RESTORING AMERICA'S FUTURE

EXECUTIVE SUMMARY

Reviving the Economy, Cutting Spending and Debt, and Creating a Simple, Pro-Growth Tax System

The Debt Reduction Task Force
Senator Pete Domenici and
Dr. Alice Rivlin, Co-Chairs
November 2010

BIPARTISAN POLICY CENTER

AN OPEN LETTER TO THE AMERICAN PEOPLE

November 17, 2010

To Our Fellow Citizens:

We believe that America is facing two huge challenges that can only be surmounted if both political parties work together: recovery from the recession and restraining the soaring federal debt. We also believe that these two challenges must be addressed simultaneously. Strong action to curb the mounting debt will reinforce the recovery, not impede it.

The federal budget is on a dangerous, unsustainable path. Even after the economy recovers from this deep recession, federal spending is projected to rise substantially faster than revenues and the government will be forced to borrow ever-increasing amounts. Federal debt will rise to unmanageable levels, which will push interest rates up, endanger our prosperity, and make us increasingly vulnerable to the dictates of our creditors, including nations whose interests may differ from ours.

This alarming prospect was created by the actions of both political parties over many years, with strong public approval. Promises to provide benefits and services through Medicare, Medicaid, Social Security and many other spending programs, as well as reductions in taxes, were extremely popular and both parties took credit for them. But now, with an aging population and increasingly expensive health care, federal spending will rise much faster than revenues if those popular policies are not changed. However, the actions needed to reduce the growth of national debt and bring deficits back to manageable levels are all unpopular. Neither party can take the required actions alone without suffering adverse political consequences. The only hope is for the two parties to come together around a bipartisan plan – which liberals, moderates, and conservatives alike see as fair – and work together to make it a reality.

On January 25, 2010, the Bipartisan Policy Center (BPC) – founded by former Senate Majority Leaders Howard Baker (R-TN), Tom Daschle (D-SD), Bob Dole (R-KS), and George Mitchell (D-ME) – launched a Debt Reduction Task Force to develop a long-term plan to reduce the debt and place our nation on a sustainable fiscal path. The BPC asked us to co-chair the Task Force and we were honored to accept.

The two of us share strong beliefs that America must learn to live within its means, that the current budget path endangers the future of our country, and that bipartisan action is urgently needed. Each of us played a significant role in the successful bipartisan efforts that brought the federal budget into surplus for four years in a row starting in the late 1990s and reduced the debt held by the public. Senator Domenici was a leader in bipartisan negotiations that crafted the Budget Enforcement Act of 1990 and the Balanced Budget Act of 1997. Alice Rivlin was part of the Clinton Administration's effort, working first with a Democrat-led and then a Republican-led Congress that achieved those surpluses.

We know from personal experience that bipartisan budget agreements are extremely difficult to create – neither side gets what it wants – but they are possible. The budget outlook is even more threatening today than it was then, but we have faith that our political leaders will see the urgency of working together to take the difficult actions that will restore America to economic health and constructive world leadership.

Our Task Force – 19 Americans from across the country, with diverse backgrounds and views – has examined a broad range of spending and revenue options for the federal government. Today we are releasing our plan, "Restoring America's Future." We believe that it provides a comprehensive, viable path to restore our economy and build a stronger America for future generations and for those around the world who look to the United States for leadership and hope.

We offer this plan as proof that a group of Republicans, Democrats, and Independents can work together to create a balanced package of spending cuts and revenue increases that solves the debt crisis. Other groups might prefer other combinations of policies to reach the same ends. We created this plan to show that it can be done – and thereby encourage others from both political parties to bring their ideas to a constructive, respectful, and ultimately successful dialogue.

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To arrive at consensus on a plan of this size and complexity, each of the Task Force members made significant compromises. Not every member agrees with every element of this plan. But, each member agrees on the urgency of economic recovery and stabilizing the debt and believes that, as a whole, this plan offers a balanced, effective, and reasonable approach to the twin challenges at hand. Perhaps most importantly, the plan demonstrates that at this time of political uncertainty, a bipartisan group can craft a comprehensive and viable blueprint to tackle the nation's most serious economic challenges.

Overview

America is the strongest, most prosperous, and most resilient nation in history. However, America's leadership and greatness, our strength and prosperity, are not guaranteed. We face two huge challenges simultaneously. First, we must recover from the deep recession that has thrown millions out of work, slashed home values and closed businesses across the country. Second, we must take immediate steps to reduce the unsustainable debt that will be driven by the aging of the population, the rapid growth of healthcare costs, exploding interest costs, and the failure of policymakers to limit and prioritize spending.

These two challenges must be addressed at the same time, not sequentially. We need immediate action to sustain the recovery and create jobs, but we cannot delay putting in place measures that will restrain the buildup of debt. If we do not control the debt, the recovery will not be sustainable.

With current policies in place, even when we recover from the recession, the debt will grow far larger than the economy itself, forcing the nation to borrow enormous and unprecedented sums of money, increasing our dependence on China and other foreign lenders, diminishing our living standards, raising risks of an economic crisis, and reducing America to a second-rate power.

At stake are both our economic security and our national security. Federal Reserve Chairman Ben Bernanke warns that threats to our economy are "real and growing" and that our path is "unsustainable" because, at some point, our creditors will refuse to lend to us. Joint Chiefs of Staff Chairman Mike Mullen calls the debt "the single biggest threat to our national security."

That's why we face a fundamental choice:

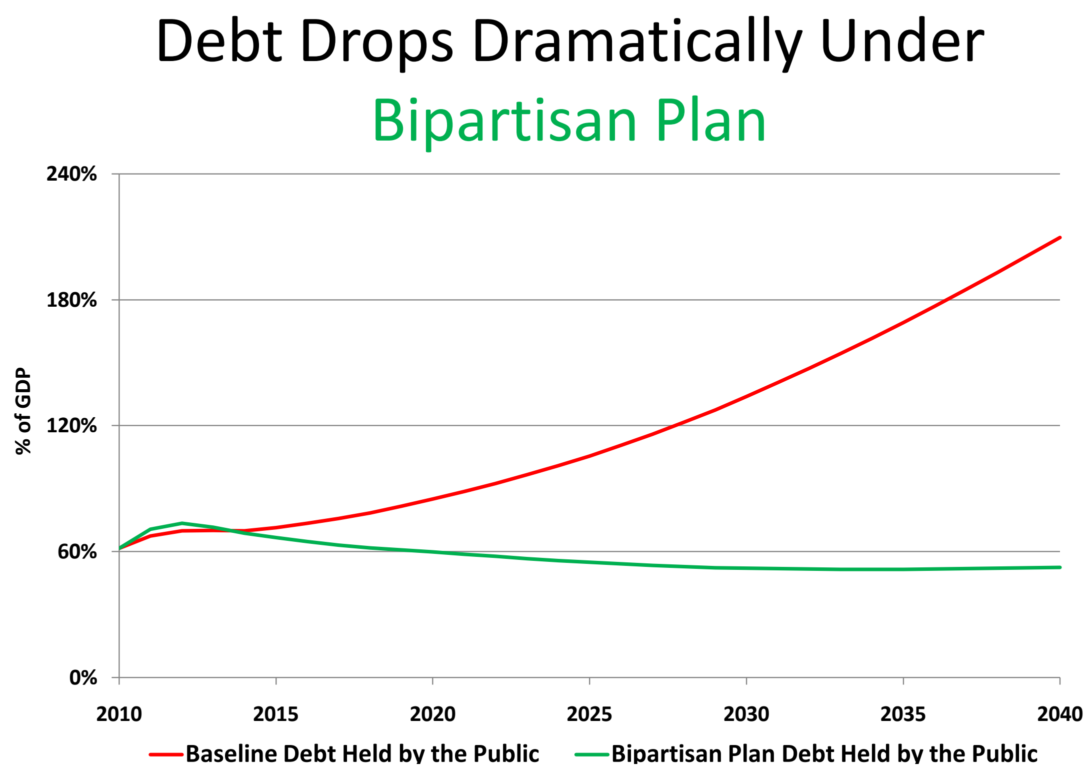
We can close our eyes, keep avoiding the problem, and generate more debt that will threaten our economy, mortgage our children's future, and diminish our leadership around the world.

Or, we can choose a new course – one that can revive our economy, create new and better jobs, restore our financial independence, and ensure that America remains the world's preeminent economic, military, and political power.

This report, "Restoring America's Future," is a plan for that new course that we believe will meet both the short- and the longer-run challenges simultaneously. It was developed by the Bipartisan Policy Center's Debt Reduction Task Force, which is chaired by former Senate Budget Committee Chairman Pete V. Domenici and former White House Budget Director Alice M. Rivlin and includes 19 leading citizens from across America.

The Task Force members are former White House and Cabinet officials, former Members of Congress, former governors and mayors, business and labor leaders, economists and budget experts. They are Democrats, Republicans, and Independents. They are Americans from across the country, with widely diverse views about public policy and the role of government.

By 2020, the plan will reduce and stabilize the national debt below 60 percent of the gross domestic product (GDP) – an internationally recognized standard – and ensure that the debt stops growing faster than our economy.



Source: CBO's "Alternative Fiscal Scenario" constructed from the August 2010 Budget and Economic Outlook, additionally assuming that troops in Iraq and Afghanistan are reduced to 30,000 by 2013.

The plan will balance the “primary budget,” the budget other than interest payments, by 2014. On a “unified budget basis,” i.e., including interest, the plan will ensure that future budget deficits are small and manageable. But, above all, it will ensure a strong economy for future generations of Americans.

The Task Force approached its task as both a challenge and an opportunity, and recommends significant and sorely needed changes to both taxes and spending.

On the spending side, this plan fixes Social Security, which is on an unsustainable path, reins in rising healthcare costs, and freezes both defense and domestic discretionary spending.

On the tax side, this plan dramatically simplifies taxes by eliminating years of tax breaks – allowing major tax rate reductions, while raising additional revenues to reduce the debt. Lower corporate rates will make America more competitive, and lower individual rates with a simplified tax system will give taxpayers renewed confidence that our system is fair and understandable. A Debt Reduction Sales Tax (DRST), along with the plan’s spending cuts, will reduce our debt.

Reviving the economy and creating up to 7 million new jobs

Currently, millions of Americans cannot find jobs or are underemployed. At the same time, we face the long-term problem of soaring deficits and debt.

Some politicians and economists present a false choice: reduce unemployment ***or*** stabilize the debt. Restoring America’s future, however, requires that we do both – and begin now.

The key to both reducing unemployment and stabilizing the debt begins with a strong economy that reignites demand for goods and services and encourages businesses to invest and create jobs. This bipartisan plan calls for suspending Social Security payroll taxes for one year (in 2011) – called a “payroll tax holiday” – which will immediately add money to employee paychecks while incentivizing companies to hire new workers. This tax cut of nearly $650 billion will provide a big shot in the arm to revive our economy and create jobs.

Restoring America's Future will:

- Revive the economy and **create 2.5 to 7 million new jobs** over two years with a payroll tax holiday.
- Balance the primary budget in 2014, reduce deficits including interest to small and manageable levels, and **stabilize the debt below 60 percent of GDP by 2020**.
- Create a simple, pro-growth tax system that broadens the base, reduces rates, makes America more competitive, and raises revenue to reduce the debt.
- Reduce the unsustainable rate of growth in healthcare costs.
- Strengthen Social Security to ensure that it will pay benefits for 75 years and beyond, while not increasing the retirement age and protecting the most vulnerable elderly.
- Freeze domestic and defense discretionary spending.
- Cut other spending, including farm and government retirement programs.

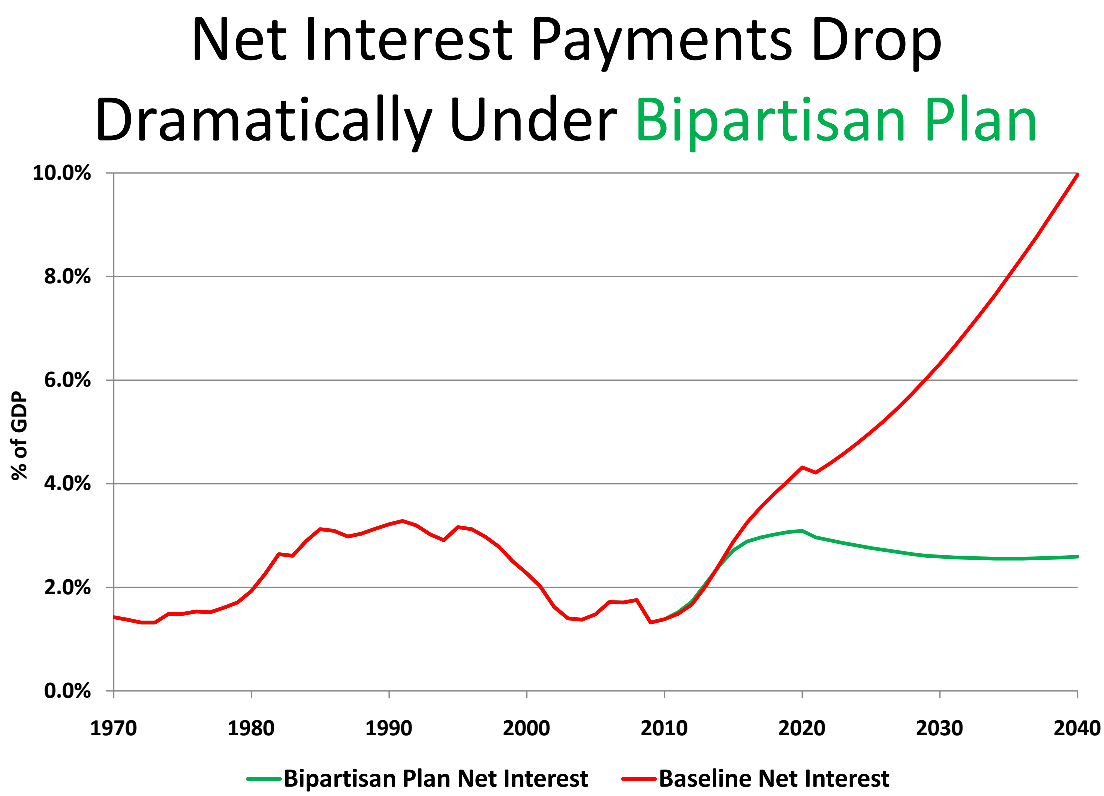
Our growing debt and the risks of inaction

At the same time, we must restore optimism about the economy's future in order to boost investment. A comprehensive debt-reduction package will assure investors worldwide that America is back on track, with a solid plan and a stable economic future.

Without action, growing deficits and debt will create serious problems for our economy, our prosperity, and our leadership role in the world.

First, the higher the debt, the more interest we have to pay. At the moment, interest rates are at historically low levels because of our weak economy and because the fiscal problems of other countries leave investors around the world few attractive alternatives to U.S. Treasury securities. But as our economy recovers and other nations address their problems, interest rates will return to higher levels, which will increase interest costs on our debt significantly.

In 2020, the federal government will pay $1 trillion – 17 percent of all federal spending – just for interest payments. Viewed another way, the federal government will have to allocate about half of all income tax receipts to pay interest, and interest payments will exceed the size of the defense budget.



Source: CBO's "Alternative Fiscal Scenario" constructed from the August 2010 Budget and Economic Outlook, additionally assuming that troops in Iraq and Afghanistan are reduced to 30,000 by 2013.

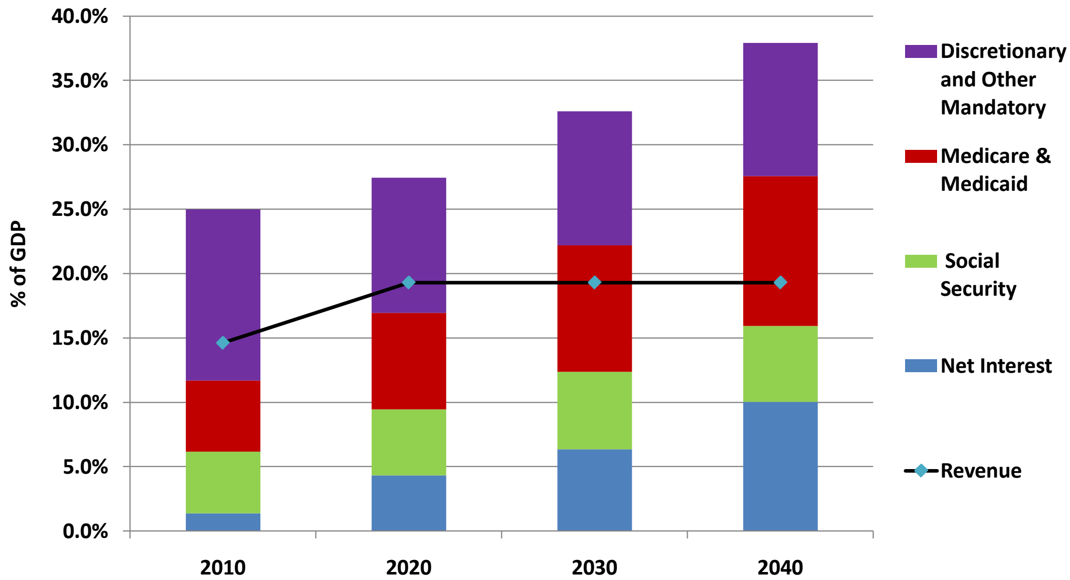
Moreover, by 2025, federal revenues will be completely consumed by the combination of interest payments, Medicare, Medicaid, and Social Security. The Treasury will have to borrow money to finance all of its other obligations – including defense, homeland security, law enforcement, food and drug inspection and other vital operations.

These projections are based on fairly moderate assumptions about future interest rates. The nation's outlook will grow far more ominous if America's creditors lose confidence in the federal government's commitment to address its debt problem – which will increase interest rates. A loss of confidence in the markets could also send the value of the dollar plunging overseas, which could trigger runaway inflation and still higher interest rates.

Rising debt and rising interest costs could evolve into a "death spiral," with the two feeding off one another in an ever-more vicious cycle. No one knows when such a catastrophe might occur, but no prudent nation would put itself at such risk.

Even without a crisis, rising debt will increase our reliance on foreign lenders, raising a host of other economic and national security issues. Already, more than half of U.S. federal debt is foreign-owned and China is the largest foreign holder.

Revenues Completely Consumed by Major Entitlements and Interest by 2025



Source: CBO's "Alternative Fiscal Scenario" constructed from the August 2010 Budget and Economic Outlook, additionally assuming that troops in Iraq and Afghanistan are reduced to 30,000 by 2013.

Rising deficits and debt will weaken the nation in other serious ways as well. Federal deficits soak up private savings that would otherwise be available for investment in factories, equipment, and jobs.

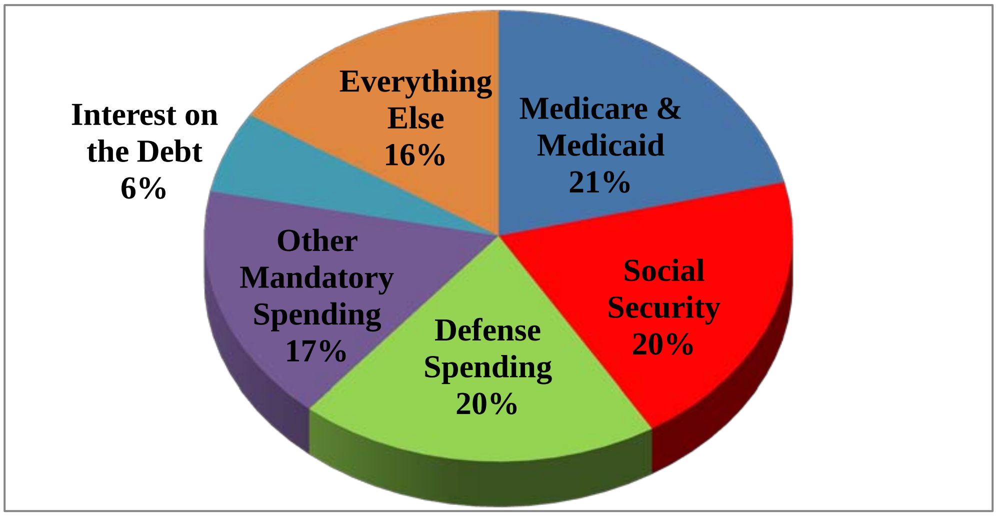
At some point, without a change in policy, the federal government's out-of-control borrowing will have to stop. The only question is whether policymakers address the debt problem now in a deliberative and thoughtful manner – or whether they will be forced to do so by a sudden economic crisis.

No easy answers

Most Americans would be reluctant to cut several key categories of federal spending. In fiscal year (FY) 2010:

- Medicare and Medicaid consumed **21 percent** of federal spending;
- Social Security consumed **20 percent;**
- Defense consumed **20 percent**;
- Other mandatory spending (for example, veterans' compensation, unemployment insurance, and food stamps) consumed **17 percent**; and

- Interest on the debt consumed **6 percent**.
- That leaves **only 16 percent** for everything else – veterans' health care, homeland security and law enforcement, education and student aid, roads and bridges, food and drug inspection, energy and the environment, and so on. Clearly, there are no easy answers to the debt crisis.



Policymakers cannot solve the debt crisis simply by eliminating congressional earmarks (less than one percent of the discretionary budget) or foreign aid, which is less than one percent of the total budget.

Nor can policymakers significantly reduce the debt by eliminating "waste, fraud, and abuse," although they surely should undertake efforts to eliminate as much waste, fraud, and abuse as possible.

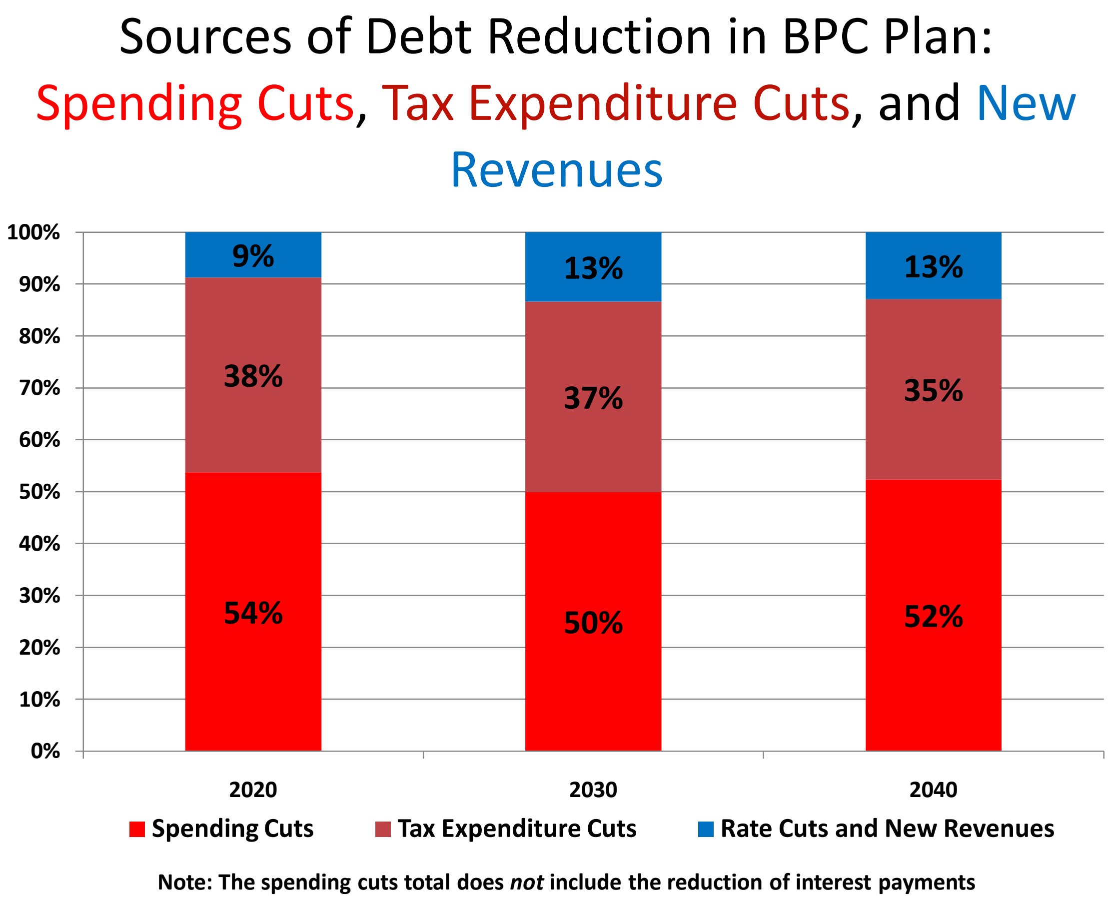
Nor can policymakers realistically solve the problem simply by cutting domestic discretionary spending. Stabilizing the debt by 2020 through domestic discretionary cuts alone would require eliminating nearly all such spending – everything from law enforcement and border security to education and food and drug inspection.

Nor can policymakers rely on hopes of a strong economy to "grow our way out of the deficit." Just to stabilize the debt at 60 percent of GDP, the economy would have to grow at a sustained rate of more than 6 percent per year for at least the next ten years. The economy has never grown by more than 4.4 percent in any decade since World War II.

Nor can policymakers solve the problem simply by raising taxes on wealthy Americans. Reducing deficits to manageable levels by the end of the decade though tax increases on the most well-to-do

Americans would require raising the top two bracket rates to 86 percent and 91 percent (from the current 33- and 35-percent rates).

There are no easy answers, no quick fixes. Following is a bipartisan, fair and reasonable plan that calls for reforms to every part of the budget and the participation of all Americans to restore America's future for our children and grandchildren.



Summary of Recommendations

1. Revive the Economy and Create Jobs

- Enact a "payroll tax holiday" for one year (2011) – excusing employers and employees from paying the 12.4 percent tax into the Social Security Trust Funds.

- Under Congressional Budget Office (CBO) assumptions, this will **create between 2.5 and 7 million new jobs**.

- The tax holiday will not impact the solvency of the Trust Funds, which will be reimbursed in full from general revenues at the same time that they would have received payments in the absence of the holiday.

2. Reduce and Stabilize the Debt

- By 2020, reduce and stabilize the federal debt below 60 percent of GDP, an internationally recognized standard for fiscal stability, and reduce annual budget deficits to manageable levels.

- The plan will balance the primary budget (the budget other than interest) by 2014.

- On a "unified budget basis," which includes interest, the plan will ensure that future budget deficits are small and manageable. But, above all, it will ensure a strong economy for future generations of Americans.

- Reduce federal spending from a projected 26 percent of GDP to 23 percent by 2020, with revenues at 21.4 percent.

- These fiscal changes will enable the Federal Reserve to hold interest rates down longer in order to strengthen the economic recovery.

3. Create a Simple, Pro-growth Tax System

- Cut tax rates; broaden the tax base; boost incentives to work, save, and invest; and ensure, by 2018, that nearly 90 million households (about half of potential tax filers) no longer have to file tax returns.

    - ✓ Cut individual income tax rates and establish just two rates – 15 and 27 percent – replacing the current six rates that go up to 35 percent.

- ✓ Cut the top corporate tax rate to 27 percent from its current 35 percent, making the United States a more attractive place to invest.
- ✓ Eliminate most deductions and credits and simplify those that remain while making them better targeted and more effective.
- ✓ Replace the deductions for mortgage interest and charitable contributions with 15 percent refundable credits that anyone who owns a home or gives to charity can claim.
- ✓ Restructure provisions that benefit low-income taxpayers and families with children by making them simpler, more progressive, and enabling most recipients to receive them without filing tax returns.

- Establish a new 6.5 percent national Debt Reduction Sales Tax (DRST) that – along with the spending cuts outlined in this plan – will reduce the debt and secure America's economic future.

- These reforms, taken together, will make the tax system more progressive.

4. **Restrain Rising Healthcare Costs** (Savings through 2020: $756 billion, excluding interest)

- Incentivize employers and employees to select more cost-effective health plans:

  - ✓ Cap the exclusion of employer-provided health benefits in 2018, and then phase it out over ten years.

- Control Medicare costs in the short term:

  - ✓ Gradually raise Medicare Part B premiums from 25 to 35 percent of total program costs (over five years).
  - ✓ Use Medicare's buying power to increase rebates from pharmaceutical companies.
  - ✓ Modernize Medicare's benefits package, including the copayment structure.
  - ✓ Bundle Medicare's payments for post-acute care to reduce costs.

- Preserve Medicare for the long term:

  - ✓ Transition Medicare, starting in 2018, to a "premium support" program that limits growth in per-beneficiary federal support (to GDP-plus-1 percent, as compared to current projections of GDP-plus-1.7 percent). The new system maintains traditional Medicare as the default, but will charge higher premiums if costs rise faster than the established limits. Alternatively, beneficiaries can opt to purchase a private plan on a health insurance exchange. Competition among plans will improve the quality of care and increase efficiency.

- Control Medicaid costs in the short term:
    - ✓ Apply managed care principles in all states to aged Supplementary Security Income (SSI) beneficiaries.

- Control Medicaid costs in the long term:
    - ✓ Beginning in 2018, reduce the amount by which Medicaid is growing faster than the economy (that is, reduce annual per-beneficiary cost growth by 1 percent).
    - ✓ There are various approaches to achieving these savings. One option would be to reform the shared financing arrangement between the federal and state governments, which has led to gaming of the matching payment system and rising healthcare costs. Through a federal-state negotiation, allocate program responsibilities between the federal government and the states, so that each will fully finance and administer its selected components of the Medicaid program. This will restore incentives for cost containment, and slow future program spending growth.

- Reform medical malpractice laws:
    - ✓ Cap awards for noneconomic and punitive damages for medical malpractice.
    - ✓ Start large-scale testing of systemic reforms, including safe harbors for practices that conform to accepted guidelines, specialized malpractice courts, and administrative proceedings to resolve disputes.

- Help reduce long-term healthcare spending to treat obesity-related illnesses – including diabetes, heart disease, cancer, and stroke – by imposing an excise tax on the manufacture and importation of beverages sweetened with sugar or high-fructose corn syrup.

- The Task Force plan accommodates a permanent fix to the sustainable growth rate (SGR) mechanism that currently requires unrealistic automatic cuts in physician payments (which Congress has been annually delaying).

5. Strengthen Social Security

In order to guarantee that Social Security can pay benefits for the next 75 years and beyond:

- Gradually raise the amount of wages subject to payroll taxes (currently $106,800) over the next 38 years to reach the 1983 target of covering 90 percent of all wages.

- Change the calculation of annual cost-of-living adjustments (COLAs) for benefits to more accurately reflect inflation. (This is a technical change that will be applied in all government programs that use COLAs, including the indexation of tax brackets.)

- Slightly reduce the growth in benefits compared to current law for approximately the top 25 percent of beneficiaries.

- Increase the minimum benefit for long-term, lower-wage earners, and protect the most vulnerable elderly with a modest benefit increase. The former is particularly targeted to address the needs of long-time laborers who are unable to remain in the workforce due to the demanding nature of their work.

- Beginning in 2023, index the benefit formula for increases in life expectancy and require the Social Security Administration to ensure that early retirees understand that they are opting for a lower monthly benefit. These changes will increase the incentive to work longer, while not changing either the age of full retirement or the early retirement age from those in current law.

- Cover newly-hired state and local government workers under the Social Security system, beginning in 2020, to increase the universality of the program.

6. **Freeze Domestic Discretionary Spending** (Savings through 2020: $1 trillion, excluding interest)

   - Freeze domestic (i.e., non-defense) discretionary spending for four years and cap at GDP thereafter.

   - Implementing the freeze will require policymakers to terminate ineffective programs and set priorities across the broad range of government programs. Savings can also be achieved through adopting state and local best practices, modernizing the federal government's regional office structure, and sharing human resources, procurement, and other services across federal agencies.

   - Enforce the freeze through statutory spending caps, enforceable through automatic across-the-board cuts in all domestic discretionary programs.

7. **Freeze Defense Spending** (Savings through 2020: $1.1 trillion, excluding interest)

   - Freeze defense discretionary spending for five years and cap at GDP thereafter (from a baseline that assumes reduction of troop levels deployed in combat to 30,000 by 2013).

- Among the options for achieving the required savings are streamlining military end strength, prioritizing defense investment, maintaining intelligence capabilities at a reduced cost, reforming military health care, and applying the savings from Defense Secretary Robert Gates' efficiency measures to deficit reduction.

- Implement the freeze through statutory spending caps, enforceable through automatic across-the-board cuts in all defense programs.

8. **Cut Spending in Other Programs** (Savings through 2020: $89 billion, excluding interest)

- Reduce farm program spending by eliminating all farm payments to producers with adjusted gross income greater than $250,000, imposing limits on direct payments to producers, consolidating and capping 16 conservation programs, and reforming federal crop insurance.

- Reform civilian retirement by calculating benefits based on a retiree's annual salary from his or her highest five years of government service; and reform the age at which career military can retire to be consistent with federal civilian retirement.

- Achieve other cost savings by raising fees for aviation security, actuarially adjusting flood insurance subsidies for risk, adjusting Pension Benefit Guaranty Corporation fees to better cover unfunded liabilities, and adopting a more accurate inflation measurement to calculate COLAs for all federal programs.

9. Enforce the Budget, Reform the Process

- Enforce the four-year domestic discretionary freeze and the five-year defense discretionary freeze, and the limits in annual growth in the years thereafter, by imposing statutory caps on both categories of spending.

  - ✓ Exempt emergency spending from the caps – but strictly limit such emergencies to specific situations, subject to certification by the President and Congress.
  - ✓ Require the Office of Management and Budget (OMB), by law, to impose across-the-board cuts in all programs within the relevant category – i.e., domestic or defense programs – if spending exceeds the caps in any fiscal year.

- Prevent new tax cuts or new entitlement spending from worsening the fiscal situation by enacting a strict, statutory "pay-as-you-go" (PAYGO) requirement:

  - ✓ Require policymakers to fully offset new tax cuts, expansions of existing mandatory spending, or new mandatory spending with increases in revenues or reductions in mandatory spending.
  - ✓ Trigger fully offsetting automatic cuts in predetermined mandatory programs if policymakers violate the requirement.

- Convert the federal budget process from annual to biennial budgeting.

- Enact explicit long-term budgets for the major entitlement programs.

  - ✓ Create a Fiscal Accountability Commission that will meet every five years to assess whether program growth is remaining within the long-term budgets and, if not, to propose measures to restore long-term sustainability.

	Cumulative Savings:			
(Fiscal Years, Billions of Dollars)	2012-2020	2012-2025	2012-2030	2012-2040
TOTAL: SPENDING POLICY REDUCTIONS	**$2,677**	**$5,728**	**$10,197**	**$25,895**
TOTAL: TAX EXPENDITURE CUTS	**$1,873**	**$4,046**	**$7,483**	**$17,160**
TOTAL: NEW REVENUES	**$435**	**$1,487**	**$2,738**	**$6,389**
TOTAL DEBT SERVICE SAVINGS	**$877**	**$3,184**	**$8,271**	**$34,160**
TOTAL DEBT REDUCTION*	**$5,866**	**$14,498**	**$28,852**	**$84,171**

***** The budget savings from covering newly-hired state & local workers under the Social Security program is included in this total, but not in any of the subtotals because it is a coverage provision.

A note on the data: For assumptions about the path of deficits and debt under current federal policies, the Task Force adopted the "Alternative Fiscal Scenario" of the Congressional Budget Office (CBO), based on CBO's August 2010 Budget and Economic Outlook. In addition, the Task Force adopted CBO's assumption that the number of U.S. troops deployed in combat would fall to 30,000 by 2013. All tax estimates have been provided by the Tax Policy Center and Social Security estimates by the Chief Actuary of the Social Security Administration.