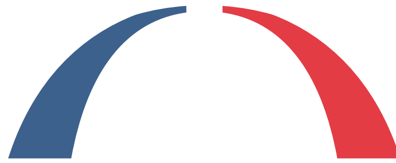

BREAKING THE BUDGET GRIDLOCK: A BIPARTISAN BLUEPRINT FOR DEBT REDUCTION

Bipartisan Policy Center

By Bill Hoagland, Jason Fichtner, Shai Akabas, Rachel Snyderman, Emerson Sprick, and Andrew Lautz

Introduction

America's budget trajectory has become increasingly alarming over the first quarter of the 21st century. A multitude of factors—from increased entitlement costs to spending on U.S. military engagements to tax cuts to the multi-trillion-dollar federal response to the pandemic—have driven the $23 trillion increase in debt since 2000. Both parties share blame for the issue, but one thing is clear above all: to stabilize the U.S. fiscal outlook, Democrats, Republicans, and Independents must work *together*. Only bipartisan compromise to address the debt and deficit will withstand political scrutiny and the test of time.

It would have been easier to stabilize the debt in 2000, when debt was $3.6 trillion and 34 percent of gross domestic product (GDP), or even in 2010, when debt was $9 trillion and 61 percent of GDP. It is now $26 trillion and nearly 100 percent of GDP. Delay has made the actions required of lawmakers more difficult and painful; further delay will make them more painful still.

The Bipartisan Policy Center's illustrative debt reduction blueprint shows how growth of debt could be slowed in the decades ahead, stabilizing debt to GDP at approximately 100 percent then slowly reducing it to below 60 percent of GDP by the end of the window. It would reduce debt by $87 trillion in FY 2054 compared to the Congressional Budget Office's March 2024 baseline. Our options would increase nominal GDP by $78 trillion over 30 years, 5 percent above baseline levels.

Mindful of the impact that tax increases and spending reductions can have on both economic growth and distributional effects, we choose debt reduction policies that will increase economic growth, provide stability for major programs and the tax code, and avoid disproportionate harm to low- and middle-income Americans. Some of these policies reduce revenues or increase spending, but they are more than offset with policies that reduce spending, grow the tax base, or reduce tax expenditures that benefit wealthy Americans. The blueprint reduces economic inequality by making targeted expansions to programs that disproportionately benefit low-income Americans, including Social Security, the Child Tax Credit (CTC), the Earned Income Tax Credit

(EITC), and Pell grants. We extend the 2017 tax law's lower marginal tax rates for the majority of taxpayers—preventing an increase in rates that could disincentivize work—and business tax provisions that would have a positive impact on job creation and wage growth, including full expensing for R&D and a 50 percent bonus depreciation allowance.

Any solutions to address the debt must be bipartisan, both to pass and to serve as good, durable policy. Our blueprint offers a template for lawmakers to compromise on the challenges they must address in the years ahead, including tax cut expirations in 2025 and the pending insolvency of Social Security and Medicare in the 2030s. Failure to break the gridlock will only further threaten economic growth and financial stability for the millions of Americans who most rely on support from government programs and services.

Spending

All spending provisions presented here are intended to be effective at the beginning of fiscal year 2025 (October 1, 2024) unless otherwise specified.

Medicare, Medicaid, and Other Federal Health Programs

Rising healthcare spending will continue to put enormous pressure on the federal budget in the years and decades ahead, particularly in the nation's two largest federal health programs, Medicare and Medicaid. BPC's blueprint includes robust changes to Medicare spending—particularly for improving competition within the Medicare Advantage (MA) program, and between Medicare Advantage and Traditional Medicare—that if successful should ease solvency concerns with the Medicare Hospital Insurance Trust Fund.

Our MA proposals would improve competitive bidding, modify the Centers for Medicare & Medicaid Services' risk-adjustment methodology within MA, and address improper MA payments. These proposals would address policymakers' concerns over higher spending for beneficiaries in the MA program than for those in Traditional Medicare. Adjusting this balance would lay the foundation for creating apples-to-apples competition between traditional Medicare and MA. This would allow beneficiaries to easily compare these coverage options based on a standard set of benefits, which would be an improved set of benefits for Traditional Medicare beneficiaries.

Social Security

Social Security, the single largest federal program, consumes 22 percent of the total federal budget—a proportion CBO projects will only increase in the coming years. But Social Security is also among the most effective and popular federal programs, enjoying overwhelming public support and lifting nearly 23 million Americans above the poverty line annually.

Our proposals, adapted from BPC's bipartisan Commission on Retirement Security and Personal Savings, would put the program on a fiscally sustainable path while also incentivizing workforce participation and bolstering support for retirees who rely most on Social Security. We accomplish this through a balanced package of cost reductions—including continuing to gradually increase the full retirement age, indexing cost-of-living adjustments to a more appropriate price index, and capping spousal benefits—and targeted benefit enhancements such as a more progressive benefit formula, a meaningful minimum benefit, and improved survivors benefits. We also implement provisions that update Social Security for the modern workforce, changing the benefit calculation to an annual-primary-insurance-amount formula ("mini-PIA"), and replacing the windfall elimination provision with a proportional benefit formula.

Defense and Nondefense Discretionary Spending

Discretionary spending still represents nearly 30 percent of the federal government's budget and we believe prudent limitations on its growth are appropriate. For both defense and nondefense discretionary spending, we limit growth to 1 percent per year for the next decade (FY 2025-2034) and then allow 2 percent growth per

year in the two decades after. Since we recognize the value in providing tangible budget options—rather than just a target growth factor—we suggest several discretionary spending reduction options that could be included in (rather than added on top of) the reductions needed to stay at or below the growth factors. In addition to these options, we encourage lawmakers to scrutinize opportunities to reduce duplication and overlap in federal programs.

Other Mandatory Spending

Outside of the major categories of mandatory spending, we make several meaningful modifications. We reduce crop insurance subsidies as outlined by the Congressional Budget Office, which should reduce benefits flowing to the highest-income policyholders. We also include a mix of reforms in the higher education arena, eliminating subsidized student loans while investing in the future workforce and in economic mobility through a matching grant to states and increased funding for Pell grants.

Revenues

All revenue proposals are intended to be effective at the beginning of calendar year 2026. We see the pending expiration of the 2017 tax cuts as an opportunity for lawmakers to gravitate towards a simpler, more progressive tax code that provides certainty for taxpayers and businesses and facilitates robust economic growth.

Individual Income Taxes

***Note**: All references to income thresholds are projected thresholds for the 2026 calendar year.*

Our framework extends the lower rates and thresholds from the Tax Cuts and Jobs Act (TCJA) for the bottom three tax brackets, preventing marginal tax rates from going up on single taxpayers making less than $105,750 and on joint filers making less than $211,500. We provide partial protection to taxpayers in the fourth bracket ($105,750 to $181,620 for single taxpayers in 2026, $211,500 to $363,240 for joint filers) by setting their top bracket at 26 percent, halfway between TCJA's 24 percent and the prior 28 percent. We modestly raise marginal rates for single/joint filers making more than $181,620/$363,240, by two percentage points over the TCJA setting for the fifth and sixth brackets (32 percent to 34 percent and 35 percent to 37 percent, respectively) and by three percentage points for the seventh and final bracket (37 percent to 40 percent). These changes in total reduce revenues by $1.6 trillion over 10 years and $7.8 trillion over 30 years from the current-law baseline.

We propose simplifying tax filing by: 1) extending TCJA's doubling of the standard deduction, 2) repealing all itemized deductions other than the charitable deduction and the medical expenses deduction, and converting the mortgage interest deduction (MID) into a nonrefundable credit, 3) extending TCJA's repeal of personal exemptions, 4) permanently repealing the individual alternative minimum tax (AMT), and 5) limiting the head of household filing status to unmarried taxpayers with a dependent under age 17.

We also propose a simplification to the taxation of long-term capital gains, with higher rates for high-income taxpayers but lower rates for low- and middle-income taxpayers. This raises revenues on net by $18 billion over 10 years and $115 billion over 30 years, roughly revenue-neutral when compared to the hundreds of trillions of dollars raised by the current tax code in the 30-year period. We explicitly align the end of the 0 percent capital gains threshold with the end of the second individual income threshold ($49,600 single/$99,200 joint) so that no households below those thresholds pay taxes on long-term capital gains. We reduce the 15 percent bracket to 12 percent for taxpayers in the third and fourth individual income brackets ($49,600 to $181,620 single/$99,200 to $363,240 joint). Taxpayers making above these thresholds would see a 22 percent maximum rate, compared to 20 percent maximum rate under current law.

Arguably our most significant reform to the taxation of high-income and/or high-wealth individuals, though, is repealing the exclusion of capital gains at death, commonly referred to as "step-up in basis." Repealing step-up in basis is a more administratively sound and legally ironclad method to increase taxes on high-income individuals than ideas like a wealth tax or a billionaire minimum tax. More importantly, it ends a tax benefit with little economic justification. This raises $217 billion over 10 years and $1.2 trillion over 30 years.

Payroll Taxes

We moderately increase both the rate and base of Social Security payroll taxes to help fully close the program's long-range deficit. Our plan increases the old-age, survivors, and disability insurance (OASDI) payroll tax rate by one percentage point (split evenly between employers and employees) over 10 years. This raises $500 billion over 10 years and $4.2 trillion over 30 years. The plan also expands the base of earnings subject to this tax by increasing the OASDI contribution and benefit base to $225,000 in equal amounts over four years and subsequently indexing increases to the average wage index plus 0.5 percentage points. This raises an additional $250 billion over 10 years and $2 trillion over 30 years. In addition, we expand the base of the 3.8 percent net investment income tax to include pass-through business income, raising nearly $300 billion over 10 years and $1.4 trillion over 30 years.

Corporate Income Taxes

We retain the 21 percent corporate income tax rate permanently modified by TCJA. Although we believe that broadening the corporate tax base could be a part of any comprehensive fiscal solution, the current rate has provided certainty and competitiveness gains to the country.

We retain the 30 percent of earnings before interest and taxes on business interest deductions but make permanent full and immediate R&D expensing and a 50 percent bonus depreciation allowance. We also repeal the corporate alternative minimum tax and broaden the tax base by requiring five-year amortization of advertising expenses and increasing taxes on U.S. multinationals' income earned abroad.

Our international tax changes are not designed to "soak" U.S. multinationals' foreign earned income. Rather, we seek to thread the needle of coming into compliance with the 2021 OECD/G20 global tax agreement and avoiding double taxation of U.S. companies while also not raising taxes on multinational income above what is needed for compliance purposes. We raise the global intangible low-taxed income (GILTI) rate from 10.5 percent to 15 percent, lower the foreign-derived intangible income (FDII) deduction so that the effective rate on FDII is also 15 percent (from current law 13.125 percent), and raise the base erosion and anti-abuse tax rate from 10 percent to 15 percent. We also expand GILTI's substance-based carveout from current law, allowing companies to carve out 5 percent of payroll and 5 percent of tangible assets (rather than 10 percent of tangible assets), eliminate GILTI's 20 percent foreign tax credit haircut, and allow carryforward of excess foreign tax credits in GILTI.

These changes, if enacted, allow the United States to adopt an Undertaxed Profits Rule under Pillar 2 of the global tax agreement. The combined corporate and international changes above raise revenues by $105 billion over 10 years and are exactly revenue neutral over 30 years.

Tax Expenditures

We make major modifications to two of the four largest itemized deductions: 1) repealing the state and local tax (SALT) deduction, and 2) converting the MID into a non-refundable 15 percent credit and capping allowable interest at $25,000 (indexed to inflation). These changes generally broaden the tax base, simplify tax filing and tax administration, and enhance the progressivity of the tax code.

We also include an option for limiting the tax exclusion for employer-sponsored health insurance (ESI)—among the largest in the tax code—and replacing it with a more sustainable approach. The new policy would limit the

ESI exclusion at a dollar amount equivalent to the 80th percentile of single and family ESI premiums, which we expect will reduce upward pressure on health insurance premiums in the years ahead. This limitation, which would only be applied to expensive plans purchased by higher-income individuals, raises revenues by nearly $600 billion over 10 years, and nearly $4.6 trillion over 30 years. This option stems from a package of reforms proposed by BPC's Future of Health Care initiative in 2020, though the score cited above only covers the limitation on the ESI exclusion and not other options in the Future of Health Care report. BPC supports devoting resources to improving coverage and affordability for consumers and finding additional offsets consistent with the overall objective of not worsening the fiscal outlook for the federal government.

We expand the CTC by indexing the base amount to inflation, providing a bonus credit for the youngest children (ages 0–3), making it fully refundable, enhancing the phase-in, and phasing the credit out for single/joint filers making more than $75,000/$150,000 (as opposed to $200,000/$400,000 under current law). We expand the EITC for childless workers only. And we make the Child and Dependent Care Tax Credit fully refundable so that this credit—the only one directed to parents for eligible child care expenses—reaches more low- and middle-income taxpayers. These credit expansions are targeted towards taxpayers who are most in need of additional support.

Other Sources

We increase gas and diesel taxes by nearly $0.15 per gallon, which will help shore up the Highway Trust Fund and fund infrastructure needs for years to come. We also extend supplemental IRS funding to ensure adequate resources for reducing the tax gap.

Finally, we enact comprehensive immigration reform, using bipartisan 2013 legislation that passed the Senate as a framework. While this is not a tax increase, it does raise significant revenue by providing a pathway to citizenship for millions of undocumented people currently living and working in the United States, allowing them to increase their taxable earnings. It also would expand legal immigration, particularly skilled immigration, which would have positive fiscal as well as GDP benefits by offsetting a projected slowing of labor force growth.

Conclusion

Our blueprint leads to declining debt-to-GDP ratios, falling from 99 percent in 2024 to 59 percent in FY 2054. We reduce deficits from 5.6 percent of GDP in FY 2024 to near zero, achieving surpluses in FY 2053 and FY 2054, by slowing the growth of spending, increasing revenues, and growing the economy through immigration reform and several initiatives to boost wages, GDP, and federal revenues.

None of the choices made in this blueprint are easy because Congress closed the door to those options long ago. However, our blueprint is capable of winning bipartisan support when presented as a comprehensive package of compromises between the two parties—a prerequisite to debt reduction efforts having a durable impact. The longer lawmakers wait to act, the less desirable choices they will face.

Percentage of GDP	2024	2034	2054
Revenues	17.5	19.0	20.7
Spending	23.1	21.6	20.4
Deficit (-) or Surplus	-5.6	-2.6	0.4
Debt Held by the Public	99.0	94.3	59.4