-17	-20	-101
Reform higher education programs	9	6	5	-2	-5	-8	-9	-9	-10	-11	-35
Increase or impose user fees	0	-1	-1	-3	-4	-5	-5	-6	-13	-13	-51
Enact additional savings	-1	-2	-2	-2	-3	-4	-4	-5	-7	-8	-39
Subtotal	3	-3	-7	-18	-26	-32	-35	-40	-51	-57	-266
Cross-Cutting											
Chained CPI w/ enhancements (spending)	-2	-4	-7	-10	-14	-17	-20	-24	-28	-32	-157
Program integrity (spending)	0	-1	-2	-2	-2	-2	-2	-3	-3	-4	-21
Subtotal	-2	-5	-9	-12	-16	-19	-23	-27	-31	-36	-178
Net interest	0	-1	-4	-11	-22	-31	-44	-59	-77	-98	-347
Total Effect on Outlays	-24	-56	-85	-120	-151	-180	-216	-255	-307	-368	-1,761
Total Deficit Reduction in "Step 3"	**-41**	**-85**	**-129**	**-171**	**-211**	**-255**	**-307**	**-359**	**-431**	**-512**	**-2,501**
Deficits under "Step 3"	**-661**	**-415**	**-366**	**-401**	**-460**	**-512**	**-547**	**-549**	**-526**	**-504**	**-4,941**
Memorandum:											
Total effects of switching to the chained CPI	3	7	13	18	23	30	36	43	50	58	280
Total effect of program integrity measures	1	3	4	4	5	5	6	7	8	9	51
Potential Deficit Reduction with "Step 4"	*-41*	*-94*	*-148*	*-193*	*-266*	*-295*	*-356*	*-409*	*-481*	*-582*	*-2,864*

Fig 22. Discretionary Caps under Several Scenarios (Budget Authority, Billions)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2014-2023
Pre-Sequester BCA Caps (CRFB Realistic)	1,058	1,086	1,107	1,131	1,156	1,182	1,208	1,234	1,266	1,299	11,727
Base Defense	552	566	577	590	603	616	630	644	661	678	6,117
Base Non-Defense	506	520	530	541	553	566	578	590	605	621	5,610
Sequester Caps (CBO Current Law)	966	995	1,016	1,040	1,066	1,093	1,120	1,147	1,177	1,208	10,828
Base Defense	497	511	522	535	548	561	575	589	605	620	5,566
Base Non-Defense	469	483	494	505	518	532	545	558	572	587	5,262
"Step 3" Caps	1,040	1,055	1,074	1,094	1,115	1,138	1,161	1,185	1,209	1,234	11,306
Base Defense	540	548	558	569	580	591	603	616	628	641	5,875
Base Non-Defense	499	507	516	526	536	547	558	569	581	593	5,431
"Step 3" Savings Compared to BCA Caps	*-18*	*-31*	*-33*	*-37*	*-41*	*-44*	*-47*	*-49*	*-57*	*-65*	*-421*
Base Defense	*-12*	*-18*	*-19*	*-21*	*-23*	*-25*	*-27*	*-28*	*-32*	*-37*	*-241*
Base Non-Defense	*-7*	*-13*	*-14*	*-15*	*-17*	*-19*	*-20*	*-21*	*-24*	*-28*	*-180*
"Step 3" Savings Compared to BCA Caps (Outlays -- including 2013 impact)	*-15*	*-24*	*-29*	*-34*	*-38*	*-41*	*-45*	*-47*	*-52*	*-60*	*-385*
Base Defense	*-10*	*-15*	*-17*	*-20*	*-22*	*-23*	*-25*	*-27*	*-30*	*-34*	*-222*
Base Non-Defense	*-6*	*-10*	*-12*	*-14*	*-16*	*-18*	*-19*	*-20*	*-22*	*-26*	*-163*

Fig 23. Effects of "Step 3" on Current Law Deficits (Billions and Percent of GDP)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2014-2023
CBO Current Law Deficits	**616**	**430**	**476**	**535**	**605**	**710**	**798**	**854**	**957**	**978**	**6,958**
Tax Reform	-15	-25	-36	-41	-45	-28	-40	-49	-63	-79	-421
Discretionary	41	15	-10	-29	-45	-57	-67	-74	-84	-91	-400
Health Care	13	2	-12	-22	-26	-32	-43	-54	-74	-102	-349
Other Mandatory Spending	8	2	-3	-15	-23	-29	-32	-37	-51	-57	-237
Cross-Cutting Reforms	-4	-9	-17	-22	-28	-35	-42	-50	-58	-67	-332
Net interest	1	1	-1	-4	-11	-19	-28	-40	-56	-75	-232
Total Deficit Reduction in "Step 3"	**45**	**-15**	**-78**	**-132**	**-178**	**-199**	**-252**	**-304**	**-386**	**-471**	**-1,971**
Timing Shifts	0	0	32	1	-33	0	0	0	45	2	47
Deficits under "Step 3"	**661**	**415**	**366**	**401**	**460**	**512**	**547**	**549**	**526**	**504**	**4,941**
Memorandum:											
Potential Deficit Reduction with "Step 4"	*41*	*94*	*148*	*193*	*266*	*295*	*356*	*409*	*481*	*582*	*2,864*
Potential Deficits under "Step 4"	*661*	*406*	*347*	*379*	*406*	*472*	*499*	*499*	*476*	*434*	*4,578*
CBO Current Law Deficits	3.7%	2.4%	2.5%	2.7%	2.9%	3.2%	3.5%	3.6%	3.8%	3.8%	3.3%
Tax Reform	-0.1%	-0.1%	-0.2%	-0.2%	-0.2%	-0.1%	-0.2%	-0.2%	-0.3%	-0.3%	-0.2%
Discretionary	0.2%	0.1%	-0.1%	-0.1%	-0.2%	-0.3%	-0.3%	-0.3%	-0.3%	-0.4%	-0.2%
Health Care	0.1%	0.0%	-0.1%	-0.1%	-0.1%	-0.1%	-0.2%	-0.2%	-0.3%	-0.4%	-0.2%
Other Mandatory Spending	0.0%	0.0%	0.0%	-0.1%	-0.1%	-0.1%	-0.1%	-0.2%	-0.2%	-0.2%	-0.1%
Cross-Cutting Reforms	0.0%	-0.1%	-0.1%	-0.1%	-0.1%	-0.2%	-0.2%	-0.2%	-0.2%	-0.3%	-0.2%
Net interest	0.0%	0.0%	0.0%	0.0%	-0.1%	-0.1%	-0.1%	-0.2%	-0.2%	-0.3%	-0.1%
Total Deficit Reduction in "Step 3"	**0.3%**	**-0.1%**	**-0.4%**	**-0.7%**	**-0.9%**	**-0.9%**	**-1.1%**	**-1.3%**	**-1.6%**	**-1.8%**	**-0.9%**
Deficits under "Step 3"	**4.0%**	**2.4%**	**1.9%**	**2.0%**	**2.2%**	**2.3%**	**2.4%**	**2.3%**	**2.1%**	**1.9%**	**2.3%**
Memorandum:											
Potential Deficit Reduction with "Step 4"	*-0.2%*	*-0.5%*	*-0.8%*	*-1.0%*	*-1.3%*	*-1.3%*	*-1.6%*	*-1.7%*	*-1.9%*	*-2.2%*	*-1.3%*
Potential Deficits under "Step 4"	*-4.0%*	*-2.3%*	*-1.8%*	*-1.9%*	*-1.9%*	*-2.2%*	*-2.2%*	*-2.1%*	*-1.9%*	*-1.7%*	*-2.2%*
Gross Domestic Product	*16,646*	*17,632*	*18,792*	*19,959*	*20,943*	*21,890*	*22,854*	*23,842*	*24,858*	*25,910*	*213,326*

Fig 24. Baseline and Bipartisan Path Forward Projections Based on OMB Assumptions (Billions and Percent of GDP)

CRFB Realistic Baseline Projections Based on OMB Economic and Technical Assumptions	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2014-2023
Revenues	3,000	3,277	3,476	3,660	3,865	4,097	4,325	4,559	4,785	5,045	40,089
Primary Spending	3,475	3,621	3,784	3,898	4,025	4,233	4,429	4,646	4,912	5,098	42,122
Net Interest	222	252	299	374	469	559	634	698	763	826	5,094
Total Spending	3,697	3,873	4,082	4,272	4,494	4,792	5,063	5,344	5,675	5,924	47,216
Deficit (-) or Surplus	-697	-597	-606	-612	-628	-696	-739	-785	-890	-879	-7,127
Debt Held by the Public	13,274	14,028	14,778	15,521	16,268	17,073	17,912	18,792	19,777	20,746	n.a.
Revenues	17.6%	18.3%	18.4%	18.3%	18.4%	18.6%	18.8%	19.0%	19.1%	19.4%	18.7%
Primary Spending	20.4%	20.2%	20.0%	19.5%	19.1%	19.2%	19.3%	19.4%	19.7%	19.6%	19.6%
Net Interest	1.3%	1.4%	1.6%	1.9%	2.2%	2.5%	2.8%	2.9%	3.1%	3.2%	2.4%
Total Spending	21.7%	21.6%	21.6%	21.4%	21.4%	21.8%	22.0%	22.3%	22.7%	22.7%	22.0%
Deficit (-) or Surplus	-4.1%	-3.3%	-3.2%	-3.1%	-3.0%	-3.2%	-3.2%	-3.3%	-3.6%	-3.4%	-3.3%
Debt Held by the Public	78.0%	78.2%	78.0%	77.7%	77.4%	77.6%	78.0%	78.4%	79.1%	79.6%	n.a.

Bipartisan Path Forward Based on OMB Economic and Technical Assumptions	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2014-2023
Revenues	3,017	3,307	3,520	3,712	3,925	4,172	4,416	4,663	4,909	5,188	40,829
Primary Spending	3,452	3,566	3,704	3,789	3,895	4,085	4,258	4,450	4,682	4,827	40,709
Net Interest	221	249	293	364	450	530	593	644	693	736	4,773
Total Spending	3,673	3,815	3,997	4,153	4,345	4,616	4,851	5,094	5,375	5,564	45,482
Deficit (-) or Surplus	-656	-509	-477	-441	-420	-444	-435	-431	-466	-375	-4,653
Debt Held by the Public	13,217	13,884	14,504	15,076	15,615	16,168	16,705	17,230	17,791	18,257	n.a.
Revenues	17.7%	18.4%	18.6%	18.6%	18.7%	19.0%	19.2%	19.5%	19.6%	19.9%	19.0%
Primary Spending	20.3%	19.9%	19.6%	19.0%	18.5%	18.6%	18.5%	18.6%	18.7%	18.5%	18.9%
Net Interest	1.3%	1.4%	1.5%	1.8%	2.1%	2.4%	2.6%	2.7%	2.8%	2.8%	2.2%
Total Spending	21.6%	21.3%	21.1%	20.8%	20.7%	21.0%	21.1%	21.3%	21.5%	21.4%	21.2%
Deficit (-) or Surplus	-3.9%	-2.8%	-2.5%	-2.2%	-2.0%	-2.0%	-1.9%	-1.8%	-1.9%	-1.4%	-2.2%
Debt Held by the Public	77.7%	77.4%	76.6%	75.5%	74.3%	73.5%	72.7%	71.9%	71.2%	70.1%	n.a.
Memorandum:											
Gross Domestic Product	17,011	17,936	18,934	19,980	21,025	22,009	22,974	23,964	24,990	26,057	214,880

Endnotes

[1] A description of the baseline used for estimates in this plan is contained in Appendix B.

[2] This includes the savings from CHIMPs (changes in mandatory programs) that were used to offset increased appropriations in fy13 and could be used to meet discretionary spending limits in future years.

[3] This would be calculated by taking the average expected cost for the buy-in population and adding a small administrative fee. To the extent actual costs were higher or lower for a given cohort, the different would be made up by modestly adjusting premiums between the normal age and age 85.

[4] The federal subsidy for premiums would generally be set based on subsidy levels set by the Affordable Care Act for those below 400 percent of poverty with a phase-out of the subsidy above that level.

[5] Congressional Budget Office. "Budget and Economic Outlook," February 2013 Medicare Baseline. http://www.cbo.gov/publication/43894.

[6] Austin B. Frakt, Steven D. Pizer Roger Feldman. "Should Medicare Adopt the Veterans Health Administration Formulary? Journal of Health Economics, April 19, 2011.

[7] As an example, some will argued against taxing capital gains as ordinary income on economic grounds. However, with a rate that is sufficiently low – 28 percent of below – we believe there is an economic advantage to reducing the differential between various types of income (short-term capital gains, long-term capital gains, dividends, interest, earned income, corporate income, etc) so work and investment decisions are made without regards for the tax code and time and dollars are no longer wasted on trying to reclassify income in an attempt to reduce tax burden.

[8] Appendix A includes a summary of the Social Security reform plan in the Fiscal Commission report, which could provide the basis for a bipartisan plan to achieve sustainable solvency with modifications to improve low income protections and achieve additional savings to close the increased in the projected shortfall since the commission report was issue.

[9] In this particular formulation, the minimum benefit would be phased in between 2017 and 2023 to avoid benefit notches would be calculated based on the poverty line through 2023, after which it would be indexed to wage growth. In addition, several anti-abuse measures would be added to the minimum benefit to prevent certain wealthier individuals substantial retirement income from outside Social Security from over-collecting.

[10] Some options include increasing CDR funds, closing record for the submission of medical evidence one week before a claimant's hearing, requiring the government to be legally represented at administrative law judge (ALJ) disability hearings, giving SSA Inspector General enhanced authority to compare various records, making the collection of civil monetary penalties mandatory, indexing vocational grid ages to the NRA, stabilizing the relationship between DI benefits and early retirement benefits by calculating DI benefits as if an individual retired 4 years after the NRA, simplifying the workers' compensation offset, and paying retroactive payments in the next check.

[11] In the long-term projections, Moment of Truth Project staff assumed that all of the savings from a health cap.

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