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Bowles–Simpson Commission Co-Chair Report: A Good and Welcome First Step

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Erskine Bowles and Alan Simpson, co-chairs for the President's bipartisan National Commission on Fiscal Responsibility and Reform, released a co-chairs' report today. Since it is a preliminary report from the chairs, it should be viewed as a model for discussion and seeding ideas for the final commission report. As such, the report tackles some of the key elements of the budget—cutting discretionary spending, cutting entitlement and other mandatory spending, and tax policy—and it suggests some small changes to the budgetary process. The co-chairs are to be commended for putting out a plan that addresses the fiscal issues confronting the nation.

Like many such reports, there are good and bad policy elements. Indeed, there's something for everyone to like and hate, though two issues have special importance. First, the co-chairs do not kick the can down the road but lay out some tough choices for cutting spending. Second, the co-chairs did not propose a value-added tax, or VAT. Interestingly, the co-chairs' report has been released nearly a month before the final commission report is due, likely to test the waters for the approach and specific proposals. Members of the commission should use this report—and the reactions to it—to inform their own report.

According to their estimates, spending will be cut to 20.5 percent of GDP by 2040—a significant reduction from the 32.9 percent level projected without reform. Taxes, however, will be increased from their historical average of 18 percent of GDP to 21 percent. These statistics offer a quick preview of one of the flaws of their plan—a 50/50 approach to eliminating the deficits and lowering the projected trajectory of the debt through tax increases and spending cuts. As revenues are projected to soon return to their historical level—even if the tax cuts are made permanent—spending is clearly the problem.

A quick pro–con review of some of the report's recommendations follows.

Entitlement Programs. The three major entitlement programs—Social Security, Medicare, and Medicaid—are the major driver of federal program spending. Reining in spending, and thus the deficit, is impossible without major changes to these programs. Moreover, the newly enacted Obamacare legislation will drive spending even further. The co-chairs are to be commended for addressing entitlements, since changes to these popular programs are necessary but politically difficult. Their entitlement proposals are a mixed bag and could have been much bolder, especially in health care.

- First and foremost, the co-chairs' proposal leaves the unpopular and unaffordable Obamacare in place. That law imposes massive new entitlement spending commitments and tax hikes. The total spending from Obamacare will be at least $2.5

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trillion over its first real decade of implementation, when both revenues and benefit payouts are included.

- On Medicare and Medicaid the proposal does not include a structural reform of either program but instead relies upon the existing system of flawed administrative payment and bureaucratic micromanagement and expands a single-payer-type global budget to private health insurance in the health insurance exchanges.

Medicare. Medicare is the fastest growing and soon largest entitlement program, but here the proposal largely misses the mark, though there are some positive steps.

- More should be done besides fixing the flawed Medicare physician payment program. The co-chairs' plan relies on the flawed assumption of government-driven cost control instead of consumer choice and a functioning marketplace. It relies on price controls that always distort the allocation of resources and lead to access problems. One of the most fundamental missing elements from their plan is moving Medicare and Medicaid toward a consumer directed model.
- The co-chairs wisely propose to repeal the Sustainable Growth Rate formula, an automatic and dramatic reduction in doctors' payments under Medicare that is routinely thwarted by the Congress.
- On the other hand, the proposal calls for comprehensive medical malpractice reform. If properly pursued by the states, comprehensive medical tort reform is a vital step toward reducing health care costs generated by defensive medicine.
- In another example of a non-serious proposal, the co-chairs call for identifying another $200 billion in savings from federal health care spending. If they are not going to have a specific proposal, why only $200 billion? Why not $400 billion or $600 billion?
- In an example of a potentially sound proposal, the co-chairs suggest setting a global target for total federal health care spending after 2020, holding growth to GDP plus 1 percent. Unfortunately, the value of the proposal is deeply blunted by the lack of effective enforcement mechanisms in the event that total federal spending were to exceed the target.

Social Security. The co-chairs include a mixed bag of proposals for Social Security. They start off by (correctly) arguing that Social Security needs to be reformed for its own sake—it is a program destined for failure today.

- The co-chairs wisely propose to continue to increase the eligibility age for increases in longevity, raising the normal retirement age by one month every two years.
- They propose a sound method for progressive indexation.
- As noted elsewhere, they also propose CPI-W (chained CPI) for all cost-of-living adjustments, which is much more accurate than the current method.
- Unwisely, they then propose a new hardship exemption for those unable to work past age 62, ignoring that the government maintains a disability insurance program and that individuals share a responsibility for their retirement that they meet through personal saving.
- Worse, they propose to increase the amount of wages subject to tax, which likely means raising the cap on the FICA tax.

Other Entitlement and Mandatory Spending Savings. The co-chairs' proposal includes a list of other savings worthy of consideration, including the adoption of a more accurate measure of inflation for programs that are inflation indexed. They also propose to cut farm subsidies, a welcome measure.

However, their proposals do not go far enough. For instance, much bigger reforms should be made to the $25 billion farm subsidy system. Recommendations to restructure the Power Marketing Administration to charge market-based rates and other similar recommendations also deserve consideration.

Non-Defense Discretionary Spending

- Statutory discretionary caps are helpful, although cutting just 1 percent annually from discretionary spending through 2015 (and growth by inflation thereafter) is too timid given today's bloated levels.

- Eliminating earmarks is an important policy direction, and the co-chairs rightly note now that the process of earmarking corrupts the legislative process. They are silent on whether the $16 billion in 2010 earmarks would reduce spending directly, however.
- The $50 billion in cuts in federal bureaucracy (mostly by freezing pay and cutting jobs) is generally good, although they disproportionately target contractors, which are often cheaper than federal employees.
- The $100 billion in non-defense discretionary cuts is a good start. The co-chairs should have included more cuts in this area given the nation's policy challenges. This spending has expanded by $144 billion in just the past two years and had grown significantly before then. The co-chairs recommended nearly $10 billion in program terminations, but in a $3.5 trillion budget, much more is possible.
- Massive recent budget increases in education (both K-12 and Pell grants), health, highways, and veterans are barely touched.
- Banning bailouts of the highway program is helpful.
- The $11 billion in savings to be identified by a "cut-and-invest committee" is vague. The commission is essentially proposing a commission to cut spending.

Defense Cuts. The co-chairs call for $100 billion cuts to the defense budget. However, their recommendations should draw from the Department of Defense Quadrennial Defense Review (QDR), established by Congress, which has been the traditional instrument for evaluating long-term defense needs. The co-chairs' proposals would completely undermine the minimum capability of the armed forces to protect and defend the American people as outlined in the Administration's own QDR. Furthermore, a recent independent commission, which included highly qualified defense experts, concluded that if anything the QDR underestimated long-term defense.

The co-chairs' defense cut recommendations would make America less safe and are thus completely irresponsible.

While there are efficiencies that can be gained in military spending, these savings need to be reinvested in the armed forces to make up for decades of neglect in long-term modernization: buying the planes, ships, and vehicles that military men and women need to protect the nation.

Indeed, defense spending as a percentage of GDP and as percentage of the federal budget are already at near historic post–World War II lows—at a time where the modern military has never been busier.

Among the cuts these proposals would require are the readiness of our armed forces for future conflicts and essential new equipment. Not only would these cuts leave America vulnerable to a resurgent threat, but they would allow China in some areas to actually gain distinct military advantages over the U.S. and send a clear message to countries like North Korea and Iran—as well as America's own allies—that the U.S. is no longer capable and willing to defend its interests.

Taxes. As feared, the co-chairs' proposal is to levy staggering tax hikes on America's families and businesses when the problem is spending and spending alone. The simple fact, as the proposal lays out plainly, is that taxes are to increase to 20.5 percent of the economy, up from even the 19.8 percent in the President's budget after all his tax hikes are implemented and far above the 18 percent historical average.

This would raise taxes by close to $1 trillion from 2012 to 2020, or more than $8,000 for every household in America. The only positive note surrounding this large of a tax increase is that the co-chairs did not do it through a VAT.

The co-chairs do, however, wrap their tax hike around the guise of tax reform. Like most tax reform efforts, the co-chairs' tax reform options have positive aspects, such as the elimination of the Alternative Minimum Tax and dramatic tax rate reductions, including the reduction of the corporate income tax rate.

But the proposals also have serious faults, such as higher tax rates on capital gains and dividends, the elimination of the home mortgage deduction, and the elimination of accelerated depreciation, thus raising taxes on capital investment. Tax hikes such as these would be exceedingly harmful to the economy. These proposals deserve consideration as complete systemic reforms, but only as part of the kind of revenue-neutral tax reform that will grow the economy and thus produce stronger tax revenues.

Legislative Requirements for Action. The co-chairs include several proposals that would require Congress and the President to take action, including annual review of whether the budget is on a sustainable path, presidential recommendations to stabilize the debt path, budget reconciliation, and a PAYGO-like point of order for legislation lowering taxes or increasing spending in any year without a budget resolution.

These are good sentiments, but much stronger changes to the antiquated budget system will be necessary to force and maintain the kinds of programmatic reforms needed. Moreover, strong enforcement tools will be needed if necessary reforms are not put in place, but these are lacking from their proposal.

Next Step: The Commission. Bowles and Simpson note that the problem is real and the solutions will thus be painful. One basic point the commission should remember is that the deficit problem is a spending problem, not a revenue problem. They also rightly note that Americans have always been willing to sacrifice to make our nation stronger for future generations, and thus their plan—with its strengths and weaknesses—lays out a model or framework for discussion.

Commission members should thank their co-chairs for jump-starting their work. Now that the elections are over and the full commission begins work on its final report in earnest, it should build on these proposals laid out by the co-chairs, keeping those that are sound, throwing out those that are harmful, and strengthening those that are too weak. The commission's full report, when it comes, should deserve the same consideration by the new Congress. Changes this important—and necessarily bold—should be given every consideration and not be crammed through by a lame duck Congress.

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