Center for American Progress

Recommendations for the Special Joint Committee on Deficit Reduction

The Criteria Any Deficit Plan Must Meet and a Recommendation that Does So

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Introduction

The Budget Control Act of 2011, more commonly known as the debt ceiling deal, set up a Special Joint Committee made up of six senators and six members of the House of Representatives tasked with finding $1.5 trillion in deficit reduction. The committee must reach agreement by Thanksgiving, after which Congress has until Christmas to enact or reject the proposal by a simple majority. No amendments will be allowed. If the committee does not come to an agreement that reduces the deficit over the next 10 years by at least $1.2 trillion, or if Congress does not pass it, a series of automatic spending cuts will be triggered. Those automatic cuts will come on top of the nearly $1 trillion in cuts already enacted as part of the Budget Control Act.

Typically, debates over deficit reduction revolve around questions of "how much in new revenue" versus "how much in spending cuts." We saw this dynamic clearly over the course of the debt ceiling negotiations. But that is the wrong approach. What matters is not the ratio of revenue to spending cuts in any particular plan. What really matters is what the plan achieves for our country—for the strength of our economy, job creation, and our society.

In their negotiations, the Special Joint Committee should keep its eye on this bigger picture. In developing our guidance to the committee, we set several criteria, which we detail below. We then present our set of recommendations based on these criteria.

Criterion No. 1

Achieve at least $1.2 trillion in deficit reduction but not more than $1.5 trillion in order to avoid the triggered cuts

This standard is simple, clear, and obvious, given the committee's legal mandate. The committee is officially tasked with finding $1.5 trillion, but so long as they get to $1.2 trillion, the automatic cuts won't be triggered. This should be the bottom-line deficit reduction target.

Total deficit reduction of $2.5 trillion, including the original $1 trillion worth of spending cuts, is an impressive amount. By 2021 it will cut the annual deficit by a full percentage point of our nation's gross domestic product, the broadest measure of national economic activity. No, it won't result in a balanced budget, but deficit reduction of this magnitude will put the budget on much more sustainable footing.

Moreover, given the deep divisions in Congress, the more deficit reduction the committee tries to achieve, the less likely they are to succeed. Both parties have already agreed that $1.5 trillion, on top of the first $1 trillion, is a reasonable target, and that's what the committee should aim for.

Criterion No. 2

Include significant job creation as part of the total package

The economy needs help. There is little debate on that point. As the Recovery and Reinvestment Act of 2009 winds down, economic growth is beginning to stall, and the already weak labor market is under siege. Over the past several weeks, a broad consensus has developed that the federal government must increase its efforts to spur job creation.

Of course, the committee's mandate is about deficit reduction, not spurring economic growth and job creation, but in fact the two are intimately connected. Harvard University economist and former National Economic Advisor Larry Summers estimates that each additional 1 percent of economic growth will close the deficit by $400 billion.

Policies that spur growth and create jobs today will help close the budget gap tomorrow. In addition, the measures that are required to spur the economy will cost something, which means they will need to be dealt with in the context of the tax and spending issues that the committee will take on. Thus, the committee needs to keep jobs at the forefront of its deliberations.

There is nothing in the Budget Control Act preventing the Special Joint Committee from including job creation measures in their overall package of deficit reduction—even if those measures increase the deficit in the near term. The committee can and should recommend the extension of the 2 percent payroll tax cut (or something similar), the continuation of extended unemployment insurance benefits, as well as other policies that the Congressional Budget Office says would spark additional growth and jobs.

Criterion No. 3

Protect Medicare, Medicaid, and Social Security beneficiaries

One of the biggest drivers of our long-term budget deficit is the rising cost of health care nationwide. As a result of this trend, the costs of the two biggest federal health care programs, Medicare and Medicaid, are projected to rise much faster than everything else in the federal budget. But it would be wrong to punish senior citizens, the disabled, and the poor for something that is far from their fault.

It is true that in the long run we are going to have to find ways to control the growth of health care costs all across the economy. But cutting Medicare and Medicaid in ways that merely shift those costs onto beneficiaries does nothing to achieve that goal. In the intermediate term, we can reduce federal spending on health care by improving efficiency and in some cases by asking health care providers to pitch in a little more. The bottom line is that cuts to these programs must not increase costs for Medicare and Medicaid beneficiaries, and must not undermine their access to quality care.

As for Social Security, the committee should leave the strengthening and reform of this program for another process. Social Security faces a long-run financing problem, too, but over the next 10 years, it does not contribute significantly to the federal budget deficit. More importantly, any option to reduce Social Security benefits that would have any impact by 2021 is one that would reduce the benefits of current retirees or those just about to enter retirement. That is both unfair, unnecessary, and politically unwise.

Criterion No. 4

Avoid dangerous cuts to discretionary spending, both nondefense and defense

The Budget Control Act already cut discretionary spending by nearly $1 trillion. The bulk of these cuts fell heaviest on a category of spending known as "non-defense discretionary." Though the bland and nebulous name does it no favors, this category actually includes some very important and popular programs and services.

For instance, the single-largest program in the category is the Veterans Health Administration, which provides health care services to our nation's veterans. Also in this category are nearly all of the country's vital investments, including education, infrastructure, energy, and science and technology research.

Nondefense discretionary spending also encompasses most of the day-to-day operations of the federal government, such as food and drug safety inspections, airport and highway safety, law enforcement, and border control. The Budget Control Act cut this entire category of spending by nearly 9 percent. With these cuts, total spending in these areas will fall to its lowest share of gross domestic product in more than 50 years.

With all those cuts already baked into the 10-year budget plan, nondefense discretionary is sure to contribute more than its fair share to deficit reduction. Though it makes up less than 15 percent of total federal spending, spending cuts in this area will account for at least 23 percent of the total $2.5 trillion in deficit reduction. The committee should not make any further reductions here.

Defense spending, too, was already cut as part of the first $1 trillion in reductions, though by a much smaller 5 percent. The committee must be prudent when considering more cuts from this area. Defense spending is currently at record-high post-World War II levels, and so there is clearly substantial room for responsible reductions. Yet the United States also has legitimate security needs. Cutting too deeply could undermine our ability to meet those challenges.

The Center for American Progress has identified hundreds of billions in responsible savings from the Pentagon in our report "Strong and Sustainable." The committee should adopt these proposals.

Our recommendations

Is it possible to construct a deficit reduction plan that meets all four of these criteria? It certainly is. The Center for American Progress developed a detailed plan that would satisfy all four of the crucial conditions. It contains $1.5 trillion in net deficit reduction and continues the payroll tax cut and extended unemployment benefits, while still leaving room for another $180 billion in job creation measures.

Our plan identifies another $700 billion in responsible spending reductions, without subjecting Medicare and Medicaid beneficiaries to cuts and without further reductions to vital investments and public services. And it reduces defense spending to levels already recommended by the Center for American Progress in previous reports.

Our plan would raise about $1 trillion in new revenue, less than the amount recommended by Erskine Bowles and Alan Simpson, the chairman of President Obama's deficit reduction panel, and less than that proposed by the bipartisan "Gang of Six," and does so without raising taxes on the middle class.

Overall, under our plan, total deficit reduction would amount to $2.5 trillion, with less than half coming from new revenue, despite the fact that federal revenues are at historic lows. (see table)

CAP's deficit reduction plan

A responsible plan for $1.5 trillion in deficit reduction that meets all four criteria

Spending	2012–2021
Total health savings	192
Medicare and Medicaid savings contained in President Obama's 2012 budget	61
Medicare Part D rebate	122
Accelerate home health savings in the Affordable Care Act	9
Total other mandatory savings	123
Index federal programs, except Social Security, to chained CPI-U	53
Reduce agricultural subsidies by 50 percent	70
No additional NDD cuts (9 percent from baseline)	0
Defense at CAP levels (8 percent from baseline)	183
Interest savings	204
Total spending savings	**701**
Revenue	
Allow the bonus Bush tax cuts to expire	806
Reform U.S. international tax system	128
Eliminate oil and gas tax subsidies	38
Eliminate the carried interest loophole	19
Eliminate the tax deduction for vacation homes and yachts	14
Implement the bank liability fee	81
Repeal "LIFO" accounting method	70
Extend payroll tax cut for one year	-112
Total revenue savings	**1,074**
Job creation spending	
Maintain extended unemployment insurance benefits for one year	57
Other measures	180
Total job creation spending	**237**
Total net deficit reduction	**1,503**

The Special Joint Committee on Deficit Reduction is not going to be able to solve the entire long-term budget problem. Nor should it try to achieve such a lofty goal. What our country needs right now, and what the committee is tasked with achieving, is substantial, but not enormous, medium-term deficit reduction. If the committee were to adopt our recommendations, then it would be a big step forward toward putting the country back on a responsible fiscal path.

Our plan isn't perfect, of course. In a more reasonable world, there would be room for much more investment in creating jobs, and laying the foundations for future growth. There would be far less concern over near-term fiscal contraction, and there would be a general understanding that more revenue must be part of the long-term solution. But given the current political and fiscal constraints, these recommendations are sound and, most importantly, meet all four critical criteria.

And since we are convinced that our criteria are the same as the American public's, if the committee is unable to agree on a plan that meets all four, then it would be far better for the country to simply allow the automatic cuts to trigger. It would be far better to allow the American people to weigh in and then try again later than to adopt a bad plan.

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Appendix

Description of individual proposals

Medicare and Medicaid savings contained in President Obama's 2012 budget. The president's fiscal year 2012 budget proposal included more than $60 billion in savings from Medicare and Medicaid. These savings derive mostly from improving program integrity through initiatives to, for example, reduce improper payments, and improve review. About $34 billion comes from Medicaid savings and the rest from Medicare.

Medicare Part D rebate. Prior to 2006, pharmaceutical companies paid rebates to the government for drugs provided to low-income seniors through Medicaid. With the establishment of Medicare Part D, drug companies were allowed to pay much lower rebates for many of the same seniors. Restoring the old rebate formula for low-income seniors would reduce net Medicare costs by $122 billion.

Accelerate home health savings in the Affordable Care Act. The Affordable Care Act contained a scheduled reduction in payments to home health providers. Moving that reduction forward will save $9 billion.

Index federal programs, except Social Security, to chained CPI-U. Many federal programs, including federal employee retirement, have benefits that are indexed to the Consumer Price Index, meaning they increase with inflation. Many experts believe that the traditional CPI overstates how fast inflation grows, and that a different measure called the chained CPI-U is better. Indexing all relevant federal programs, with the exception of Social Security, to this new measure would reduce federal spending by more than $50 billion over 10 years.

Reduce agricultural subsidies by 50 percent. The federal government is projected to spend about $140 billion on direct agricultural subsidies from 2013 through 2021. This does not include the billions in additional subsidies to agriculture that will be delivered through the tax code. Cutting in half the direct spending on agriculture subsidies will save $70 billion.

Defense at CAP levels. In our long-term budget plan entitled "Budgeting for Growth and Prosperity," we proposed cutting defense spending by $110 billion in 2015 and then allowing defense funding to grow by inflation plus 1 percent. Bringing defense spending down to that path would save about $183 billion on top of the cuts already enacted as part of the Budget Control Act's first $1 trillion in reductions.

Allow the bonus Bush tax cuts to expire. Permanently extending all of the Bush tax cuts will cost approximately $3.3 trillion over the next 10 years, not including added interest costs. Allowing the tax cuts that only affect income of more than $250,000 for married couples ($200,000 for singles) will save about $800 billion.

Reform the U.S. international tax system. In each of his budget proposals, the president has called for several specific reforms to improve the way the tax code treats multinational corporations. Together, these reforms would raise $128 billion from 2013–2021.

Eliminate oil and gas tax subsidies. From 2013 through 2021 the U.S. tax code will deliver billions of dollars in subsidies to oil and gas companies through a variety of special tax breaks. Eliminating all of these subsidies will save nearly $40 billion.

Eliminate the carried interest loophole. Currently, managers of hedge funds and private equity funds are allowed to pay preferential tax rates on much of their compensation. Closing this loophole and requiring them to pay the same rates as everyone else will yield nearly $20 billion in additional revenue.

Eliminate the tax deduction for vacation homes and yachts. The tax code currently allows a break for interest paid on loans used to buy vacation homes and yachts. Eliminating this tax break will raise about $14 billion.

Implement a bank liability fee. In his fiscal year 2011 budget, President Obama proposed a new fee on very large banks that would raise about $9 billion a year.

Repeal "LIFO" accounting method. The current tax code allows companies to choose the most favorable method for valuing their inventory and the cost of goods sold—a method known as "last in, first out." Transitioning to a more consistent accounting method would raise about $70 billion from 2013–2021.

Extend the payroll tax cut for one year. For calendar year 2011 the Social Security payroll tax paid by employees is 2 percentage points lower than normal. This policy means every working person's paycheck is a little bigger each week. The current payroll tax cut is set to expire at the end of this year. Extending it into calendar year 2012 would cost about $112 billion. Note that this is paid for out of the general fund and does not diminish the Social Security Trust Fund to which revenue from this tax is normally designated.

Maintain extended unemployment insurance benefits for one year. Ordinarily, unemployment insurance benefits run out after between 26 weeks and 46 weeks, but it has been routine that during periods of high unemployment, Congress extends those benefits to 99 weeks. At the end of this year, those extended benefits will expire. Continuing the extended benefits for next year would cost about $57 billion.