TAX FOUNDATION Since 1937

FISCAL FACT

December 2, 2010
No. 253

President's Deficit Commission Says Federal Government Should Be 21 Percent of GDP

Proposal Would Cut Spending and Raise Taxes to Reduce Deficit; Many Principled Tax Reforms Suggested

By Joseph Henchman

On December 1, 2010, the National Commission on Fiscal Responsibility and Reform published "Moment of Truth," its recommendations to correct the nation's "unsustainable fiscal path." Here we summarize the report's major recommendations.

Through six major components (discretionary spending cuts, comprehensive tax reform, health care cost containment, savings in mandatory programs, Social Security reforms, and process changes), the Commission aims to reduce the federal deficit to 2.3% of GDP by 2015 (down from 8.9% in 2010), greatly simplify the tax code, make Social Security solvent, begin reducing the national debt, cap revenue at 21% of GDP (compared to 14.9% in 2010, an unusually low year), and bring expenses below 22% of GDP (compared to 23.8% in 2010).

Compared to the deficits projected in a "plausible baseline" scenario, similar to the CBO's alternative fiscal scenario, the Commission estimates that its plan will reduce deficits between 2012 and 2020 by $3.885 trillion. These are summarized in Table 1 and the bullet-point lists below.

Table 1: Commission Plan Deficit Reductions
$Billions

Category	2012-15	2012-20	Shares of Deficit Reduction (2012-20)
Discretionary Spending Cuts	$464	$1,661	42.8%
Mandatory Spending Cuts	$134	$556	14.3%
Subtotal, Spending Reductions	$598	$2,217	57.1%
Tax Reform/Revision of Tax Preferences	$140	$785	20.2%
Other New Revenue	$34	$210	5.4%
Subtotal, Revenue Increases	$174	$995	25.6%
Savings in Interest Payments on National Debt	$56	$673	17.3%
TOTAL DEFICIT REDUCTION	$828	$3,885	100.0%

Joseph Henchman is tax counsel and director of state projects at the Tax Foundation.

Discretionary Spending Cuts

- Freeze discretionary spending at 2011 levels in 2012, and reduce it to 2008 levels (adjusted for inflation) in 2013. After 2013, hold spending growth at half the rate of inflation.
- Require equal percentage cuts in both security and non-security spending.
- Require affirmative vote in the House of Representatives and a 60-vote point of order in the Senate to spend above the caps.
- Require the President to propose annual limits for war spending.
- Establish a disaster fund limited to the rolling average of disaster spending in the most recent 10 years, instead of emergency supplemental funding requests.
- Increase procedural hurdles for emergency spending bills.
- Require that the transportation trust fund be fully funded with transportation revenues. If current spending levels continue, adjusted for inflation, this would require a 15-cent gasoline tax increase. The current 18.4-cent rate would start rising in 2013 and reach 33.4 cents in 2015. (Current state-level rates range from 8 cents in Alaska to 46.1 cents in California.)
- Require agency heads to include recommendations for budget reductions, and give them more authority to rearrange personnel duties and arrange buyouts to reduce staff. Suggests Congress use a BRAC-type commission to eliminate non-essential weapons systems.
- Establish a committee to identify low-priority spending for termination and consolidation of duplicative programs. As an example, the Commission cites 44 separate job training programs across 9 agencies, 20 invasive species programs across 12 agencies, and 105 programs meant to encourage participation in science, technology, education, and math.
- Immediate "lead by example" changes:
  - Reducing congressional and White House budgets by 15%
  - Three-year freeze on congressional pay
  - Three-year pay freeze for federal workers and Department of Defense civilians. This is similar to President Obama's two-year freeze proposal unveiled earlier in the week.
  - Through attrition, reduce the federal workforce by 10%, from 2 million to 1.8 million.
  - Reduce federal travel, printing, and vehicle budgets through greater use of teleconferencing and telecommuting. The vehicle budget reduction excludes the Department of Defense and the Postal Service.
  - Sell unused federal buildings and land.
  - Eliminate congressional earmarks.

Tax Reform

The commissioners recommend enacting fundamental tax reform by 2012 that will lower rates, reduce deficits, and simplify the code. The elements would include:

- Cutting rates across the board and reducing the top rate to between 23 and 29 percent.
- Reforming key tax provisions: the child tax credit, the earned income tax credit, the mortgage interest deduction for principal residences, the exclusion of employer-provided health insurance, the deduction for charitable gifts, and the provisions for retirement savings and pensions.
- Eliminating all other special tax preferences.

The commissioners would dedicate $80 billion of the new revenue for annual deficit reduction in 2015 and $180 billion in 2020, with the balance used to lower rates.

One option proposed is a three-bracket income tax (12%, 22% and 28%) with just a few surviving tax preferences: a mortgage interest credit, a charitable gift credit available to all filers, the current standard deductions, and consolidated retirement account options. All other tax preferences would be repealed, eliminating the need for the alternative minimum tax and other provisions that phase out tax preferences, such as PEP and Pease. Interest for future state and municipal bonds would be taxable. The net result would be a slightly more progressive income tax.

The commission would reform corporate taxes as well, lowering rates, closing loopholes, and adopting the territorial approach to international taxation. Currently the United States has a comparatively high statutory rate imposed on the worldwide income of U.S. firms, along with many provisions that minimize tax and a complicated credit system. The commission suggests eliminating deferral, the manufacturing deduction and many other preferences in order to achieve a revenue-neutral reduction of the statutory corporate income tax to something between 23% and 29%. The commission states that the changes would make the U.S. more globally competitive by bringing the system in line with other countries.

Health Care

The commission basically left the recent tax reform law alone, but it suggested a number of reforms in the health arena:

- Implement the Medicare "doc fix" fully offset, freezing payments through 2013 and cutting them in 2014, and directing the creation of an improved physician payment formula.
- Reform or repeal the Community Living Assistance Services and Supports program, as unsustainable.
- Achieve Medicare savings by reducing fraud, reforming cost sharing, restricting Medigap coverage, and reducing excess payments.
- Achieve Medicaid savings by eliminating state gaming of the program and reducing administrative costs.
- Expedite state applications for Medicaid waivers.
- Adopt medical malpractice reform.
- Pilot a "premium support" program for federal employees, whereby employees would receive a set amount each year, adjusting for economic growth plus 1%, to purchase health insurance.
- Greater use of pilot programs.
- Establish a long-term global budget for total health care spending, and limit the growth to GDP growth plus 1%.

Other Mandatory Program Savings

- Review civil service and military health and retirement programs for savings.
- Reduce agricultural subsidies.
- Eliminate in-school subsidy payments on student loan interest for borrowers.
- Allow the Pension Benefit Guaranty Corporation to increase premiums to cover losses.

- Eliminate payments to states for abandoned mines.
- Extend FCC's authority to auction spectrum.
- Increase user fees with inflation.
- Charge market rates for sales of federally owned electricity generation.
- Require the Tennessee Valley Authority to charge rates to cover its costs.
- Greater autonomy to the Postal Service to restructure operations.

Social Security

- Increase benefits for low-income beneficiaries but decrease them for higher-income people, achieving a net reduction in benefit payments. Accomplish this by switching from the current three-bracket formula to a more progressive four-bracket formula, phasing in the change over time from 2017 to 2050.
- Ensure the minimum benefit is 25% higher than the poverty level.
- Enhance benefits for individuals over age 85.
- Increase the eligibility retirement age to 68 by 2050 and 69 by 2075. It is currently being phased in to be 67 by 2027.
- Create a hardship exemption for individuals who cannot work beyond 62 but cannot claim disability, enabling them to claim some Social Security benefits.
- Raise the Social Security tax's cap on wages to cover 90% of wages by 2050 (up from 83% in 2009). This would result in a taxable maximum of approximately $190,000 in 2020, compared to $168,000 under current law.
- Use "chained CPI" instead of the standard CPI to measure Social Security cost of living adjustments.
- Extend Social Security to newly hired state and local workers beginning in 2020.
- Offer more information on retirement options and personal retirement savings.

Process Reform

- Standardize inflation adjustment with use of chained CPI instead of standard CPI.
- Develop a process to enforce deficit reduction targets.
- Allow spending cap adjustments for reviewing disability claims, IRS enforcement, and anti-fraud efforts in health and labor programs.
- Adopt automatic triggers for extended unemployment benefits, based on an unemployment threshold.

National Press Building
529 14th Street, N.W., Suite 420
Washington, DC 20045
202.464.6200
www.TaxFoundation.org

About the Tax Foundation

The Tax Foundation is a 501(c)(3) non-partisan, non-profit research institution founded in 1937 to educate the public on tax policy. Based in Washington, D.C., the Foundation's economic and policy analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability.