Hearing before the Senate Budget Committee on

Setting and Meeting an Appropriate Target for Fiscal Sustainability

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Committee for a Responsible Federal Budget

Chairman Conrad, Ranking Member Gregg, and Members of the Committee, good morning – it is an honor to appear before this Committee. Thank you for holding this important hearing on the specifics of achieving fiscal sustainability – it comes at a critical time.

I am the President of the bipartisan Committee for a Responsible Federal Budget. Our Co-Chairs are Congressmen Bill Frenzel (R-MN), Tim Penny (I-MN), and Charlie Stenholm (D-TX). The Board is made up of past Directors of the Office of Management and Budget, the Congressional Budget Office, and the Government Accountability Office, as well as Chairmen of the Federal Reserve Board and the Budget Committees, and other budget experts. Additionally, I am the Director of the Fiscal Policy Program at the New America Foundation, a non-partisan think tank. I am also a member of the Peterson-Pew Commission on Budget Reform, which, in December, released *Red Ink Rising: A Call to Action to Stem the Mounting Federal Debt*, which proposes a six-step framework to address the growing federal debt.

The main points I would like to emphasize today are:

- The need to pick a fiscal goal
- How to think about the right goal
- How to think about the right policies to achieve that goal
- The types of policies it will take to close our fiscal gap
- The consequences of failing to act

The need for a fiscal goal

Clearly, the federal budget is on an unsustainable path. Assuming current law, the debt held by the public will grow from $7.5 trillion (53 percent of GDP) in 2009 to $15 trillion (67 percent of GDP) by 2020. Continuing a number of policies that are slated to expire, including the 2001 and 2003 tax cuts, patching the Alternative Minimum Tax, and reforming the sustainable growth rate for Medicare, without offsetting the costs, would make this bad situation dramatically worse, with the debt growing to well over 100 percent of GDP—or $22 trillion in 2020. Things only get worse after the ten-year window.

We must change course. Nobody can predict at exactly what point excessive debt would lead to a fiscal crisis, but we can all agree it would be best not to find out. The policies needed to bring down the deficits and debt to sustainable levels—cutting spending and raising taxes—are not the types of budgetary change politicians relish making. The current political environment makes this already unenviable task even harder.

There are a number of compelling reasons to pick a fiscal goal. The first is to reassure credit markets that the United States is serious about controlling its debt and its dependency on borrowing. Currently, creditors are quite willing to lend to the United States and interest rates are historically low, allowing us to borrow at relatively low cost. This is undoubtedly the result, at least in part, of the 'flight to quality' that regularly occurs during uncertain times. But how long will our debt be viewed as 'quality'?

Our current budget plan relies on trillions and trillions of dollars of borrowing over the next decade. Even if we make significant improvements to the budget's path, we likely will still have to borrow staggering amounts in the coming years. We must find a way to reassure credit markets so we can continue to borrow at manageable interest rates. Significant upward pressure on interest rates—either gradual and steady, or sudden—could prove destabilizing to our economic recovery at just the wrong time.

While history and international experience shows that cutting government spending or raising taxes too early during an economic recovery can push the economy back into recession, it also shows that committing to a sensible framework for medium-term debt reduction can improve creditors' expectations of a country's fiscal management and strengthen a recovery. The "announcement effect" from a credible commitment can have positive economic effects by signaling that the United States is serious about reducing its debt, which in turn can lead to relatively lower interest rates and boosts to growth and employment. In other words: the mere announcement of a plan to achieve a goal—if viewed as credible—can make achieving a fiscal goal easier, even before any policy changes have been made.

The Committee for a Responsible Federal Budget strongly supports this model, and we even started a club, the "Announcement Effect Club," modeled on Greg Mankiw's Pigou Club, which recognizes economists, budget experts, and lawmakers who also support it.

There rarely are free lunches in budget policy, but the ability to bring about economic improvements prior to action is at least a small one, or free amuse-bouche.

The second reason to commit to a fiscal goal is to help lawmakers to say no. There are plenty of compelling spending increases and spending cuts that could, and ideally would, be made. Two of my personal preferences are for lowering corporate income tax rates (in an era of mobile capital and global competition, it is counter-productive to have such high marginal corporate tax rates), and increasing government spending on well-targeted investments in education, R&D, and infrastructure. But as compelling as these and other priorities may be, there is absolutely no room in the budget to deficit finance them. It should not even be a matter for discussion (other than, perhaps, for stimulus measures, but even stimulus policies should come with offsets so that they are repaid over a longer time period to allow for stimulative effects.)

Establishing a fiscal goal allows policymakers to say "No" to the notion that we can deficit finance any new initiatives, no matter how worthy. It helps to operationalize the principle that anything worth doing is worth paying for. And it goes further, requiring policymakers to prioritize developing a sustainable budget plan in front of other new budgetary endeavors, including even new priorities that are paid for. One of the risks to saying yes to major new initiatives that are paid for is that they consume budget offsets that might otherwise be used for deficit reduction, making the development of a budget plan even more difficult.

Finally, having a unified goal allows for comparison of the tradeoffs between different approaches. If, for instance, health care reform only slows the growth of health care spending slightly, much larger sacrifices will have to be made in other areas of the budget to achieve the goal. If a plan doesn't raise taxes, entitlements and discretionary spending will take a much larger hit. A plan that protects all benefits for people above a certain age, say 55, will result in younger participants enduring much larger reductions. A budget that includes all sorts of "sweeteners" to make it politically easier to pass, also will have to have more offsets to achieve the goal. And so on.

Right now it is much too easy to demagogue any approach: "You would cut Social Security benefits by 50 percent!" Or: "That would be the largest tax increase ever!" But it isn't fair to compare a policy change to the lack of one—because the latter is not sustainable. A single fiscal goal is the critical first step to creating a level playing field for comparing budget reform options.

Picking the right goal

While there is no single "right" fiscal goal, the Peterson Pew Commission on Budget Reforms proposes stabilizing the debt held by the public at 60 percent of GDP by 2018. Specifically, we recommend six steps:

Step 1: Commit immediately to stabilize the debt at 60 percent of GDP by 2018
Step 2: Develop a specific and credible debt stabilization package in 2010
Step 3: Begin to phase in policy changes in 2012
Step 4: Review progress annually and implement an enforcement regime to stay on track
Step 5: Stabilize the debt by 2018
Step 6: Continue to reduce the debt as a share of the economy over the longer term

We based the 60 percent target on a number of factors, including what we viewed as politically achievable, the right balance between economic recovery and fiscal considerations, and the standards used by other industrial nations.

From a financial perspective, the United States must persuade credit markets that it is serious about debt reduction. Global markets are more likely to embrace a plan if the goal has international credibility and the 60 percent debt threshold has become an international standard. In the EU, under the requirements of the Maastricht Treaty and the Growth and Stability Act, EU countries must satisfy a benchmark target of 60 percent of GDP for debt and 3 percent for annual deficits. Likewise, the IMF has singled out the 60 percent debt target as a reasonable benchmark.

We believe a 60 percent target is the most ambitious and economically sensible target that can reasonably be achieved in this timeframe—given the significant risks of high U.S. debt, a less aggressive target might be insufficient to reassure the markets. Over the longer-term, we think it is critical that the debt decline to pre-crisis levels—under 40 percent of GDP, but more time will be needed to get there. Lowering the debt too quickly could hurt our economy, and if too many other nations cut their debt at the same time, the global economy as well.

This goal really requires two pieces: bringing the debt down to a reasonable level of 60 percent of GDP in the medium term and then stabilizing that the debt so it doesn't grow faster – and eventually grows slower – than the economy. It is quite likely that the medium and longer-term objectives will require different policy approaches, with the first prioritizing policies that can be phased in more quickly—probably cuts and freezes in discretionary spending and revenue increases; whereas the longer term changes will have to focus on the real drivers of the longer-term deficit problems—aging and healthcare, and will require structural changes to Social Security, Medicare and Medicaid.

More important than any specific fiscal goal is that the goal be an economically and politically reasonable target with widespread buy-in. This will allow policymakers to proceed to determining how best to achieve that goal and assessing the tradeoffs involved.

Getting specific

Picking the fiscal goal, of course, is the easier part. Getting there is much more difficult.

The starting point matters

Whatever fiscal goal we end up picking, the starting point matters. Achieving a fiscal goal will be greatly affected by whether policymakers let policies that are slated to expire do so, or whether they are renewed but are paid for, or whether they are made permanent and deficit-financed.

If we assume the fiscal goal of stabilizing the debt at 60 percent of GDP by 2018, under current law (where policies expire) it would require roughly $1.5 trillion in savings over the next nine years. (The specific savings required would depend on how quickly policies were phased in, which affects the level of interest savings generated.) We assume no policy changes for two years and very minimal changes for the next few years, and a gradual glide path to very small deficits (less than 1 percent of GDP) by 2018. Thereafter, you can stabilize the debt while still running small deficits as long as the economy is growing faster than the debt.

We included a *Budget Blueprint* as an appendix to our *Red Ink Risking* commission report that shows what this would require. This is not a specific plan endorsed by our commissioners, but rather it illustrates the level and type of policy changes required. (Appendix 1.) The blueprint includes:

- Savings from defense/lower war costs ($50 bil)
- Cuts to/elimination of outdated programs ($5 bil)
- Agriculture cuts ($5 bil)
- Changes to Social Security: raise retirement age, reduce benefits for higher earners, other benefit calculation changes ($20 bil)
- Changes to health care ($15 bil)

- Reforms to contracting payments ($15 bil)
- Other mandatory savings ($15 bil)
- Tax base broadening ($35 bil)
- Change to the superlative CPI for indexing of certain programs and tax policies ($30 bil)

Note: All savings are average 1-year savings

If these policies were enacted, it would save roughly $1.3 trillion over seven years and would generate an additional roughly $200 billion in interest savings. Under this scenario, in 2018, the debt would stand at $12 trillion (60 percent of GDP) instead of $13.5 trillion.

If instead we assume those expiring policies are extended and deficit financed, the task becomes *significantly* harder, requiring a total of $5 trillion in savings over the same time period instead of $1.5 trillion.

Our second illustrative path includes additional options, including:

- Discretionary spending caps pegged to inflation (our baseline assumes it grows with GDP, which is more in line with what it has done historically) ($130 bil)
- Reducing the 2001/03 tax cuts (reduce rate cuts by half) ($35 bil)
- Introducing a new energy tax ($100 bil)
- Larger savings in some of the above categories

Both examples illustrate that substantial changes will be required. Virtually no area of the budget will be unaffected—and if any area is exempted, it will mean larger changes elsewhere.

The policies I have touched upon here are much larger than the specifics policymakers tend to discuss publicly—if they discuss deficit reduction policies at all. Unfortunately, the political environment currently is not conducive to an honest discussion about the magnitude of changes necessary to achieve any reasonable fiscal goal. Whenever policymakers dare to be specific about cuts to programs or tax increases, they are too often met with criticism and attacks. We need to find a way to have a more honest and constructive dialogue about our fiscal future.

I would like to take the opportunity to thank both Chairman Conrad and Ranking Member Gregg for their important work in promoting a bipartisan commission to help in this process. I am very sorry the Senate did not accept this idea last month, and I hope we will find a way to transform it into the next productive mechanism for moving this process forward.

Principles for change

Given how large the necessary changes will need to be, we suggest some principles for determining what those changes should be:

Change should be conducive to economic growth, or at least minimize the degree to which it hinders it, wherever possible. The Committee for a Responsible Federal Budget has spent a lot of time exploring fiscal turnarounds, both domestically and abroad. Nearly all of them have one component in common – strong economic growth. On the one hand, strong economic growth helps bring in more revenues, and it means less spending will be required on unemployment and other so-called "automatic stabilizers." At the same time, it means a larger GDP – so we are actually increasing the denominator as we shrink the numerator in the debt-to-GDP equation. Don't get me wrong, our problems are too severe to mitigate through a strong and growing economy, but this surely can help. To this end, it is important to understand that not all policy changes are equal. Pro-growth policies—such as fundamental tax reform, improving labor force incentives, and protecting productive investment spending—should be given special consideration when crafting a fiscal plan. On the revenue side in particular, assuming taxes go up, it becomes increasingly important to have as an efficient a tax system that depresses growth as little as possible—something our current tax system doesn't come close to resembling.

Spending growth is the crux of the long-term budget problem, but both spending and revenues will probably have to be part of any budgetary solution. Anyone who has tried to develop a plan to achieve a reasonable fiscal goal either solely through spending reductions or tax increases knows just how close to impossible it is. Realistically it is hard to envision a workable plan that doesn't involve both spending cuts and tax increases, and it is even more difficult to imagine a political "grand bargain" where both are not involved.

Focus on the drivers of program growth. Though everything will have to be on the table, any package should be weighted toward reforms of the most problematic areas of the budget. Reforms in programs that are growing faster than the economy, such as health and retirement programs, are the most likely to produce large and compounding savings, which not only help stabilize the debt in the medium term but keep it from growing again over the longer term.

The sluggish economy should not be an excuse to delay crafting a plan. Developing and implementing a plan can and should occur at two different points, with policymakers developing a plan as quickly as possible, while phasing it in more gradually only as the economy is strong enough to accommodate those changes.

Specific ideas

The Committee for a Responsible Federal Budget does not endorse specific policy changes. Our board members—two of whom I am sitting next to at this hearing—do, but as an organization we do not. So I will speak on my own behalf, not the entire board's, when I mention what I think are the most promising policies.

1 Raising the retirement age. Over the past 50 years or so, life expectancy has increased significantly, yet the average retirement age has fallen from 65 to 62. Raising the retirement age for Social Security would not only reduce the program's obligations, but likely would encourage people to work longer. And a larger work force means more taxable income and stronger overall economic growth. An increase in the age for Medicare (possibly combined with an option to buy into the program at earlier ages) would also be sensible.

2. More means-testing in entitlements. Given that entitlement spending will have to be reduced, we can proceed by reducing all benefits, or by reducing them more for those who depend on the programs less. I favor the second option and think we should consider slowing the growth of Social Security benefits for the well-off and asking them to pay a greater share for their Medicare benefits.

3. Do more on health care. Whether the bills being considered as part of health care reform pass or not, more will have to be done to control costs. We should proceed with changes to slow the growth of overall healthcare costs—such as changing the tax treatment of employer-provided health insurance, as well as changes specific to Medicare, Medicaid, and other government health care programs. We have to have a sensible discussion about how much the government should pay for when it comes to health care costs and how to introduce more price sensitivity into the public and private insurance arrangements.

4. Reintroduce discretionary spending caps. Over the past decade or so, discretionary spending has grown far faster than the economy, even excluding defense spending. To ensure that politicians make tough decisions in this area of the budget, we must have strong enforceable spending caps in place. In the past, they have proved to be the sensible companion to PAYGO.

5. Broaden the tax base. The tax base is replete with credits, exemptions, deductions, and exclusions. All told, the government loses around a trillion dollars *a year*, due to these tax expenditures. While politicians love these tax breaks since they allow them to achieve spending priorities – for education, housing, favored industries – all while appearing to give tax cuts, they are really spending programs dressed up as tax cuts. We should dramatically reform this part of the tax code, in a way that would simplify the code, make it more efficient, and raise government revenues.

6. Even after spending has been reduced and the tax code reformed, there is likely to be a gap between spending and revenues. If so, we will need to consider new revenues. Given some of the options likely to be discussed – higher income tax rates, a transaction tax, and VAT, my preference would probably be for an energy tax which could have positive effects on energy policy, the environment, and the budget. Certainly a cap and trade regime that did not return all revenues to families and businesses would be more sensible than one that does, from a budgetary perspective.

Finally, I will also suggest two process recommendations.

First, a budget deal should be enforced with a new debt trigger. The Peterson Pew Commission recommends a trigger which would take effect if an annual debt target were missed. Any breach of the target would be offset through automatic spending reductions and tax increases applied to both sides of the budget equally. Past automatic policy changes failed in part because so many programs were exempt from the trigger and it was so easy to bypass the restrictions. A debt trigger should be punitive enough to cause lawmakers to act but realistic enough that it can be enacted as a last resort if policymakers fail to act or select policies fall short of the goal.

Second, we currently have a hammer built into the budget: the expiration of the 2001 and 2003 tax cuts, the bulk of which both political parties support extending. Lawmakers could consider agreeing not to extend these tax cuts until a reasonable fiscal target has been put into place and a plan to achieve it has been agreed upon. Given the support for extending the tax cuts, this would help motivate lawmakers of both parties to create a comprehensive budget reform plan.

The risks of inaction

The risks of inaction are becoming more apparent every day: We see what is happening to overleveraged nations around the globe. We regularly are reminded by credit rating agencies that the United States is risking its own triple-A credit rating by failing to act, and by foreign leaders, that they are concerned about our fiscal well-being.

Excessive debt can hurt a country, its citizens, and its economy in many ways. It can harm the economy by pushing up interest rates—particularly dangerous as we emerge from a severe recession. It can slow the growth of wages and keep living standards from increasing by as much as they otherwise would have, leaving the country's citizens worse off. The massive amount of debt issued by countries around the world risks crowding out private investment. We already are already seeing the cost of capital increase for corporate borrowers—the opposite of what we want to see in terms of job creation. And excessive debt deprives the country of the fiscal flexibility to respond to future crises and new national priorities as they arise.

If we do not get our fiscal house in order, we ultimately risk a fiscal crisis. It could come sooner rather than later. It could come from a shock elsewhere or at home. History shows that tipping points are difficult to predict, but that vulnerabilities are usually well-known. With the federal debt about to expand dramatically, the risks of doing nothing are unacceptably high for the American taxpayer.

Thus, this is exactly the right time to focus on dealing with the medium and long-term budget challenges facing the country. Over the past year, the top priority was – as it should have been – dealing with the very serious economic and financial crises facing the country. But continuing to add to the debt without a plan to bring it back down to a sustainable level jeopardizes the recovery and puts the future growth path of this country at grave risk.

The most prudent course of action would be to announce a credible course of action for addressing the nation's budgetary challenges *immediately*, while phasing in the actual policy measures to get there more *gradually*. Simultaneously, we must be preparing the country for the large changes that will be required to accomplish any reasonable fiscal goal. Perpetuating the notion that we can achieve a sustainable fiscal future while taking major areas of the budget off the table and focusing only on minor incremental changes, stand in the way of making progress in time to get in front of the problem.

Thank you again for inviting me here today. I look forward to any questions.

Budget Blueprint: Paths to 60%

	7-year savings, 2012 – 2018
Current Law: Debt in 2018 (% GDP)	**$13.5 TRILLION (67%)**
Defense# (lower war costs)	$350 billion
Outdated Programs (eliminate or cut certain discretionary programs)	$25 billion
Agriculture (reduce direct payments to farmers)	$25 billion
Social Security* (raise retirement age, reduce benefits for high earners; enact other changes)	$150 billion
Health Care* (enact deficit-reducing health reform which slows health care cost growth)	$100 billion
Contracting Reform (gradually reduce number of contractors; reform payments)	$100 billion
Other Mandatory Savings (reduce federal benefits, increase user fees; cut certain programs)	$100 billion
Tax Base Broadening (consolidate and cap breaks for housing, health, education & saving)	$250 billion
Superlative CPI* (index government benefits and tax code to alternative measure of inflation)	$200 billion
Deficit Reduction	$1,300 billion
Interest Savings	$200 billion
Debt (% GDP)	$12 TRILLION (60%)

	7-year savings, 2012 – 2018
Today's Policies: Debt in 2018 (% GDP)	**$17 TRILLION (85%)**
Defense (reduce certain weapons systems)	$100 billion
Outdated Programs (eliminate or cut certain discretionary programs)	$100 billion
Discretionary Caps (cap normal discretionary spending growth at inflation)	$900 billion
Agriculture (phase out payments to farmers and other agricultural subsidies)	$100 billion
Social Security* (raise retirement age, reduce benefits for middle-high earners; enact other changes)	$300 billion
Health Care* (enact deficit reducing health reform and cap growth of government health spending)	$400 billion
Contracting Reform (reduce number of contractors and reform payments)	$150 billion
Other Mandatory Savings (reduce federal benefits, increase user fees; cut certain programs)	$200 billion
Tax Base Broadening (consolidate and cap breaks for housing, health, education & saving)	$400 billion
Reduce 2001/2003 Tax Cuts (gradually reduce rate cuts by half)	$250 billion
State & Local Tax Deduction (phase-out deduction to finance AMT patches)	$600 billion
Energy Tax (institute tax on carbon emissions or equivalent cap-and-trade system)	$700 billion
Superlative CPI* (index government benefits and tax code to alternative measure of inflation)	$200 billion
Deficit Reduction	$4,400 billion
Interest Savings	$600 billion
Debt (% GDP)	$12 TRILLION (60%)

Current law assumes greater war costs than does the Commission's baseline
* Certain policies such as changes to Social Security, health care, and indexing will contribute more to the goal of keeping the debt stable as a share of GDP after 2018.

Note: The budget blueprint is an illustration of the types and magnitudes of policies that would be necessary to achieve debt stabilization goal under different scenarios. Both targets and savings estimates are rounded for illustrative purposes. Numbers vary tremendously depending on policy specifics, timing phase-ins, and interactions. In general, reaching our target from a "current law" baseline requires smaller changes, since that baseline assumes policies – such as the allowed expiration of the 2001 and 2003 tax cuts — which would result in lower levels of debt. The Peterson-Pew Commission on Budget Reform does not endorse either of these plans, but rather provides them in order to demonstrate the magnitude of choices which would be necessary to reach our recommended goal.

Sources

The source for most of the options contained in the Budget Blueprint is the Congressional Budget Office's (CBO) Budget Options reports released in December 2008 and August 2009. We specify where an insufficient amount of savings exists from these options.

Scenario 1: Assumes Current Law

Defense: According to CBO's August *Budget and Economic Outlook: An Update*, gradually reducing the number of troops in Iraq and Afghanistan from 210,000 to 75,000 would save nearly $600 billion by 2018. We assume a drawdown would be possible as the Iraq war phases down, although it may not be as large as described above due to new commitments to Afghanistan.

Outdated Programs: CBO's *Budget Options* includes well over $150 billion in options to reduce discretionary spending over 10 years. For example, eliminating the Department of Energy's research on energy-efficiency and renewable energy technologies would save $10 billion over the next decade, eliminating the Department of Transportation's New Starts Transit programs would save almost $15 billion over ten years, and eliminating federal funding for national community service programs could save nearly $8 billion over ten years.

Agriculture: According to OMB, the Administration's proposal to phase out direct payments to high-income farms would save $10 billion over 10 years and their proposal to reform the crop insurance program would save another $5 billion over ten years. Since OMB estimates farm commodity payments, alone, to total nearly $65 billion over the next decade, we assume additional savings can be achieved through reducing these payments.

Social Security: CBO estimates Social Security savings of $111 billion over 10 years for progressive price indexing, or slowing the growth of benefits in a progressive manner, and $92 billion in savings over 10 years from raising the retirement age. Additional savings could come from other smaller changes such as reducing the spousal benefit.

Health Care: CBO's health care *Budget Options* includes over $2 trillion in potential health care savings. Additional savings have been scored from many of the recent health care reform bills. We assume many of these policies would be adopted as part of a health reform bill, but others could be used for debt reduction. Examples for potential health care savings include cutting subsidies to Medicare Advantage, (more than $150 billion over 10 years), raising the age of eligibility for Medicare to 67 (more than $90 billion over 10 years) and reducing Medicare's payment rates across the board in high-spending areas (more than $50 billion in savings over 10 years). To put these numbers in perspective, the government is expected to spend over $6.5 trillion on Medicare and Medicaid alone from 2012 – 2018.

Contracting Reform: In July the White House announced it would begin to implement reforms to the federal contracting system that would save $40 billion a year. We assume these savings would accrue slowly over time as reforms take effect.

Other Mandatory Savings: CBO's regular *Budget Options* includes well over $200 billion in possible savings over 10 years through a variety of mandatory spending cuts, imposition of fees, and changes to certain federal employee benefits. Over $150 billion in additional 10-year savings can be found between the recommendations in the President's Budget and options related to federal employee health benefits in CBO's health care *Budget Options*. For example, replacing private student loan subsidies with direct federal loans could save more than $40 billion over 10 years, and reducing veterans' disability benefits to account for Social Security payments could save $20 billion. For perspective, total mandatory spending, excluding Social Security, Medicare, and Medicaid, is projected to be around $3.5 trillion from 2012 through 2018.

Tax Base Broadening: Revenues lost to tax expenditures represent upwards of $1 trillion a year, according to some estimates; and a number of options exist for reducing the various tax credits, deductions, and exclusions. Limiting the mortgage interest deduction for expensive homes, for example, would raise over $40 billion over 10 years; and converting it to a 15 percent credit would raise almost $390 billion over that same period. Another option might be to change the tax treatment for life insurance for as much as $265 billion in ten-year revenue, or limit the deduction for charitable giving, resulting in as much as $220 billion in revenue over ten years.

Superlative CPI: CBO estimates that using a different measure of CPI for the Social Security COLA would save nearly $110 billion over 10 years, and using it for the tax code would generate just under $90 billion. Additional savings would also accrue due to other federal programs tied to inflation.

Scenario 2: Assumes Commission's Fiscal Baseline

Defense: The Commission's fiscal baseline already assumes a troop drawdown for Iraq and Afghanistan, and that any new costs associated with the wars in Iraq and Afghanistan would be paid for. CBO's *Budget Options* includes over $170 billion in savings options over a 10 year period in addition to this drawdown. Some of the biggest savings could come from cancelling programs such as the Joint Strike Fighter ($37 billion) and Future Combat Systems ($22 billion). To put these proposed cuts in perspective, the government is projected to spend roughly $4.5 trillion on defense between 2012 and 2018.

Outdated Programs: See Outdated Programs above. Additional savings would be necessary, and could come from, for example, eliminating federal grants for wastewater and drinking water, which would save $11 billion over 10 years or increasing fees for aviation security to save almost $20 billion over ten years.

Discretionary Caps: The Commission baseline assumes discretionary growth at the rate of GDP. According to CBO's *August Budget and Economic Outlook: An Update*, assuming discretionary spending growth at the rate of inflation, by itself, would save roughly $1.7 trillion over 10 years, including over $1.3 trillion between 2012 and 2018. To put the savings in perspective, total discretionary spending would be about $10.5 trillion between 2012 and 2018 under the Commission's fiscal baseline.

Agriculture: This option would eliminate most agricultural subsidies. In 2008, CBO estimated that commodities payments, crop insurance, and related programs would cost around $95 billion between 2012 and 2018; the 2008 farm bill changed these spending levels only modestly. In addition to largely eliminating these programs, savings could come from phasing out subsidies to ethanol and other biofuels, ending the market access program, and phasing out certain subsidies administered through the tax code such as the supplemental revenue assistance program, among other options.

Social Security: See Social Security above. Additional savings could be achieved through more aggressive forms of indexing reform, extending the years of work used to calculate benefits, as well as modifying the tax treatment of Social Security benefits.

Health Care: See Health Care above. Additional savings could come from more expansive and aggressive changes to the government health care savings, including a revenue positive reform of the sustainable growth rate for Medicare physician payments and a cap on the growth of overall government health care spending.

Contracting Reform: See Contracting Reform above. Here we assume a faster phase in of the reforms.

Other Mandatory Savings: See Other Mandatory Savings above. Additional spending cuts would be necessary. For example, adoption of a voucher program for federal employee health care could save $40 billion over 10 years, and financing the food safety and inspection service solely through fees would raise almost $10 billion.

Tax Base Broadening: Simply limiting the tax benefit of itemized deductions to 15 percent brings in $1.3 trillion over 10 years according to CBO.

Reduce 2001 and 2003 Tax Cuts: The Commission's fiscal baseline assumes most of the 2001 and 2003 tax cuts would be extended — other than those for families making over $250,000 annually. But, significant savings would be realized if fewer of these cuts were extended. For instance, we estimate from CBO's *Budget Options* that allowing the remaining brackets to revert to halfway between their current and scheduled levels would save nearly $300 billion between 2012 and 2018.

State and Local Tax Deduction: CBO estimates in its *Budget Options* that eliminating this deduction would save more than $860 billion over 10 years. We estimate that approximately $680 billion of this would accrue between 2012 and 2018.

Energy Tax: In its *Budget Options*, CBO estimates that putting a price on "upstream emissions of greenhouse gases" would generate more than $880 billion in the 8 years between 2012 and 2019. We assume this would occur through either a carbon tax or a fully-auctions cap-and-trade system.

Superlative CPI: See Superlative CPI above.