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EXPANDED VIEWS ON THE FISCAL COMMISSION

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Introduction

President Obama established the National Commission on Fiscal Responsibility and Reform on February 18, 2010, and appointed Erskine Bowles and Alan Simpson to co-chair it. The Commission was charged with "identifying policies to improve the fiscal situation in the medium term and to achieve fiscal sustainability over the long run." Specifically, the Commission was to make recommendations for balancing the "primary" budget – excluding interest payments – by 2015, and for improving the government's long-term fiscal problems.

The Co-Chairmen achieved a remarkable success in pursuing the Commission's mandate in a bipartisan fashion. That accomplishment is even more noteworthy when one considers the extraordinary nature of the challenge, and the equally difficult political environment over the past year. In 2009, the deficit soared to 10 percent of gross domestic product [GDP], the highest level since World War II. Projections by the nonpartisan Congressional Budget Office [CBO] show the debt spiraling out of control due to entitlement spending, primarily driven by two existing health care entitlements. While the Commission worked on this problem over the past year, the President and Congress pursued the enactment of a new $1-trillion health care entitlement – which also raised taxes by a half trillion dollars and reduced Medicare by another half trillion – and they used the Budget Act's reconciliation procedures to force this legislation through Congress on a purely partisan vote.

In this climate, the Co-Chairs of the Fiscal Commission proposed a comprehensive and credible plan for getting the Federal Government's fiscal house in order. By laying out specific proposals, they have shown the magnitude of the government's spending and debt problems, but they have also demonstrated that fiscal solutions are indeed necessary and possible. Although I could not support the entire plan, many of its elements surely are worthy of further pursuit. They establish a much-needed foundation and justification for fundamental policy reforms.

Testimony before the Commission, and the reports of the CBO and the Government Accountability Office [GAO], make clear the government's current course is unsustainable.

- The GAO currently estimates the fiscal gap – that is, the difference between planned spending and the revenues coming in – is equal to $88.6 trillion. This is a 40-percent increase from the March 2009 estimate, demonstrating the extent to which delay only makes the problem worse.

- The CBO's economic model breaks down after 2037 due to the excessive levels of debt the government is expected to accumulate over the course of the coming decades.

- By 2025, CBO estimates that spending on Social Security, Federal health care and net interest will use every single dollar of revenue the Federal Government takes in.

America is rapidly approaching a tipping point. Should the government fail to reform entitlements, those very programs will collapse of their own weight and bury the next generation under a crushing debt. Clinging to the status quo will only lead, inevitably, to economically stifling tax increases, or deep, sudden, and highly disruptive benefit cuts. Failing to address this problem now – when the necessary adjustments are manageable – assures forced austerity in the near future, imposed by credit markets in a state of panic.

This was the problem I tried to confront in my own comprehensive entitlement and tax reform plan, *A Roadmap for America's Future,* which I initially released in 2008. In developing and releasing this plan, I sought to advance the debate on the government's long-term fiscal challenges, and hoped it would lead other policy makers of both parties to put forth their own plans aimed at tackling these problems and allowing America to continue fulfilling its promise: to leave the next generation better off.

In this spirit, the balance of this statement analyzes and critiques key elements of the Co-Chairs' proposals.

Social Security Reform

The Co-Chairs' recommendations agree with the near unanimous conclusion – by both Republicans and Democrats – that Social Security must be reformed to prevent severe cuts in future benefits. Moreover, their proposals have the right goal: enabling the system to continue contributing to retirement security as the U.S. population grows older (a principal aim of my own Social Security reform proposals).

In one of their most important steps, the Co-Chairs have established a more ambitious criterion than previous reforms. Instead of merely making Social Security solvent over the 75-year actuarial period, they seek to ensure the program is *sustainably* solvent. They do so by achieving solvency *on a cash basis* in the 75th year of their proposal. In this respect the plan differs significantly from the last major reform to Social Security, in 1983, which looked at the program on an *average* basis, and so did not create a sustainable solution. Such an approach now would only push the problem further down the road, where it will still wait to burden future generations.

Other significant strengths of the Co-Chairs' Social Security proposals include the following:

- *Increase progressivity of the benefit formula.* This provision would reduce the growth in benefits for higher income workers. It would not cut benefits; in fact, benefits would continue to grow in real terms.

- *Index the retirement age to increases in longevity.* When Social Security was enacted in 1935, the average man in America was expected to live 60 years, and the average woman 64 years. Since then, Americans grew healthier and came to live longer, so that today's life expectancy exceeds 75 years for men and 80 years for women – and life spans are continuing to lengthen. But only once has the original Social Security retirement age, 65, been adjusted in response to lengthening life spans. Average retirement ages, however, have been declining, from 68 in 1950 to just above 63 today. In offering a gradual increase in the retirement age that will not begin for another 13 years, and will not be fully implemented until the next century, the Co-Chairs have confronted a key demographic problem deteriorating Social Security's financial condition.

- *Reduce poverty among the elderly*. Currently, the Social Security system still leaves some below the poverty line in retirement. By modernizing the special minimum benefit, the Co-Chairs' proposal helps target Social Security benefits to those who most rely on the program.

One can disagree with certain details of the Co-Chairs' Social Security proposals, and some adjustments may be warranted. But their focus on this program – once considered, in the great cliché, the "third rail" of American politics – helps advance two crucial and related arguments: that only through reform can Social Security be saved; and that such reform is an essential component of solving the Nation's looming fiscal crisis.

Discretionary Spending

A key aspect of discretionary spending, as distinct from entitlements, is that Congress determines this category of spending through enactment of annual appropriations legislation. While discretionary spending is not the driver of the long-term budget problem, it has exploded over the past 2 years. Reducing and getting control of discretionary spending can make an immediate and important contribution to addressing the government's spending problems. To this end, the Co-Chairs' propose to establish statutory caps on discretionary spending enforced by automatic across-the-board spending reductions if spending exceeded these caps.

The discretionary savings should be more aggressive. The Co-Chairs would freeze discretionary spending in 2012 at 2010 levels and then require a 1-percent cut in discretionary budget authority between fiscal years 2013 and 2015. By contrast, the Republican agenda, *A Pledge to America*, reduces non-security discretionary spending to fiscal year 2008 levels, prior to the 84-percent increase in this category that resulted from an explosion of spending in regular appropriations bills, and the "stimulus" legislation.

The Co-Chairs would split these reductions between security and non-security categories and establish separate binding caps, effectively establishing a "firewall" between them. While I support caps on discretionary spending, I do not support a firewall at the levels recommended by the Co-Chairs, because it would reduce Congress' flexibility to achieve discretionary savings. Also, while I believe there is waste in the Department of Defense [DoD] that needs to be eliminated, I do not think the commission has fully explored the potential impact on national security from the reduction in DoD's budget. The magnitude of reductions contemplated in the Co-Chairs' proposal would necessitate changes in national security strategy. The consequences of such changes have not been fully studied or discussed.

The Co-Chairs are to be commended for identifying specific cuts that could more than achieve their proposed cap levels. One can disagree with particular reductions – and surely many will – but these are precisely the kinds of debates policy makers need to have; and the specificity of the proposals proves it is possible to make the cuts necessary to get the government's spending under control.

Fundamental Tax Reform

At least in part, the Co-Chairs' tax recommendations reflect their acknowledgement of a crucial point: *lower tax rates are critical to economic growth*. Hence the Co-Chairs concentrate on creating a more efficient and less distortive tax code, calling for individual rates as low as 8 percent, 14 percent, and 23 percent – and a corporate tax rate as low as 26 percent. They also would simplify the tax code, wiping away the complex web of exemptions and deductions – declaring an end to the government's social and economic engineering through the tax code. By reducing rates and moving to a territorial tax system, the Co-Chairs' proposal would make the U.S. more competitive in an increasingly global economy. Finally, their cap on total revenue in principle prevents the government from chasing ever-higher spending with ever-higher taxes – recognizing that the fundamental problem is *spending*.

But the revenue increases called for in this proposal are simply too high, and threaten to stifle the very growth needed for economic prosperity and fiscal stability. Over the past 40 years, revenue has averaged between 18 percent and 19 percent of GDP. The Co-Chairs would increase revenues to 21 percent of GDP – not including increases to the Social Security payroll tax. Relative to a current policy baseline, the proposal would increase revenues by $2 trillion over 10 years. Increasing the government's take from the economy hinders growth, and it is doubtful these revenues would be used for deficit reduction: there is no guarantee that reductions in Federal spending would be achieved.

Health Care Reform

The primary driver of the government's fiscal problems is its health care spending; and the fundamental weakness in the Co-Chairs' proposal is its failure to structurally reform health care. Before the recent enactment of the Patient Protection and Affordable Care Act [PPACA], the government had three major entitlements: Medicare, Medicaid, and Social Security. These programs are the root cause of the government's structural deficits in future years. PPACA created a new entitlement program that has greatly increased the government's burgeoning structural deficits. The new health care law should be repealed and replaced with an approach that strengthens the doctor-patient relationship and truly eases pressure on medical costs by enhancing consumer choices, while preserving the safety net for those who need it most. President Obama sees enactment of this new health care entitlement as a signature achievement in a heated partisan battle over the past year, so it is understandable the Co-Chairs did not confront it or health care reform generally. But it is a disappointing and critical short-coming of the Co-Chairs' proposal.

Medicare has a critical mission to provide health security for the Nation's elderly, but its fee-for-service defined benefit structure is fundamentally flawed and is accelerating the program towards bankruptcy. Moreover, it and Medicaid are the largest contributors to the government's long-term fiscal problems. According to the Medicare program's actuary, the provider reductions in PPACA are unsustainable and will drive doctors, hospitals, and other providers out of the program.

Because of this concern, I worked with fellow Commissioner Alice M. Rivlin to develop a plan for Medicaid and Medicare (see Appendix 1). The proposal would make no changes for those now 55 or older, as efforts to save these programs ought not disrupt benefits for those in or near retirement. For those younger than 55, Medicare would provide a list of approved health plans, along with a payment equal to average Medicare costs, so they could select a plan suitable for their needs. This payment would be means-tested and risk-adjusted, and would grow at a rate of GDP + 1 percent. The CBO confirmed this would help address Medicare's long-term sustainability by saving roughly 4 percent of GDP by 2050. It would also give seniors the same high-quality health insurance options I have as a Member of Congress.

While I agree that the current health care exclusion in the tax code distorts health care markets, I have serious concerns about the consequences if it were repealed under PPACA's infrastructure. In the absence of a healthy, vibrant, competitive market for health insurance, the exclusion's repeal would accelerate the move of employees away from job-based health insurance to the government-controlled exchanges established by PPACA. This would cause spending on this new entitlement to soar, putting additional pressure on deficits and debt and deteriorating health care for American families.

Conclusion

The Co-Chairs' deficit reduction plan was greeted with much talk of "painful choices" and widespread "sacrifice." Clearly some of the decisions raised by their proposals are deeply challenging. Some require a thorough re-evaluation of the government's role in American society, and some entail broad restructuring of government programs. But the source of America's strength and prosperity has always been its people, exercising choices through a free economy *supported*, not directed, by their government. For those who brand the Co-Chairs' proposals as "austere" or "draconian" – or apply similar labels to other comprehensive plans, such as my *Roadmap*, that address the government's unsustainable entitlement programs – have it backwards: failing to confront this problem, and simply defending the status quo, will eventually lead to a debt crisis and produce real sacrifice – an outcome that would smother economic growth and create a long-lasting period of austerity.

I cannot overstate my respect for, and gratitude to, Erskine Bowles and Alan Simpson for their leadership as Co-Chairs of the Fiscal Commission. Tasked with an extraordinarily difficult challenge, they put forth a comprehensive and provocative proposal to help tackle the debt threat, advancing a sorely needed debate on these critical issues. While I disagree with several specific aspects of the plan – most notably the increase in taxes and the lack of structural reform to health care – the proposal makes an important contribution toward getting the Federal Government's fiscal house in order. It is a serious and credible deficit-reduction plan that can help launch the critically important debate that faces this country: how to ensure a prosperous future for coming generations of Americans. I look forward to working with my colleagues in Congress to build on the success of this Commission.

APPENDIX 1

A Long-Term Plan for Medicare and Medicaid

Alice Rivlin and Paul Ryan

The Goal

The Medicare and Medicaid programs are currently the primary drivers of upward pressure on the Federal budget. This proposal aims to show a path to achieving the Co-Chairs' goal of containing the growth this program to GDP +1 percent, and to demonstrate that Republicans and Democrats can come together to reform entitlements.

Proposal for Medicare Reform

Create a Sustainable Medicare Program for the 21st Century

A new Medicare Program should be created for future retirees (those who first become eligible by turning 65 on or after January 1, 2021). The new Medicare Program would provide a payment – based on what the average annual per-capita expenditure is in 2021 – to purchase health insurance. The payment would grow annually at a rate of GDP +1 percent. The annual payment would be adjusted by income, with high-income seniors receiving a reduced payment and low-income seniors receiving extra support. The payment would also be geographically rated and adjusted for health risk. In addition to a higher Medicare payment amount, low-income "dual-eligibles" would also receive a fully funded account from which to pay out-of-pocket expenses.

To receive the Medicare payment, a beneficiary would select a plan from a newly created Medicare Exchange. Health plans that choose to participate in the Medicare Exchange must agree to offer insurance to *all* Medicare beneficiaries, to prevent cherry-picking and ensure that Medicare's sickest and highest cost beneficiaries receive coverage.

For those now enrolled in Medicare, or becoming eligible before 2021, the traditional fee-for-service Medicare Program would continue. Premiums for the current program would be held harmless from the effects of the creation of the new Medicare Program.

Raise the Medicare Retirement Age

In 2021, this plan begins raising the Medicare eligibility age to correspond to the normal Social Security retirement age (2 months per year beginning in 2021 and stopping at age 67).

Repeal the CLASS Program

The Patient Protection and Affordable Care Act created a new long-term care entitlement for the Medicare Program that is set to collect premiums beginning in 2014. The premiums are used to pay for the new health care benefit, and not for the new long-term care program. Because the Community Living Assistance Services and Support Program is a new unfunded entitlement, this proposal repeals it. Otherwise it will increase the deficit over the long term.

Other Changes

The current Medicare Program should undergo a number of small, common sense changes to help achieve long-term sustainability. These savings should include comprehensive medical malpractice reform, combining Parts A and B deductibles and eliminating first-dollar coverage in Medigap plans

Proposal for Medicaid Reform

Convert the Federal Share of Medicaid into an Allotment to States

Beginning in 2013, the Federal share of Medicaid's payments for acute and long-term care services should be converted into an allotment to States.

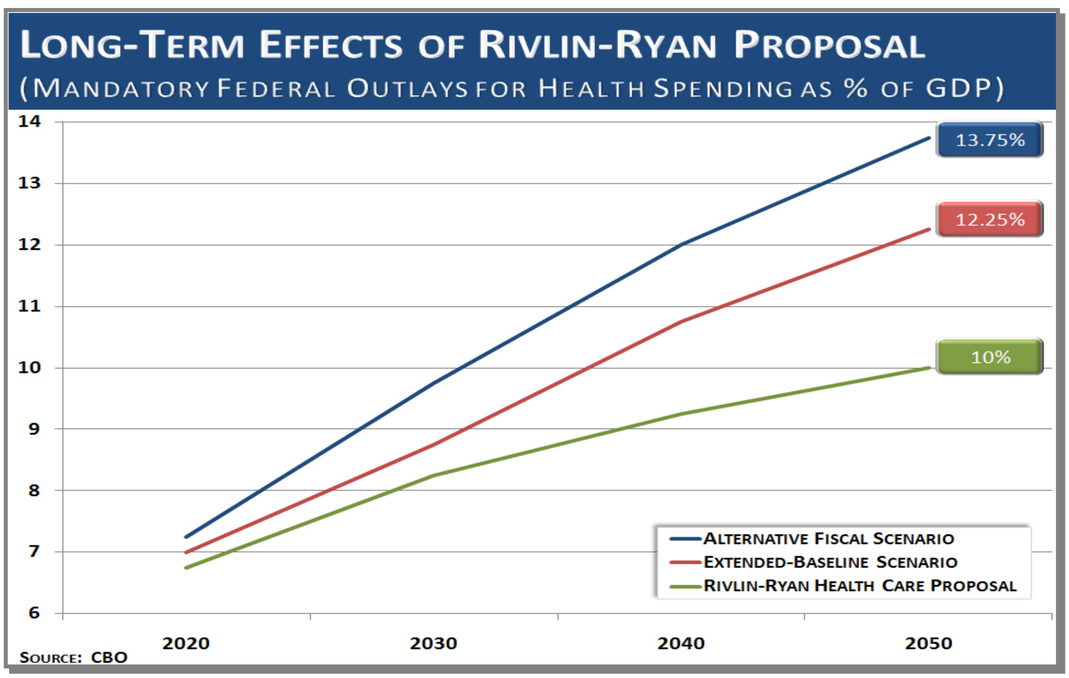
In exchange for slower growth in the Federal Government's Medicaid payment, states will have more flexibility in how they use Medicaid funds to meet the needs of their low-income populations.

Each State's initial allotment would be determined by the State's per capita low-income population based on the Federal Poverty Level. The state allotment would grow at GDP +1 percent and would be further adjusted for population growth.

Near-Term Effects of Rivlin-Ryan Proposal

Provision	Change in Unified-Budget Deficits, 2011 - 2020 ($ billions)
Change Medical Malpractice Laws	-$60
Repeal CLASS Program	+$70
Modify Medicare Cost Sharing	-$110
Establish Medicaid Block Grants	-$180
Total Savings	**-$280**

Source: CBO



APPENDIX 2

Impact of Fiscal Commission's Recommendations on the Budget

To determine the budget impact of any plan, it is measured against a "baseline," a projection of future spending and revenue levels. The claim is made that the Bowles-Simpson plan leads to a 3:1 ratio in spending savings to revenue increases. In addition, it is asserted that the spending reductions are achieved before any tax reductions take effect. A much different conclusion is reached if a different baseline is used.

The Congressional Budget Office [CBO] measures legislation relative to a baseline rooted in the Budget Enforcement Act and past conventions. Under this baseline, CBO assumes the expiration of all tax provisions enacted in 2001 and 2003, and current war funding levels – including additional expenditures for the surge – inflated over 10 years. It is not an accurate picture of current policy.

As a result, adjustments are frequently made to the baseline to provide a better point of comparison.

Table 1: Crosswalk from CBO to Fiscal Commission to Current Policy Baseline

($ in billions)	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	**10 Year**
CBO Current Law Deficit Baseline (August)	-1,066	-665	-525	-438	-507	-585	-579	-562	-634	-685	-6,246
Fiscal Commission Baseline Adjustments (impact on deficit):											
Permanent doc fix (President's proposal)	-9	-19	-22	-23	-25	-28	-31	-35	-40	-44	-276
Partial extension of 2001 & 2003 tax relief (President's proposal)	-58	-156	-144	-146	-147	-147	-146	-146	-147	-148	-1,385
Extension of estate tax at 2009 Levels (President's proposal)	0	-34	-21	-23	-26	-28	-30	-31	-33	-34	-260
Extend current AMT "patch" (President's proposal)	-79	-77	-88	-99	-110	-122	-136	-152	-169	-188	-1,220
Adopt President's Discretionary spending path	-10	24	67	84	88	94	98	102	105	101	753
Assume Gradual Decline in OCO Troop Levels	0	-70	-68	-45	-17	-2	4	7	8	8	-175
Debt Service	-1	-6	-18	-33	-53	-72	-92	-113	-135	-146	-669
Subtotal Baseline Adjustments	-157	-338	-294	-285	-290	-305	-333	-368	-411	-451	-3,232
Fiscal Commission Deficit Baseline	-1,223	-1,003	-819	-723	-797	-890	-912	-930	-1,045	-1,136	-9,478
Additional adjustments to extend current policy:											
Require doc fix to be offset	9	19	22	23	25	28	31	35	40	44	276
Permanent repeal of Estate Tax	-11	-8	-28	-32	-35	-37	-38	-41	-42	-45	-317
Full extension of 2001/2003 tax relief	-39	-29	-52	-57	-65	-73	-79	-85	-91	-97	-666
Remove President's non-OCO discretionary Increases[a]		27	30	34	40	38	35	35	38	45	322
Debt Service	0	-1	-1	-3	-5	-8	-11	-15	-19	-23	-87
Subtotal Incremental current policy Adjustments	-41	8	-29	-34	-41	-52	-63	-70	-74	-76	-471
Current Policy Baseline	-1,264	-995	-848	-757	-838	-942	-975	-1,000	-1,119	-1,212	-9,949

[a]Because of the uncertainty of what the Commission assumes for the discretionary baseline in FY 2011, no adjustment is made to achieve a current policy baseline level. For FY 2011, the President's budget is $25 billion above the CBO baseline and the continuing resolution (CR) level the Commission assumes is $3 billion below the CBO baseline.

The Commission adjusted the baseline to more closely follow the President's budget, for both revenues and spending (see Figure 14 from the Co-Chairs' modified proposal). Table 1 above first shows these same adjustments to the CBO baseline that the Commission staff made to arrive at the baseline the Commission used to illustrate the budgetary impact of its recommendations. As displayed in this table, and the Commission's report, most of these adjustments reflect the President's policies.

A baseline should be a neutral benchmark to show the budgetary effects of policy changes. The Commission's adjusted baseline is not entirely neutral. It reflects the President's policy references for extension of 2001 and 2003 tax relief, for increases in non-emergency discretionary spending, and for the extension of provisions avoiding reductions through Medicare's Sustainable Growth Rate formula (the "doc fix"). For war funding, President Obama's budget, to its credit – and unlike President Bush's budgets – includes a stream of spending in the out-years. Given the uncertainty inherent in projecting future war spending, and the importance of not telegraphing to enemies planned future force levels, these out-year funding levels are placeholders and do not reflect his strategy for prosecuting the war. The Commission staff felt this stream may understate war costs. So, for the purposes of the Commission's baseline and the Commission's recommendations, they adopted a CBO scenario of a drawdown to 60,000 military personnel.

Next, Table 1 shows some additional adjustments to reflect a current policy baseline and to remove the President's policy preferences: 1) requiring the doc fix to be offset; 2) permanently repealing the estate tax; 3) fully extending 2001 and 2003 tax relief; and 4) removing the President's proposed increases in non-emergency discretionary spending. For the current policy baseline, this table retains the Commission's assumption of future war spending, although as the Commission proposal acknowledges "budget rules should not determine war policy" and this should not be interpreted as an endorsement of the force drawdown described in the CBO scenario.

Table 2: Fiscal Commission Deficits Relative to Commission Baseline

($ in billions)	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	10 Year	% Share
Fiscal Commission Deficit Baseline	-1,223	-1,003	-819	-723	-797	-890	-912	-930	-1,045	-1,136	-9,478	
Fiscal Commission savings:												
Discretionary	0	49	102	141	172	194	215	236	261	291	1,661	
Mandatory	0	1	32	47	54	64	70	88	97	104	557	
Subtotal: spending savings	0	50	134	188	226	258	285	324	358	395	2,218	57%
Tax Expenditures & Reforms	0	0	20	40	80	90	105	120	150	180	785	
Other Revenue	0	1	5	11	18	27	32	36	39	43	212	
Subtotal: revenue increases	0	1	25	51	98	117	137	156	189	223	997	26%
Debt Service	0	1	5	16	33	58	87	119	155	199	673	17%
Total Savings	0	52	164	255	357	433	509	599	702	817	3,888	
Fiscal Commission Projected Deficit[a]	-1,223	-951	-655	-468	-440	-457	-403	-331	-343	-319	-5,590	

[a]Does not include effects of the Fiscal Commission's proposal on Social Security taxes and spending

Table 2 above shows the budgetary impact of the recommendations relative to the Commission's baseline, and then shows the share of the major revenue and spending components of the savings. Spending savings from debt service (lower interest cost as a result of lower deficits and debt) are different from spending reductions in Federal programs, because these savings flow from both revenue and spending reductions. As a result, debt service savings are displayed separately. Using the Commission's baseline, excluding debt service, the Bowles-Simpson plan achieves 57 percent of its savings from spending and 26 percent from revenue increases – about a 2:1 ratio of spending reductions to revenue increases.

Table 3 shows the impact of the Commission's proposal relative to a current policy baseline, and not the Commission's baseline. Relative to this more realistic measure, the Commission's proposal ends up producing about $4.4 trillion in deficit reduction over 10 years, with revenue increases dominating the savings (45 percent), while spending reductions contribute just 37 percent. Another 17 percent of savings comes from debt service. In addition, the Commission report claims the spending reductions are achieved before the revenue increases. That is not the case relative to this baseline. Taxes are raised by $88 billion in the first 2 years, and no net spending savings are achieved until 2013.

Table 3: Fiscal Commission Deficits Relative to Current Policy Baseline

($ in billions)	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	10 Year	% Share
Current Policy Deficit Baseline	-1,264	-995	-848	-757	-838	-942	-975	-1,000	-1,119	-1,212	-9,949	
Fiscal Commission savings:												
Discretionary	0	22	72	107	132	156	180	201	223	246	1,339	
Mandatory	-9	-18	10	24	29	36	39	53	57	60	281	
Subtotal: spending savings	-9	4	82	131	161	192	219	254	280	306	1,620	37%
Tax Expenditures & Reforms	50	37	100	129	180	199	222	246	283	322	1,768	
Other Revenue	0	1	5	11	18	27	32	36	39	43	212	
Subtotal: revenue increases	50	38	105	140	198	226	254	282	322	365	1,980	45%
Debt Service	0	2	6	19	38	66	98	134	174	222	760	17%
Total Savings	41	44	193	289	398	485	572	669	776	893	4,359	
Fiscal Commission Projected Deficit[a]	-1,223	-951	-655	-468	-440	-457	-403	-331	-343	-319	-5,590	

[a]Does not include effects of the Fiscal Commission's proposal on Social Security taxes and spending