A CENTRIST AND PLAUSIBLE BLUEPRINT TO STABILIZE THE FEDERAL DEBT

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Introduction

In the past year, annual budget deficits doubled to $2 trillion and are headed towards $3 trillion a decade from now. Social Security and Medicare face a combined $124 trillion cash deficit over the next 30 years. The Congressional Budget Office (CBO) projects that the national debt will soar past 165 percent of GDP within three decades—or as high as 300 percent of GDP if interest rates remain elevated and Congress extends expiring policies. At that point, interest costs could consume half or even three-quarters of all federal tax revenues. Unless reforms are enacted, Washington's escalating borrowing demands will likely—at some point—overwhelm the capacity of financial markets to supply the required deluge of lending at plausible interest rates. When that event occurs, or even approaches, interest rates will soar, and the federal government may not be able to pay its bills, causing dire consequences for the U.S. economy.

Ultimately, addressing long-term budget deficits is impossible without fundamentally addressing Social Security and Medicare's cash shortfalls that are projected to leap from $650 billion this year to $2.2 trillion a decade from now, and are set to total $124 trillion over the next three decades (CBO projects the rest of the budget to be roughly balanced over three decades). Three decades from now, Social Security and Medicare are projected to collect 6.3 percent of GDP and cost 17.6 percent of GDP (including interest on the national debt). This is neither economically sustainable nor morally reasonable, especially when seniors comprise America's wealthiest age group.

That said, stabilizing the long-term debt around the current level of 100 percent of GDP—which will also stabilize interest costs and prevent a debt spiral—requires a broad and bipartisan range of policies. As policy, there is no single set of narrow reforms on the left or right that can plausibly close deficits of this magnitude. Politically, the controversial nature of such steep savings reforms requires bipartisan cover and a sense of shared sacrifice. A singular conservative or liberal solution would be too draconian and unpopular to be sustained. Both parties will have to hold hands and jump together.

Thus, the proposal presented here is intended to serve as the basis for bipartisan negotiations should lawmakers ever decide to stabilize the long-term debt. It is not a conservative or liberal fantasy scenario, or even the plan the author would design if no political constraints existed.

This budget blueprint works largely within the current structure of major policies, rather than proposing complete rewrites of major programs or the tax code. It divides reforms into four tiers and seeks maximum savings in a given tier before moving to the next:

- Tier 1: Squeeze out inefficiencies from the major health programs driving spending upward.
- Tier 2: Trim Social Security and Medicare benefits primarily for upper-income retirees.
- Tier 3: Trim other federal programs to the extent feasible on a bipartisan basis.
- Tier 4: Close the remaining gap with new taxes in the least damaging manner possible.

The blueprint also provides that: the lowest-income 40 percent of seniors are largely protected from Social Security and Medicare cuts (beyond raising the Social Security eligibility age); antipoverty caseloads and benefits are not reduced; parity is maintained between discretionary defense and nondefense spending; Washington's structural budget deficits are not passed on to the nation's governors; tax increases are kept within reasonable limits; and policy changes are phased in gradually, mostly beginning in 2026.

The blueprint presented would stabilize the long-term debt around the current level of 100 percent of GDP through 2040, after which the blueprint's compounding policy and interest savings would create a "virtuous cycle" that reduces the debt to 68 percent of GDP by 2054.

Spending

Medicare, Medicaid, and Other Federal Health Programs

Medicare. Medicare's spending, which is projected to soar from 3 percent to 5.4 percent of GDP over the next few decades, is the single largest driver of long-term budget deficits.

The first place to seek savings is by making Medicare more efficient. The largest efficiencies would come from implementing a premium support system for Medicare Parts A and B, much like the original Medicare Part D (the prescription-drug program), which cost far less than had been originally projected. Instead of the traditional Medicare system's one-size-fits-all model (which is slightly improved by the Medicare Advantage option), premium support creates a healthcare market where insurers must compete for retirees. This model has proved, in the case of Medicare Part D, to empower seniors, encourage innovation, and reduce premium growth. As applied to Medicare overall, this budget proposal's federal premium support payment would equal the average bid of all competing plans, all of which would be required to offer benefits at least actuarially equivalent to the current system. CBO estimates that premiums paid by retirees would fall by 7 percent, and the federal Medicare savings for affected beneficiaries would total 8 percent, by the fifth year. In short, premium support means more choices for seniors, no reduction in benefits, and substantial cost savings both for seniors and the federal government.

Past premium support proposals were criticized for tying the payment level to a variable such as inflation or economic growth that may not keep up with the rising cost of health plans—or tying the payment level to one of the lowest-bid plans, thus making it likely that seniors would pay more out-of-pocket for a typical plan. By contrast, the premium support proposal in this report is more generously set at the average local bid. No matter how much healthcare costs rise, the premium support payment would remain tied to the cost of the average plan.

Once Medicare has maximized its efficiency savings, the next step is to rebalance the responsibility for funding

Medicare Parts B and D. Currently, more than 90 percent of seniors are charged premiums that cover no more than 26 percent of the cost of their coverage. Taxpayers fund the rest. The federal subsidies for Medicare Parts B and D were not "earned" with earlier payroll taxes—which contribute only to Medicare Part A.

Senior premiums would gradually rise to cover 50 percent of Medicare Part B costs—matching the original program design—and 30 percent of Medicare Part D costs. The monthly premiums would rise on a sliding scale, based on current, post-retirement income. Retirees whose income is at or below the 40th percentile would see no premium hikes. However, the Part B monthly premium would increase between the 41st and 80th income percentile, until it reaches 95 percent of the cost of the insurance plans. The Part D monthly premium would gradually rise for those above the 40th percentile until it reaches 85 percent of the cost of coverage.

The cost of these higher premiums would be partially offset by efficiency gains from the premium support mechanism that should reduce the total cost of the Part B program. Once fully phased in, total Medicare premiums would rise by approximately 3 percent of aggregate senior income relative to the baseline.

Medicaid. Recent eligibility expansions and natural caseload increases have raised federal Medicaid spending from 1.3 percent to more than 2 percent of GDP since 2007—and spending is projected to reach 2.5 percent of GDP within 30 years. Achievable reforms can maintain Medicaid spending at 2 percent of GDP while improving the program.

Congress should first repeal the 90 percent long-term federal reimbursement rate for the newly eligible population of non-disabled, working-age adults with higher incomes that was implemented a decade ago. States should continue to be allowed to include these newly added adults in their Medicaid programs; but no rational explanation exists for Washington subsidizing non-disabled, higher-earning, working-age adults on Medicaid with a much higher reimbursement rate than children, the elderly, and the disabled.

Next, Congress should cap Washington's per-capita Medicaid payments to states beginning in 2026. The current system irrationally reimburses a preset percentage of state Medicaid costs, which means that the more a state spends, the larger its federal subsidy. The current system also restricts state innovation in healthcare. Per-capita caps would provide an incentive and added flexibility for states to devise innovative coverage for low-income residents. States developing successful approaches will certainly be copied by other states.

In keeping with the principle that deficit reduction should not simply dump the federal budget deficit onto states, the federal per-capita payments would grow by 3.5 percent annually for children and adults; and 4 percent annually for the elderly and disabled. This weighted average of 3.8 percent per-capita spending growth is not too far below the estimated 4.6 percent annual rate assumed in CBO's long-term budget baseline. Innovative governors should be able to stay under these more generous caps without raising state taxes or deeply limiting eligibility.

Social Security

The Social Security reforms are designed to achieve sustainable solvency by gradually reducing spending down to the system's long-term revenues of 4.5 percent of GDP, rather than allowing spending to rise to 5.9 percent of GDP. Because most tax increases are reserved to help finance the larger Medicare and interest costs, Social Security is reformed exclusively through spending reforms.

Essentially, these reforms would flatten Social Security benefits, shrinking the benefit gap between high- and low-earners. This would return Social Security to its original social insurance purpose of poverty protection, rather than distributing many of its largest benefits to high earners. The other effect is to ensure that average benefit levels grow roughly by price inflation over the long-term (slightly faster for low-earners, slightly lower for high-earners), ensuring parity across generations as well as long-term fiscal sustainability.

Specifically, the blueprint would gradually raise both the early and normal eligibility ages (currently 62 and rising to 67, respectively) by three months per year beginning in 2030, until they reach 64 and 69. Initial benefit levels would be indexed to price inflation rather than wage inflation, yet low-income seniors with a full work history would be protected with a new minimum benefit set at 125 percent of the federal poverty line.

From there, annual Social Security benefits would grow with the more accurate chained CPI. No cost-of-living adjustment (COLA) would be provided to seniors whose income in the previous year exceeded $100,000 (single) and $200,000 (married), a threshold that would adjust annually for inflation. Benefits for retirees and survivors would be based on 38 earning years rather than the current 35, the non-working spousal benefit would be reformed, and Social Security Disability Insurance would be improved.

Senior impacts. Well-off retirees will shoulder most of the costs of bringing Social Security and Medicare finances to a sustainable level. The wealthiest half of seniors often have income and net worth (even excluding illiquid home equity) that exceed those of young workers, while typically not having mortgage or child-raising expenses. The following 2035 impact figures are adjusted for inflation:

- Seniors with household incomes below the 40th percentile come out largely unchanged in Social Security (although the eligibility age rises), as well as Medicare.
- Senior households in the 41st–60th income percentile—with an average household income of $92,000 in 2035—would see a $2,700 reduction in annual Social Security benefits (relative to the growing baseline levels) and $2,800 in higher Medicare premiums.
- Senior households in the 61st–80th income percentile—with an inflation-adjusted average household income of $137,000 in 2035—would face $4,200 in lower-than-projected Social Security benefits and $7,300 in higher Medicare premiums.
- Retiree households in the 81st–90th income percentile—with average household incomes of $257,000 by 2035—would experience a decline in their projected Social Security benefits of $5,700 and a rise in Medicare premiums of $15,000.
- The highest-earning 10 percent of retiree households—with average household incomes of $478,000 by 2035—would experience a decline in their projected Social Security benefits of $7,400 and a rise in Medicare premiums of $5,700 before their premiums hit the maximum cost of the insurance.

Defense and Nondefense Discretionary

Following several years of large expansions, the blueprint freezes discretionary appropriations through 2025, and then caps its annual growth at 3.5 percent afterwards. Because that rate is slower than the projected nominal economic growth rate, total discretionary outlays would fall to 5.4 percent of GDP over three decades. With parity maintained between defense and nondefense spending, each would gradually fall to 2.7 percent of GDP. This would represent the smallest defense budget since the 1930s, and also gradually push nondefense appropriations below post-1960s levels.

Other Mandatory

Starting a decade from now, the blueprint would cap the growth of most of this spending at the inflation rate plus population growth. Veterans' income benefits would be exempt from this constraint. Additional reforms would extend the Inflation Reduction Act's tax enforcement funding after its scheduled 2031 expiration, reform student loans, pare back farm subsidies, hike Pension Benefit Guaranty Corporation premiums, extend the current mandatory spending sequester beyond 2031, and switch annual spending inflation adjustments to the more accurate chained CPI.

Revenues

Even after building the largest plausible package of spending savings for a bipartisan negotiation, it is simply not possible to stabilize the long-term debt with revenues remaining at 17 percent or 18 percent of GDP. This is especially true when most spending reform proposals—which are based on reduced annual growth rates—take a decade or more to ramp up their budget savings. Under this proposal, tax revenues would gradually rise to 20.3 percent of GDP by 2054.

Individual Income Taxes

This blueprint aims to include "tax the rich" policies that do not dramatically increase marginal tax rates. Thus, the 2017 tax cuts are extended—except for the 20 percent pass-through tax deduction (repealed), and the 37 percent top tax bracket (which would return to 39.6 percent). Additionally, high earners would have their itemized tax deductions capped at 15 percent of the amount deducted, their capital gains would become taxable after death, and the Inflation Reduction Act's tax enforcement spending would be made permanent.

Raising the 2.9 percent Medicare payroll tax rate by one percentage point is necessary because Medicare faces a 30-year cash shortfall of $49 trillion ($87 trillion including interest costs) that cannot be addressed on the spending side alone. This tax also ensures shared sacrifice on the tax side, while being still modest enough to avoid significant disruption to families and the economy.

The Social Security payroll tax would be eliminated at age 62 to promote hiring and assist those affected by the eligibility age adjustment.

Corporate Income Taxes

The energy tax preferences created in the Inflation Reduction Act have come in extraordinarily over budget and would be repealed. Also repealed would be the corporate state and local tax deduction, Low-income Housing Tax Credit, and Last-in First-out and Lower of Cost or Market inventory valuation methods. The expiring portions of the 2017 corporate tax reforms—which modernized the archaic and globally-uncompetitive corporate tax code at minimal cost—would be extended.

Tax Expenditures

The tax exclusion for employer-provided healthcare would be capped at 50 percent of the average premium. Within broader tax increases, capping the employer healthcare tax exclusion is both sound tax policy and sound health policy. Many economists agree that the employer health exclusion encourages businesses to overspend on health benefits and downplay cost-containment, while disproportionately benefitting upper-income employees who would otherwise pay higher tax rates on that compensation. It also penalizes families who buy their own health insurance and do not get a tax break. Capping the exclusion will contribute to broader efficiency savings in healthcare. It will also raise revenue not only from businesses paying the tax on generous health plans, but also from families receiving more of their compensation in the form of (taxable) wages—which still may result in higher take-home pay.

Also eliminated would be the American Opportunity Tax Credit, Lifetime Learning Credit (addressed in student aid reform), and the tax exemption for new qualified private activity bonds.

Other Sources

To reduce the shortfalls in the Highway Trust Fund, the federal gas tax—which has not been raised since 1993—would rise by 15 cents per gallon and then be indexed annually for inflation. Additionally, a modest carbon tax would have its revenues rebated back to all but the top-earning half of households.

Those who would prefer that all new taxes come from upper-income taxpayers should note that such families would already bear nearly the entire cost of 3 percent of GDP in Social Security and Medicare reforms—as well as most of the new taxes. The bottom-half of earners would see only a 1 percent payroll tax hike (which will help finance their own Medicare benefits), and a small gas tax increase (a user fee needed to close the shortfalls in the highway program)—plus the benefits of no Social Security payroll taxes beginning at age 62. Given the principle that everyone should contribute to closing these shortfalls, low earners are overwhelmingly shielded from new costs.

Conclusion

This blueprint has something for everyone to oppose. At first glance, many conservatives will assert that raising any taxes rather than eviscerating antipoverty and nondefense discretionary spending represents a weak-kneed surrender to big government.

In reality, it accepts that voters are not going to balance the budget on the backs of low-income families, social programs, and foreign aid. Nor will voters accept larger-than-necessary cuts to social and entitlement spending just to shield millionaires and corporations from contributing an additional dollar in taxes. The savings described above—focused mostly on health efficiencies and upper-income seniors—represent the ceiling of plausible spending savings, and produce 60 percent of this proposal's noninterest deficit reduction. As the baby boomers grow too old to absorb Social Security and Medicare reforms, the likely solutions will only become more tax-heavy the longer reform is delayed.

Many liberals will also dismiss even these modest versions of Medicare premium support and Medicaid per-capita caps, as well as income-relating of Social Security and Medicare benefits—especially with just 2.3 percent of GDP in new taxes compared to current policies.

However, the unforgiving math shows that it is simply not possible to raise more than 1 percent to 2 percent of GDP by taxing the rich, even if all economic considerations are ignored. Defense spending is already set to fall to 1930s levels, and Medicare-For-All would require large new taxes without reducing Medicare's current liabilities. Long-term spending must be significantly reduced, and starting with healthcare inefficiencies and benefits for wealthier seniors can minimize the cuts to low-income seniors, the safety net, and social spending. Furthermore, the alternative approach of closing Social Security's and Medicare's massive shortfalls with exorbitant taxes would leave no room to raise taxes down the road for other progressive goals such as climate, education, safety net, and infrastructure.

Virtually everyone will have preferred tweaks to this blueprint. However, it may provide a useful starting point for bipartisan negotiations because it avoids as many partisan "poison pills" as possible while still meeting its ambitious target of stabilizing the long-term debt at 100 percent of GDP. Every year of delay raises costs and thus requires even more expensive and drastic reforms. It is imperative that the White House and Congress begin a bipartisan process to stabilize the debt as soon as possible.

Percentage of GDP	2024	2034	2054
Revenues	17.5	18.8	20.3
Spending	23.3	22.3	19.6
Deficit (-) or Surplus	-5.8	-3.5	0.7
Debt Held by the Public	99.1	102.3	67.9