

The First Step

A Progressive Plan for Meaningful Deficit Reduction by 2015

Michael Ettlinger, Michael Linden, and Reece Rushing December 2010



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Introduction and summary

We can do this. Addressing the long-term federal budget deficit is a daunting challenge, no doubt, but it is not an insurmountable one. In this paper we offer plans to take the first big step toward a fiscally sound budget—the step needed to get the federal budget into primary balance in 2015. Bringing total government revenues to equal total government spending, with the exception of interest payments on the national debt, is achievable and would pave the way for a federal budget on a sustainable, responsible, path.

Getting to primary balance

The Center for American Progress previously published three other reports on federal budget deficits that point the way to this goal, and feature some of the means to reach it—details that are fully laid out in this report. In September 2009 we released Deal With It, in which we examined the descent from federal budget surpluses in the years 1998 through 2001 to a steady stream of deficits that, with the coming of the Great Recession, spiked upwards in 2009. We were not critical of the deficits of 2009, 2010, or the years that will immediately follow as we dig ourselves out of our economic hole. Instead, we looked with alarm at the longerterm deficit projections. It is those deficits of the future that are unsustainable and pose substantial risks.

In December of 2009, we released A Path to Balance, in which we suggested a framework for deliberate, steady progress toward fiscal balance. We called for an intermediate goal of primary balance. In February of this year, President Barack Obama signed an executive order establishing the National Commission on Fiscal Responsibility and Reform, and set out for them the goal of reaching primary balance by 2015 as well as a long-term goal of meaningful deficit reduction.

Then, in September this year, we published A Thousand Cuts: What Reducing the Federal Budget Through Large Spending Cuts Could Really Look Like. In this paper we launched into hitting the primary balance goal—which we estimate will require deficit reduction of \$255 billion in 2015. This estimate begins from the baseline of President Obama's most recent budget plan. If the various measures included in that plan to reduce the deficit, most notably the proposal to allow the Bush tax cuts to expire on income over \$250,000 for married couples (\$200,000 for singles), are not adopted, then the amount of deficit reduction needed to reach the goal will be even higher.

In A Thousand Cuts we offered an array of spending cut plans to achieve 33 percent, 50 percent, 67 percent, and 100 percent of the deficit reduction necessary to achieve primary balance. These correspond to \$85 billion, \$127 billion, \$170 billion, and \$255 billion in cuts. The goal was to find the spending cuts that we would implement if we had to hit those targets, while simultaneously trying to protect the most vulnerable Americans, continuing crucial economic investments, and adequately funding other national priorities—all while considering the reality that any deficit reduction will necessarily have to take into account a wide range of views on what our national spending priorities should be.

Cutting spending, raising taxes

Now we turn to the revenue side of the equation—offering revenue options that fill in the spending cut plans from A Thousand Cuts. In this paper we present five complete plans for hitting primary balance in 2015.

In A Thousand Cuts, not surprisingly, as the target level increased so did the draconian nature of the cuts. In the final plan, which would achieve primary balance through spending reductions alone, the cuts are quite widespread and very deep. They include a 40 percent cut to highway funding, a 20 percent reduction to immigration and customs enforcement and customs and border protection, a 40 percent cut to the Office of Safe and Drug-Free Schools, a 50 percent reduction to the Universal Service Fund that brings telecommunications services to rural and underserved areas, and close to \$100 billion in defense cuts.

These are not the sorts of cuts that the country would be able to absorb without real pain and significant adjustments. But these are exactly the kinds of cuts we will be forced to make if we try to achieve primary balance without generating any new revenue.

Thus the need for revenue. In this report we offer revenue-generating plans that will hit four deficit-reduction targets: 33 percent of the way to primary balance in 2015, then 50 percent, 67 percent, and 100 percent. The most far-reaching of the revenue plans, the 100 percent tax revenue option, relies on seven distinct tax increases. This plan would generate \$255 billion in new revenue by:

- Implementing a graduated surtax on adjusted gross income for households making more than half a million dollars per year
- Imposing a \$10 per barrel fee on imported oil
- Returning the estate tax to pre-Bush tax cut levels—a \$1 million exemption and a 55-percent rate
- Removing the cap on the employer side of the Social Security payroll tax
- Indexing the entire tax code to a better measure of inflation
- Increasing the top rate on capital gains and dividends
- Increasing the ordinary income tax rates on tax brackets between \$140,000 and \$380,000

Most of these revenue raisers drop out of the other plans we present in this paper as the revenue target decreases. The first to go are the ordinary income tax rate increases and the more robust estate tax. Then the new measure of inflation indexing and the capital gains rate increase drop out. Finally, in the 33 percent revenue plan, all we are left with is a small income surtax on adjusted gross income above \$1 million, and the elimination of the cap on the employer side of the payroll tax.

These tax revenue plans are the complements to those spending cut plans outlined in our previous report. Taken together, these are five separate tax and spending plans that would put the federal budget into primary balance in 2015. The major difference between them, of course, is the varying ratio of spending cuts to revenue increases. In the abstract, some might prefer a solution that is completely, or mostly, spending cuts. With the details laid out, however, such a course seems foolish and politically impossible. The other extreme, getting to primary balance solely with new revenue, is also a highly unlikely outcome.

In this paper we argue that, after balancing the needs of the country and the range of divergent views on the path forward, the 50-50 plan we offer represents the most reasonable compromise. Under this plan, spending would be 22.7 percent of GDP, down from 24.8 percent of GDP in fiscal year 2010, and revenue would be 19.8 percent of GDP, still lower than the 20.6 percent of GDP raised at the end of the Clinton administration.

We are *not* endorsing a 50-50 split for reaching primary balance as a matter of principle. What we are endorsing is our specific approach to doing so. A 50-50 proposal that decimated programs that help the neediest or promote economic growth, or raised taxes in ways that were unfair and discouraged productive investment could be worse than no plan at all.

In fact, we acknowledge that even the plan we endorse leaves the country with important unmet needs. We need to invest more, not less, in infrastructure, in domestically produced clean energy, and in education. But given the tight budget situation, it is going to be a constant struggle to make these needed investments.

Which is why, in addition to cutting spending and raising revenue, it is absolutely crucial that the government improve its efficiency so that it can do more with less. Government must embrace a culture of accountability and drive for greater public-sector productivity. Every dollar we save in improved government operations is a dollar we put to more productive use.

Any deficit reduction plan is a balancing act between spending cuts, tax increases, the needs of the nation, and the wide range of views on which of these are most important. This report offers five different balances for getting to the 2015 target of primary balance. We believe the 50-50 plan, accompanied by a crusade to deliver government services more efficiently and effectively, offers the best option.

Approaching the revenue question

Getting to primary balance in 2015 is going to take a mix of spending cuts and revenue increases. In our recent report, A Thousand Cuts, we described several plans for finding the spending cuts that would contribute to deficit reduction. This report will fill in the revenue side of the equation, and present five complete plans, each of which would get the budget into primary balance in 2015. Four of these five plans entail raising some amount of new revenue.

The amount of revenue needed, and the options available to raise it, are dependent on what we think the budget will look like in 2015. In approaching the question of how to raise the additional revenue, we began with President Obama's most recent budget proposal for the next decade as the foundation. This is not because we believe that the president's budget is a perfect predictor of the budget situation five years from now. On the contrary, it would be extraordinarily unlikely for the 2015 budget to look exactly as the president has proposed. But any attempt to achieve primary balance must start with some assumption of what the spending and tax situation will look like.

There are a variety of other projections of the 2015 budget that we might have used. The official Congressional Budget Office projection is one obvious possibility. The problem, however, is that because CBO is legally required to assume that nothing changes in current law, the picture of the 2015 budget that it presents is an extraordinarily unrealistic one. Under CBO's assumptions, for example, the entire raft of Bush tax cuts expire as scheduled, as do a whole host of other popular revenue-reducing provisions which have been, in recent years, routinely extended.

Or consider another unrealistic assumption in the official CBO projection. It must show that revenue from the alternative minimum tax, a tax code provision designed to limit the value of tax breaks for higher income earners, grows larger each year, affecting more and more people. But this is something Congress routinely prevents. As a result of these rules, the 2015 budget deficit in the official CBO projections looks to be in far better shape because of much higher revenues from the alternative minimum tax and expiration of the Bush tax cuts than it actually will be.

Conversely, we could start from a 2015 spending and tax landscape based on "current policy." This approach would assume that everything the federal government is doing now will stay the same going forward, such as a permanent extension of all the Bush tax cuts, which the president has ruled out. This assumption results in a projection of budget deficits that are much higher than they are likely to actually be.

The president's budget lies somewhere between these two approaches. President Obama's budget includes dozens of proposals, on both sides of the balance sheet, which would alter the federal deficit over the next five years compared to both current law and current policy. On the spending side, the president's budget includes a drawdown in military forces commensurate with the conclusion of the wars in Afghanistan and Iraq. He also proposes a three-year freeze on nonsecurity discretionary spending. The combined effect is to reduce total discretionary spending from about 9.5 percent of GDP in 2010 to just over 7 percent of GDP in 2015. The president's budget also includes a variety of smaller proposals that would reduce mandatory spending, such as reducing commodity payments to wealthy farmers and eliminating improper payments within the unemployment insurance program.

On the revenue side, the president's budget contains proposals that would increase revenue and decrease revenue. Revenue-constraining proposals include the permanent extension of the Bush tax cuts for 98 percent of all Americans, the estate tax at 2009 parameters, a permanent research and experimentation credit, as well as indexing the alternative minimum tax to inflation. Revenue-enhancing proposals include the expiration of the Bush bonus tax cuts on incomes over \$250,000, a limit on the value of itemized deductions for high earners, reforms to the way multinational corporations are taxed, repeal of the so called carried-interest loophole, and the elimination of tax subsidies to oil, gas, and coal companies.

Many of these proposals address longstanding problems with our tax code. Closing the carried-interest loophole, for example, which would make certain hedge fund and private equity fund managers pay the same tax rate on their income as everyone else. This would raise revenue and eliminate an unfair and unnecessary special preference. So, too, would finally eliminating the myriad of tax subsidies we provide to fossil-fuel companies that neither need nor deserve the assistance.

Similarly, the proposal to limit the value of itemized tax deductions at 28 percent is a good first step toward addressing the problem that the way deductions work provides more help for people at the top of the income ladder than they do for people in the middle or at the bottom. This proposal would also limit the fiscal damage that some of the largest deductions do to the federal budget.

Because we begin our deficit reduction from the starting point of president's budget, all of these policies—from the drawdown in Iraq and Afghanistan to the middle-class tax cuts to the multinational tax reforms—are implicitly included in every one of our plans. That's why you won't see any explicit discussion of the alternative minimum tax, for example, in our plans. We are assuming that the AMT has already been permanently indexed to inflation, as per the president's budget. In other words, anything that is already in the president's budget is also already in our plans. While our proposals do not hinge on exactly these measures being in place, other measures of equal value on the tax and spending sides would have to be substituted for primary balance to be achieved.

Another parameter for our analysis is a constraint we put on the revenue sources we considered. There are several important, and widely discussed tools for revenue raising that are neither in the president's budget nor in our plans. We did not include, for example, any large-scale new taxes like a value-added tax, a financial transactions tax, or a carbon tax. Nor do our plans amount to a vision of a comprehensive reform to either the individual income tax or the corporate income tax.

We eschewed these options not because they are bad ideas but because we sought to achieve primary balance within the broad confines of our current tax code. This is not to suggest that our current code is perfect or sufficient. Far from it. But it is important to realize that we actually can achieve our deficit goals with the basic tax structure we have now. Discussions of comprehensive tax reform are incredibly important. But they will not be quick, nor will they be easy. Our first steps in deficit reduction should not be dependent on the outcome of a larger discussion about tax reform.

Similarly, continued deliberations over new forms of taxation like a value-added tax or a financial transactions tax could yield beneficial results, but designing and imposing a major new tax will not be easy. Yes, these policies could raise a significant amount of new revenue—and in some cases in potentially efficient and desirable ways. Revenue estimates for a financial transaction tax are somewhat disputed, but a report from the Center for Economic and Policy Research estimates that a tax equivalent to a rate of 25 basis points on equities would generate between \$177 billion and \$354 billion. With respect to a value-added tax, recent estimates show that a 5 percent value-added tax could raise tax revenues equal to about 2 percent of GDP.3 In 2015, that translates to about \$360 billion, or more than enough to achieve primary balance all by itself.

Comprehensive reform and new taxes are worth considering carefully. But we need to move ahead with deficit-reduction as we consider them. Proposals for medium-term deficit reduction that hinge on achieving major broad tax reforms, or designing and imposing a major new tax, risk outright failure in achieving deficit reduction, or an out-of-whack result that overemphasizes spending cuts, in the event that these ambitious tax changes come up short of fruition. For a longer time horizon such proposals are reasonable—there's time to work things out. For a plan aimed at 2015 we have chosen not to assume that the barriers can be overcome.

Our revenue raisers

We now turn from those revenue levers that we did not pull to those we did. Each of the four primary balance plans that include new revenue makes varying use of a small number of revenue-raising policies. There are a total of seven different tools we use to raise the required revenue:

- Implementing a surtax on adjusted gross income for high-income households
- Modifying the cap on the employer side of the Social Security payroll tax
- Imposing a new fee on foreign oil imports
- Changing the indexing of the tax code
- Modifying the estate tax
- Changing the ordinary marginal income tax rates
- Changing the top rate on capital gains and dividends

Each of the plans draws on two or more of these, with only the 100 percent plan drawing on them all. So let's first examine each of these tools in turn.

Surtax on adjusted gross income for high-income households

Adjusted gross income, or AGI, is a taxpayer's total gross income—wages, interest, capital gains, and all other kinds of income—after certain above-the-line reductions are subtracted. Taxable income, the actual amount of income to which the current income tax rates are applied, comes from AGI after subtracting the personal exemption, and itemized or standard deductions. In other words, AGI is a broader measure of a person or household's income.

Overall for those with incomes greater than \$500,000, AGI is about 15 percent higher than the current measure of "taxable income." By imposing a high-income surtax on this broader measure of income, as we propose, the rate does not have to be as high to generate a given amount of revenue. It also prevents the use of many of the deductions that high-income people use to reduce their tax liability.

All four revenue plans apply some form of a surtax to AGI above various thresholds. This kind of tax would be very simple to calculate. Say we were to impose a 1 percent surtax on AGI above \$10 million. A taxpayer who had \$10.1 million in AGI would simply pay an additional \$1,000 in taxes: 1 percent multiplied by (10,100,000 minus 10,000,000) equals \$1,000. AGI is already part of the income tax calculation, so adding this surtax would not substantially increase complexity. Nor would it require more than a few extra lines on the income tax form.

In all of our plans, the AGI surtax is only applied to income above a very high threshold. The proposed surtaxes range from just 1 percent on AGI over \$1 million in the one-third revenue plan, to a graduated surtax on AGI starting with 2 percent on AGI over \$500,000 up to 7 percent on AGI above \$10 million in the all-revenue plan. In 2008, the latest year for which there is data available, only 0.6 percent of all tax returns had AGI above \$500,000, only 0.2 percent had AGI above \$1 million, and less than 0.01 percent had AGI over \$10 million.

We are proposing these surtaxes in the context of an economy in which the very wealthiest have fared extremely well. More than half of the nation's income goes to the richest 20 percent. From 2000 to 2007, real income for the wealthiest 1 percent increased by more than 20 percent while the real income for the median household declined. The well-to-do also appear to have weathered the storm of the Great Recession in good form. The wealthiest 5 percent of Americans enjoyed an overall increase in real income from 2008 to 2009, while the bottom 80 percent of Americans suffered a decline.

What we are proposing would only reduce after-tax income for the wealthiest by a very small portion of the enormous income increases that they have experienced in recent decades. 4

Nor would these increases, as some will claim, be damaging to the economy. There were several nails in the coffin of that argument even prior to the supply-side tax cut escapades of President George W. Bush. The results of his policies drove in the final ones. 5 That isn't to say, of course, there is no limit to taxing the wealthy above which it becomes harmful to the economy. That's why we have kept the highest top rate we propose—47 percent, combining both the ordinary tax rate with the AGI surtax—well within historic norms.

From 1982 through 1986, for example, the top tax rate on ordinary income was 50 percent. Before that, rates were even higher, averaging about 70 percent from the mid-1960s through the early 1980s. From 1951 through 1964 the top rate was 91 percent. These periods are inclusive, of course, of some of the periods where the country enjoyed its greatest economic success.

Given that the very well-off have fared so well it makes sense to ask more of them than the middle class and the poor in our first steps to deficit reduction.

Removing the cap on the employer side of the Social Security payroll tax

Currently, both employees and employers pay a 6.2 percent Social Security tax on payroll earnings, but only up to a limit. We estimate that in 2015, that limit will be about \$115,000.6 For workers who make more than this, employers and the employees themselves do not have to pay any Social Security tax on their earnings above the limit.

The cap on the payroll tax increases each year, with some exceptions, by the growth rate of overall average wages across our economy. As recently as the early 1980s, about 90 percent of all earnings were below the cap, and therefore subject to the tax. But since then, the pay for high-wage jobs increased much faster than for average-wage jobs. As a result, the share of total earnings subject to the cap fell substantially, to just 84 percent in 2008.7

All four of our revenue plans remove the limit on the employer side only of the payroll tax. This would mean that employers pay the 6.2 percent tax on the entire payroll of their employees, while employees would still pay the tax only on their earnings up to the original cap. This policy would raise approximately \$76 billion in 2015. Because this is revenue raised by the Social Security payroll tax, the money would go into the Social Security trust fund. This would both improve Social Security's finances and reduce the total public budget deficit. This proposal is part of a forthcoming Center for American Progress Social Security proposal.

Per-barrel fee on imports of foreign oil

In 2009, the United States imported about 4.3 billion barrels of crude oil and associated products. Imported crude oil made up about 64 percent of all the crude oil used in the country last year.8 Imposing a small fee on each barrel of imported oil and associated products would generate billions of dollars in revenue per year.

Doing so would also have the added benefit of discouraging the use of foreign oil. There are economic and security risks to relying on imports for nearly two-thirds of our country's oil needs, especially considering that one out of every five barrels of oil consumed in the United States comes from "dangerous or unstable" countries. Not only would a per-barrel fee on foreign oil imports improve the prospects of domestic energy production vis-à-vis foreign imports, helping us along the path toward energy independence, but by reducing imports of oil it would also reduce our overall trade imbalance.

Three out of the four revenue plans impose this kind of fee, with the size of the fee ranging from \$5 per barrel to \$10 per barrel. Currently, the price of a barrel of crude oil is around \$77. Over the past five years, the price has ranged from a low of \$31.76 to a high of \$134.44. The average, however, has been just under \$70.

Indexing of the tax code

There are several important aspects of the federal tax code that change each year based on the level of inflation, among them: the income thresholds for each tax bracket, the size of the standard deduction, phase-out points for various tax credits, to name just a few. But all of these tax-code calculations are based on a measure of inflation known as the CPI-U, which stands for Consumer Price Index for all Urban Consumers. CPI-U is not the best currently available measure of inflation. A better measure is called the chained CPI-U, which better accounts for the changing basket of goods that consumers purchase.

Switching to the chained CPI-U would result in slower increases to those aspects of the code that are indexed. The tax bracket thresholds, for example, would rise slower than they do now. The effect would be to slightly increase revenue over time, compared to the current policy of indexing according to the traditional measure.

This is a common sense reform. Even though it would raise taxes, relative to current law, on middle-income taxpayers, it wouldn't actually increase their taxes in real terms (after adjusting for inflation) because the alternative measure of inflation is actually a better measure. In other words, the "indexing" of the tax code for inflation would still serve the purpose it was originally designed to serve—preventing tax increases that are purely an artifact of inflation as incomes go up relative to fixed-dollar amounts in the tax code. What would stop happening is "over-indexing," which is effectively providing small, unintended, tax cuts every year as the tax brackets, exemptions, etc. are increased at a greater rate than true inflation.

Still, we only include it in our 100 and 67 percent revenue plans because, given the rapid escalation of incomes at the top and stagnant or falling incomes of the rest, this first step toward deficit reduction should focus any additional taxes on the best-off.

Estate tax

In addition to substantially reducing income taxes, especially for those at the top of the income ladder, the Bush tax cuts also dramatically reduced the federal estate tax. This reduction phased in over the course of several years, until finally in 2010, the estate tax disappeared altogether. If the Bush tax cuts expire, as scheduled, the estate tax will return next year at essentially 2001 levels, which means an exemption of \$1 million per person, and a rate of 55 percent.

President Obama in his budget proposes a much smaller version of the estate tax, with an exemption at \$3.5 million per person and a 45 percent rate. These were the 2009 parameters of the tax under the Bush plan. Because we begin with the president's budget as our foundation, we assume that this 2009 estate tax will be in place in 2015.

Lowering the exemption from \$3.5 million or raising the rate from 45 percent would, therefore, raise additional revenue compared to the president's budget. The 100 percent revenue plan returns the estate tax to its pre-Bush tax cuts level. The Tax Policy Center estimates that this change would leave 99.97 percent of all taxpayers completely unaffected. We employ this option only in the 100 percent revenue plan.

Top marginal tax rate on capital gains and dividends

Currently, the top marginal tax rate for long-term capital gains and dividends is 15 percent. This is the lowest rate since 1933. Low capital gains and dividends rates mainly benefit the very wealthy as the middle class has little in the way of taxable investment income. And we are only adjusting the top rate on capital gains and dividends, which further exempts most middle-class taxpayers from any impact. Most middle-class investment is in tax-preferred retirement or education vehicles, which are dealt with differently in the tax code.

At the end of this year, the capital gains rate is scheduled to return to it's pre-Bush tax cut level of 20 percent, and dividends will revert to being taxed as ordinary

income. The president's budget includes the expiration of the Bush rate on capital gains for those who make more than \$250,000, and also includes keeping the rate on qualified dividends tied to capital gains. This capital gains rate is quite low compared to the historical norm, and it would still be almost 20 points lower than the top rate on ordinary income. From 1987 through 1997, for example, the top rate on capital gains was 28 percent.

Two of the revenue plans increase the top marginal rate on capital gains and dividends. The two-thirds revenue plan includes a 2 percentage point increase, and the all revenue plan includes a 3 percentage point increase. All four plans would leave a substantial differential between capital gains tax rates and ordinary income tax rates.

Marginal ordinary income tax rates

Under the president's budget plan, the marginal income tax rates on ordinary income will stay the same as they are right now for 98 percent of all Americans. That is to say that the brackets will remain precisely where they are now for income up to \$250,000 (for married couples). The top two tax brackets will go from 33 percent and 35 percent this year to 36 percent and 39.6 percent next year, which would affect only the richest 2 percent of Americans.

Four out of the five complete plans offered here leave the ordinary marginal income tax rates right there. Note that these rates are wholly different from (though related to) the adjusted gross income surtax described above. The AGI surtax is a small tax applied to adjusted gross income above a certain threshold. Currently there is no AGI surtax in the tax code. The ordinary marginal income tax rates are the standard rates that all Americans pay on their taxable ordinary income each year. The 100 percent revenue plan does include small increases in these rates for income between about \$140,000 and \$380,000.

Five plans for achieving primary balance

What follows is a brief description of each of the five plans for getting \$255 billion in deficit reduction in 2015. For more information on the spending portion of each plan, refer to A Thousand Cuts. But it should be mentioned that our spending plans have changed somewhat since first publishing them several weeks ago. The most important change has to do with how federal programs are indexed to inflation.

There are dozens of federal programs, most notably Social Security, whose benefits rise automatically each year with inflation (so as to keep the benefits at a constant, real, value). We now include in all our spending plans savings from changing the inflation measure for all relevant federal programs to the more accurate chained CPI-U. We then use the resulting savings to reduce the cuts in some other areas.

In the pages that follow we will present the details of our spending and revenue plans based on these breakdowns:

- The 100 percent revenue plan
- The 67 percent revenue plan
- The 50 percent revenue plan
- The 33 percent revenue plan
- The 100 percent spending plan

As you'll see, we are methodical in our analysis but favor the 50-50 plan.

The 100 percent revenue plan

100 percent tax revenue increases, no spending cuts

The 100 percent revenue plan gets all the way to primary balance in 2015 without cutting a single dollar from the budget beyond what the president has proposed. It does so by imposing a 5 percent surtax on adjusted gross income starting at \$500,000, and then an additional 2 percentage points, for a total of 7 percent on AGI above \$5 million. As in all of our plans, we remove the cap on the employer side of the payroll tax. The per-barrel fee on imported oil is \$10, the estate tax is returned to 2001 levels, and the tax code is indexed to the chained CPI-U.

These five policies raise about \$230 billion. To get the final \$25 billion, this plan increases the marginal rate on taxable income between about \$140,000 and \$380,000 (the second and third highest brackets, currently), as well as the top rate on capital gains and dividends, by 3 percentage points.

Revenue

		Revenue generated
Adjusted gross income surtax		\$74.8
Adjusted gross income	Tax rate	
\$500,000-\$5,000,000	5.0%	
\$5,000,000+	7.0%	
Remove the cap on the employer side of the Social Security payroll tax		\$76.0
Per barrel tax on foreign oil imports	\$10.0	\$43.0
Top rate for capital gains and dividends	23%	\$13.8
Return estate tax to 2001 levels		\$28.0
Marginal income tax rates		\$11.1
Marginal taxable income	Change	
\$0-\$237,300	+3%	
\$237,300- \$382,650	+3%	
Index the tax code to chained CPI-U		\$8.1
Total new revenue		\$254.8

Source: Center for American Progress calculations based on data from the Congressional Budget Office, the Tax Policy Center, the U.S. Internal Revenue Service, and other sources.

The 67 percent revenue plan

67 percent revenue increases, 33 percent spending cutscuts

The two-thirds revenue, one-third spending cut plan generates \$170 billion in new revenue, and cuts \$85 billion from the budget. On the spending side, the savings come mainly from \$51 billion in defense cuts and \$18 billion in tax subsidy reductions. Another \$14 billion results from indexing all relevant federal programs to the chained CPI-U. The only nondefense discretionary cuts are to fossil-fuel research programs.

On the revenue side, this plan does not change any ordinary income tax rates. Nor does it restore the estate tax to higher levels, as the previous plan did. Its adjusted gross income surtax is lower, and more graduated, the per-barrel foreign oil fee is five dollars lower, and the top rate on capital gains and dividends goes up by only 2 percentage points. As with all our plans, the cap on the employer side of the social security payroll tax is lifted.

Revenue

		Revenue generated
Adjusted gross income surtax		\$55.0
Adjusted gross income	Tax rate	
\$500,000-\$1,000,000	2.0%	
\$1,000,000-\$5,000,000	4.0%	
\$5,000,000-\$10,000,000	6.0%	
\$10,000,000+	6.0%	
Remove the cap on the employer side of the Social Security payroll tax		\$76.0
Per barrel tax on foreign oil imports	\$5.0	\$21.5
Top rate for capital gains and dividends	22%	\$9.2
Index the tax code to chained CPI-U		\$8.1
Total revenue		\$169.8
Source: Center for American Progress calculations base	ed on data from	the Congressional Budget Office

the Tax Policy Center, the U.S. Internal Revenue Service, and other sources.

Spending

	Cuts in billions	% cut
Mandatory	\$15.4	
Social Security	\$10.5	1.2%
Federal employees and military pensions program	\$2.7	2.6%
Index all other relevant federal programs to chained CPI-U	\$1.4	N/A
Federal subsidies and other mandatory support for agriculture	\$0.8	5.0%
Tax expenditures	\$18.5	
Deduction for business meals and entertainment	\$10.0	100.0%
Exclusion of interest on life insurance savings	\$5.0	16.7%
Exemption of credit union income	\$1.0	100.0%
Capital gains treatment of certain income from sales of agricultural items	\$1.0	100.0%
Special Blue Cross/Blue Shield deduction	\$0.7	100.0%
Expensing of multiperiod timber growing costs	\$0.3	100.0%
Tax exemption of certain insurance companies owned by tax-exempt organizations	\$0.2	100.0%
Expensing of certain multiperiod agricultural production costs	\$0.1	100.0%
Capital gains treatment of certain timber income	\$0.1	100.0%
Expensing of certain capital outlays including fertilizer and feed	\$0.1	100.0%
Defense	\$51.1	5.7%
Overhead	\$25.0	
Military personnel stationed in Europe and Asia	\$12.0	
U.S. deployed strategic nuclear arsenal	\$5.5	
V-22 Osprey	\$1.9	
DDG-51 Arleigh Burke class destroyers	\$1.9	
CVN-80 aircraft carrier	\$1.5	
Littoral combat ships	\$1.4	
Missile defense programs	\$1.3	
Marine Corps expeditionary fighting vehicle	\$0.6	
Non-defense discretionary	\$0.5	
Energy supply programs	\$0.5	10.0%
Total spending cuts	\$85.5	

The 50 percent revenue plan

50 percent revenue increases, 50 percent spending cuts

The 50-50 plan gets to primary balance with just about as much new revenue as spending reductions. As with the previous plan, most of the spending cuts come from defense and tax subsidies. There are a number of additional cuts made in the nondefense discretionary area, with reductions to a larger swath of programs. Some notable additions to the cut list in this plan include ending the exception for certain landlords from so-called passive loss rules for \$25,000 of rental income losses, reforms to military compensation and health care, and slowing the growth of funding to immigration-related agencies.

As for revenue, this plan employs only three policy changes: an adjusted gross income surtax, the imported oil fee, and the change to the payroll tax. The surtax in this plan starts at 2 percent on AGI above \$1 million, and rises to 5 percent on AGI above \$10 million. The oil fee is \$5 per barrel.

Revenue

		Revenue generated
Adjusted gross income surtax		\$29.5
Adjusted gross income	Tax rate	
\$1,000,000-\$10,000,000	2.0%	
\$10,000,000+	5.0%	
Remove the cap on the employer side of the Social Security payroll tax		\$76.0
Per barrel tax on foreign oil imports	\$5.0	\$21.5
Total revenue		\$127.0

Source: Center for American Progress calculations based on data from the Congressional Budget Office, the Tax Policy Center, the U.S. Internal Revenue Service, and other sources.

THE 50 PERCENT REVENUE PLAN (CONTINUED)

Spending

	Cuts in billions	% cut
Mandatory	\$21.5	
Social Security	\$10.5	1.2%
Federal employees and military pensions program	\$2.7	2.6%
Index all other relevant federal programs to chained CPI-U	\$1.4	N/A
Federal subsidies and other mandatory support for agriculture	\$3.8	25.0%
Veterans' disability compensation	\$2.2	3.1%
Universal Service Fund	\$0.9	10.0%
Tax expenditures	\$35.1	
Deduction for business meals and entertainment	\$10.0	100.0%
Exclusion of interest on life insurance savings	\$5.0	16.7%
Exemption of credit union income	\$1.0	100.0%
Capital gains treatment of certain income from sales of agricultural items	\$1.0	100.0%
Special Blue Cross/Blue Shield deduction	\$0.7	100.0%
Expensing of multiperiod timber growing costs	\$0.3	100.0%
Tax exemption of certain insurance companies owned by tax-exempt organizations	\$0.2	100.0%
Expensing of certain multiperiod agricultural production costs	\$0.1	100.0%
Capital gains treatment of certain timber income	\$0.1	100.0%
Expensing of certain capital outlays including fertilizer and feed	\$0.1	100.0%
Exception from passive loss rules for \$25,000 of rental loss	\$13.0	100.0%
Exclusion of interest on private purpose bonds	\$3.6	25.0%
Defense	\$59.2	7.0%
Overhead	\$25.0	
Military personnel stationed in Europe and Asia	\$12.0	

Spending (continued)

Defense (contnued)		
U.S. deployed strategic nuclear arsenal	\$5.5	
V-22 Osprey	\$1.9	
DDG-51 Arleigh Burke class destroyers	\$1.9	
CVN-80 aircraft carrier	\$1.5	
Littoral combat ships	\$1.4	
Missile defense programs	\$1.3	
Marine Corps expeditionary fighting vehicle	\$0.6	
Military compensation	\$5.5	
Defense health program	\$3.0	
Non-defense discretionary	\$12.0	
Energy supply programs	\$1.1	20.0%
International security assistance	\$2.5	15.0%
Federal Highway Administration	\$2.1	5.0%
Immigration and Customs Enforcement	\$1.2	19.0%
Federal Aviation Administration	\$0.9	5.0%
National Institutes of Health	\$0.9	3.0%
International development and humanitarian assistance	\$0.9	2.4%
Customs and Border Protection	\$0.8	7.0%
National Aeronautics and Space Administration	\$0.6	3.0%
Bureau of Land Management	\$0.4	33.0%
Federal correctional activities	\$0.3	4.0%
Federal legistlative activities	\$0.2	5.0%
Courts of appeals, district courts, and other judicial services	\$0.1	2.0%
Legal activities and U.S. Marshals	\$0.1	2.0%
Total spending cuts	\$128.2	

The 33 percent revenue plan

33 percent revenue increases, 67 percent spending cuts

This plan generates \$86 billion in new revenue, and produces \$170 billion in savings from spending reductions. The additional \$43 billion (compared to the previous plan) comes from, among other cuts, greater reductions in agriculture subsidies, a more stringent limitation on the tax subsidy for so-called private purpose bonds, which are subsidized bonds for government approved private projects, a partial rollback in the growth of U.S. ground forces since the start of the Afghanistan and Iraq wars, a broad range of cuts to nondefense discretionary programs, and a general reduction on all other nondefense discretionary programs of 1 percent.

The revenue portion of this plan is comparatively light. It includes only the removal of the cap on the employer side of the Social Security payroll tax, and a 1 percent surtax on adjusted gross income above \$1 million. Together, these two policies raise close to \$86 billion.

Revenue

		Revenue generated
Adjusted gross income surtax		\$9.7
Adjusted gross income	Tax rate	
\$1,000,000+	1.0%	
Remove the cap on the employer side of the Social Security payroll tax		\$76.0
Total revenue		\$85.7
Source: Center for American Brogress calculations has		bha Caranasianal Budant Office

the Tax Policy Center, the U.S. Internal Revenue Service, and other sources.

Spending

	Cuts in billions	% cut
Mandatory	\$28.4	
Social Security	\$10.5	1.2%
Federal employees and military pensions program	\$2.7	2.6%
Index all other relevant federal programs to chained CPI-U	\$1.4	N/A
Federal subsidies and other mandatory support for agriculture	\$7.5	50.0%
Veterans' disability compensation	\$2.2	3.1%
Universal Service Fund	\$3.0	33.0%
Pell Grants and other mandatory support for higher education	\$1.0	2.5%
Tax expenditures	\$43.7	
Deduction for business meals and entertainment	\$10.0	100.0%
Exclusion of interest on life insurance savings	\$5.0	16.7%
Exemption of credit union income	\$1.0	100.0%
Capital gains treatment of certain income from sales of agricultural items	\$1.0	100.0%
Special Blue Cross/Blue Shield deduction	\$0.7	100.0%
Expensing of multiperiod timber growing costs	\$0.3	100.0%
Tax exemption of certain insurance companies owned by tax-exempt organizations	\$0.2	100.0%
Expensing of certain multiperiod agricultural production costs	\$0.1	100.0%
Capital gains treatment of certain timber income	\$0.1	100.0%
Expensing of certain capital outlays including fertilizer and feed	\$0.1	100.0%
Exception from passive loss rules for \$25000 of rental loss	\$13.0	100.0%
Exclusion of interest on private purpose bonds	\$12.2	85.0%

THE 33 PERCENT REVENUE PLAN (CONTINUED)

Spending (continued)

Defense	\$70.7	8.7%
Overhead	\$25.0	
Military personnel stationed in Europe and Asia	\$12.0	
U.S. deployed strategic nuclear arsenal	\$5.5	
V-22 Osprey	\$1.9	
DDG-51 Arleigh Burke class destroyers	\$1.9	
CVN-80 aircraft carrier	\$1.5	
Littoral combat ships	\$1.4	
Missile defense programs	\$1.3	
Marine Corps expeditionary fighting vehicle	\$0.6	
Military compensation	\$5.5	
Defense health program	\$3.0	
U.S ground forces	\$6.0	
Civilan personnel	\$5.5	
Non-defense discretionary	\$27.2	
Energy supply programs	\$1.1	20.0%
International security assistance	\$4.9	30.0%
Federal Highway Administration	\$4.2	10.0%
Immigration and Customs Enforcement	\$1.2	20.0%
Federal Aviation Administration	\$0.9	5.0%
National Institutes of Health	\$1.5	5.0%
International development and humanitarian assistance	\$2.0	5.5%
Customs and Border Protection	\$1.3	12.0%
National Aeronautics and Space Administration	\$0.9	5.0%
Bureau of Land Management	\$0.6	50.0%
Federal correctional activities	\$0.3	4.0%
Federal legistlative activities	\$0.4	10.0%

Spending (continued)

No. defense discussion (continued)		
Non-defense discretionary (continued)		
Courts of appeals, district courts, and other judicial services	\$0.1	2.0%
Legal activities and U.S. Marshals	\$0.1	2.0%
Forest Service	\$0.5	10.0%
Corps of Engineers-Civil Works	\$0.5	10.0%
Conduct of foreign affairs	\$0.4	2.5%
Office of Safe and Drug-Free Schools	\$0.4	20.0%
Office of Vocational and Adult Education	\$0.4	20.0%
National Park Service	\$0.3	10.0%
Federal Emergency Management Agency	\$0.3	3.5%
National Infrastructure Innovation and Finance Fund	\$0.2	5.0%
Agricultural Research and Services	\$0.2	4.0%
United States Fish and Wildlife Service	\$0.2	10.0%
Wildland Fire Management and other Department of Interior programs	\$0.1	10.0%
Natural Resources Conservation Service	\$0.1	10.0%
Foreign Information and Exchange Activities	\$0.1	5.0%
Minerals Management Service (equivalent)	\$0.02	10.0%
General reduction on all other non-defense discretionary spending	\$4.2	1.0%
Total spending cuts	\$170.7	

The 100 percent spending plan

No revenue increases, 100 percent spending cuts

The 100 percent spending plan delivers primary balance without raising any new revenue. It does so by cutting both widely and deeply. It includes \$95 billion in defense cuts, more than \$50 billion in savings from eliminating or reducing tax subsidies, and more than \$70 billion from non-defense discretionary programs, including a 2.5 percent reduction or more to every program in that category.

Spending

	Cuts in billions	% cut
Mandatory	\$35.6	
Social Security	\$10.5	1.2%
Federal employees and military pensions program	\$3.5	3.4%
Index all other relevant federal programs to chained CPI-U	\$1.4	N/A
Federal subsidies and other mandatory support for agriculture	\$11.3	75.0%
Veterans' disability compensation	\$2.2	3.1%
Universal Service Fund	\$4.6	50.0%
Pell Grants and other mandatory support for higher education	\$2.1	5.0%
Tax expenditures	\$52.6	
Deduction for business meals and entertainment	\$10.0	100.0%
Exclusion of interest on life insurance savings	\$5.0	16.7%
Exemption of credit union income	\$1.0	100.0%
Capital gains treatment of certain income from sales of agricultural items	\$1.0	100.0%
Special Blue Cross/Blue Shield deduction	\$0.7	100.0%
Expensing of multiperiod timber growing costs	\$0.3	100.0%

Spending (continued)

Tax expenditures (continued)		
Tax exemption of certain insurance companies owned by tax-exempt organizations	\$0.2	100.0%
Expensing of certain multiperiod agricultural production costs	\$0.1	100.0%
Capital gains treatment of certain timber income	\$0.1	100.0%
Expensing of certain capital outlays including fertilizer and feed	\$0.1	100.0%
Exception from passive loss rules for \$25000 of rental loss	\$13.0	100.0%
Exclusion of interest on private purpose bonds	\$14.3	100.0%
Exclusion of interest on public purpose state and local bonds	\$6.0	14.7%
Empowerment zones and renewal communities	\$0.7	100.0%
Defense	\$95.7	12.5%
Overhead	\$25.0	
Military personnel stationed in Europe and Asia	\$12.0	
U.S. deployed strategic nuclear arsenal	\$11.4	
V-22 Osprey	\$1.9	
DDG-51 Arleigh Burke class destroyers	\$1.9	
CVN-80 aircraft carrier	\$1.5	
Littoral combat ships	\$1.4	
Missile defense programs	\$1.3	
Marine Corps expeditionary fighting vehicle	\$0.6	
Military compensation	\$5.5	
Defense health program	\$6.0	
U.S ground forces	\$12.1	
Civilan personnel	\$8.0	
F-35 Joint Strike Fighter	\$4.7	
Virginia class submarines	\$2.8	

THE 100 PERCENT SPENDING PLAN (CONTINUED)

Spending (continued)

Non-defense discretionary	\$71.1	
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Energy supply programs	\$2.7	50.0%
International security assistance	\$8.2	50.0%
Federal Highway Administration	\$16.9	40.0%
Immigration and Customs Enforcement	\$1.2	20.0%
Federal Aviation Administration	\$2.7	15.0%
National Institutes of Health	\$2.4	8.0%
International development and humanitarian assistance	\$5.7	15.6%
Customs and Border Protection	\$2.2	20.0%
National Aeronautics and Space Administration	\$1.9	10.0%
Bureau of Land Management	\$1.1	100.0%
Federal correctional activities	\$0.6	8.0%
Federal legistlative activities	\$0.5	11.6%
Courts of appeals, district courts, and other judicial services	\$0.3	5.0%
Legal activities and U.S. Marshals	\$0.2	5.0%
Forest Service	\$1.5	30.0%
Corps of Engineers-Civil Works	\$0.7	15.0%
Conduct of foreign affairs	\$2.6	15.5%
Office of Safe and Drug-Free Schools	\$0.8	40.0%
Office of Vocational and Adult Education	\$0.7	40.0%
National Park Service	\$0.5	15.0%
Federal Emergency Management Agency	\$0.6	7.0%
National Infrastructure Innovation and Finance Fund	\$1.4	30.0%
Agricultural Research and Services	\$0.4	8.0%
United States Fish and Wildlife Service	\$0.5	30.0%
Wildland Fire Management and other Department of Interior programs	\$0.3	30.0%
Natural Resources Conservation Service	\$0.3	30.0%

Spending (continued)

Non-defense discretionary (continued)		
Foreign Information and Exchange Activities	\$0.2	15.0%
Minerals Management Service (equivalent)	\$0.1	30.0%
Research and general education aids	\$1.6	41.4%
Office of Innovation and Improvement	\$0.7	10.0%
Environmental Protection Agency	\$0.5	5.0%
Federal aid to the District of Columbia	\$0.4	50.0%
Office of Federal Student Aid	\$0.3	10.0%
Office of Postsecondary Education	\$0.2	10.0%
Corporation for National and Community Service	\$0.2	10.0%
Rural Utilities Service and Rural Development	\$0.2	20.0%
Federal Bureau of Investigation	\$0.2	5.0%
Economic Development Administration	\$0.1	50.0%
Rural Business Cooperative Service and other small agencies	\$0.1	50.0%
Drug Enforcement Administration	\$0.1	5.0%
Departmental Management and Operations	\$0.1	5.0%
United States Secret Service	\$0.1	5.0%
United States Geological Survey	\$0.1	5.0%
Bureau of Alcohol, Tobacco, Firearms, and Explosives	\$0.1	5.0%
General reduction on all other non-defense discretionary spending	\$8.7	2.5%
Total spending cuts	\$254.9	

Source: Center for American Progress calculations based on data from the Congressional Budget Office, the Tax Policy Center, the U.S. Internal Revenue Service, and other sources.

Picking a path

Each of the above five plans would achieve the same goal: primary balance in 2015. But they achieve it in very different ways, with some cutting spending more heavily, and others relying more on revenue increases.

These are the tradeoffs that we must confront. If we want to actually reach primary balance in 2015 then we will need to actually raise new revenue. Pretending that tax cuts result in higher revenue doesn't count. And pretending that "waste, fraud, and abuse" will get us there doesn't count either.

It's also important to get specific. Abstract spending caps might sound good, but without specifics it's not real because there's no way to assess whether a plan is politically feasible or economically and socially advisable. It would be a dereliction of duty for lawmakers to impose broad limits without honestly reckoning with the challenges that any deficit reduction plan will eventually face. That is why we sought to be as specific as possible in each plan, to illustrate clearly the choices we have before us.

The 100 percent spending plan would entail some very significant and painful cuts to services, programs, and benefits that the American people rely upon and would miss when they were gone or reduced. By contrast the 100 percent revenue plan includes no spending cuts, but it would clearly mean higher taxes for people making more than about \$100,000.

Neither of these extremes is politically possible. Notwithstanding pontification to the contrary, there are not enough votes in Congress to actually cut \$255 billion in spending from the budget when it gets down to specifics. Nor are there votes for that size of a tax increase.

After considering the options, the consequences, and the politics, we believe the most reasonable plan is in the middle: a 50-50 split between new revenue and spending cuts. This is not because it's in the middle. A 50-50 plan could be a terrible plan. But we believe that, balancing out the realities we face and the needs of the country, the 50-50 plan presented here is the best of these options. It reduces the size of government below projections but would generally spare spending that supports economic growth and protects the most vulnerable, the tax increases are modest relative to the size of the economy, and the policies are within the realm of political possibility.

The 50-50 plan in more detail

On the spending side, we index all relevant federal programs (including Social Security) to the chained CPI-U. This would reduce spending in 2015 by more than \$15 billion. We would cut agriculture subsidies, something experts from across the political spectrum repeatedly point to as being wasteful, by 25 percent.¹⁰ We would also eliminate about \$35 billion worth of corporate subsidies and other spending that is delivered through the tax code, including ending targeted subsidies to agribusiness and some types of insurance companies.

The 50 percent plan cuts defense spending by 7 percent from currently projected 2015 levels under the president's budget plan. It does so mainly by redirecting planned efficiency gains into deficit reduction, reducing the number of military personnel stationed in Europe and Asia, reforming military compensation and health care and reducing procurement of certain weapons systems. All together, the plan includes about \$60 billion in defense cuts.

We should mention that the Center for American Progress, in our recent report Strong and Sustainable: How to Reduce Military Spending While Keeping Our Nation Safe, identified almost \$110 billion in potential defense cuts that would make the nation stronger and our defense more sustainable The \$60 billion here already represents a compromise between our enthusiasm for the cuts in that report and a desire to not count on so much being cut from a single area with a powerful constituency.

Finally, on the spending side of the balance sheet, the 50 percent plan includes about \$12 billion in nondefense discretionary cuts. These are drawn mainly from eliminating certain fossil-fuel research expenditures, holding down the growth in spending on immigration-related agencies, and reductions in the budgets for the Federal Highway Administration, the National Institutes of Health, NASA, and the Federal Aviation Commission.

Together, all of these cuts produce about \$128 billion in savings for 2015. That leaves about \$127 billion to find in new revenue to get all the way to primary balance.

We generate that new revenue in three ways. First, we remove the cap on the employer side of the social security payroll tax. This produces about \$76 billion in 2015. Second, we impose a new fee of \$5 per barrel on foreign oil imports. Assuming the levels of foreign oil imports remain roughly similar to 2009 levels, this fee would raise around \$22 billion. Finally, we apply a new surtax of 2 percent to adjusted gross income above \$1 million, and an additional 3 percent to adjusted gross income above \$10 million. Together, the AGI surtax would raise around \$29 billion.

We do not pretend that this plan is perfect. In an ideal world, we would rather not cut certain programs that this plan would cut, among them highway funding, the NIH budget, and investments in aviation infrastructure. But we believe that the 50-50 plan presented here is a fair balance. It would reduce the overall size of government but would generally spare those services and programs that most boost economic growth and protect the most vulnerable. Spending under the 50-50 plan would decline from 24.8 percent of GDP in 2010, to 22.7 percent of GDP in 2015.

The plan would raise only a relatively small amount of additional revenue. In fact, the revenue proposals outlined here would generate just 0.7 percent of GDP in new revenue. All together, after implementing this plan, federal revenue would be just 19.8 percent of GDP in revenue. Though higher than it was during the Bush administration, 19.8 percent would still be almost a full percentage point lower than the revenue level was, as a share of GDP, at the end of the Clinton administration when the budget was in surplus.

What isn't in our 50-50 plan

There are a number of proposals that keen-eyed observers will note are absent from our plans. Health care savings for one. We discuss this in A Thousand Cuts, but the short version is that the Affordable Care Act needs to be given a chance to work. If aggressively implemented it will reduce costs substantially—at levels even above the official scorekeeping. But for our purposes we don't believe substantial additional savings beyond what's in the president's budget can be responsibly gained by 2015.

Also missing are broad, cross-agency initiatives such as pay freezes, hiring cutbacks, efficiency commissions, and the like. Specifically with-respect-to pay freezes and mass reductions in the numbers of federal employees, we view these instruments as far too crude for responsible reduction of federal spending. Some departments of the government certainly are overstaffed but some are understaffed. Some federal workers make too much and some too little. The federal government, in short, is like any other large institution or corporation in this regard—although undoubtedly less nimble than most at correcting problems.

Creating a dynamic in which all the functions of government are hurt indiscriminately and identically without serious examination is the wrong way to approach the problem. There is a need for the federal government to undertake a thorough examination of its management practices, and such an examination should come first, before drastic steps are taken. That, however, will take time. With primary balance in 2015 as our goal, we focus on cutting what the public can most do without instead of employing such broad brush approaches.

We are optimistic that much can be gained by improving government efficiency across a broad range of activities, but realistic about the challenges we face in realizing these gains. So rather than have deficit reduction hang on such improvements, we have for the most part not counted on them for achieving primary balance in 2015. If efficiency gains are achieved, there is no shortage of ways to use savings.

Government efficiency for needed public investment

Improved government performance is key

If President Obama and Congress adopt, and then aggressively implement, the 50-50 plan presented here, they will achieve primary balance, stabilize the debt-to-GDP ratio, and move the federal budget decisively onto a more sustainable path. But it will be just the beginning. Even if they are successful, the country will still have to face up to the fact that the country will still have enormous needs that call out for more, not less, investment.

We will still need to transition from a 20th century energy policy into a 21st century one. We will still need to upgrade our crumbling infrastructure, and the cost of doing so has recently been estimated at \$2.2 trillion.11 We will still need to invest more in educating our children. And we will still need to care for an aging population.

That is why it is absolutely crucial for the government to improve the way it does business. We can save billions by improving the way government performs routine tasks, such as benefit payments and contracting, and making better use of information technologies. These operational savings can then be used to further pay down the deficit and to reinvest toward meeting the existing needs of the country.

The Social Security Administration last year mistakenly issued 89,000 stimulus checks of \$250 to dead or incarcerated people, the agency's inspector general reported in September. Federal prosecutors two weeks later charged a network of Armenian gangsters and their associates with cheating Medicare out of \$163 million, the largest alleged fraud by one criminal enterprise in the program's 45-year history. These alarming reports of improper federal payments—a \$110 billion problem in 2009 alone—underscore the need for action and highlight the large savings that are possible.

The White House has set an ambitious goal of reducing improper payments by at least \$50 billion by 2012. President Obama issued Executive Order 13520

in November 2009 directing federal agencies to take specific actions to reduce improper payments. And in July, he signed into law the Improper Payment Elimination and Recovery Act, which gives agencies new tools to address the problem. "Agencies are making progress toward achieving their reduction targets," Federal Chief Performance Officer Jeffrey Zients reported in a September memo to senior executive officials. "For example, the United States Department of Agriculture announced this summer a reduction in the Supplemental Nutrition Assistance Program's payment error rate to an all-time low in 2009, avoiding more than \$300 million in improper payments."12

Better use of information technology is another key part of streamlining the federal government and combating waste. The website Recovery.gov, which provides the ability to track funds disbursed under the American Reinvestment and Recovery Act of 2009, shows this potential. Fraud complaints have been filed on less than 2 percent of recovery contracts and grants; typically, complaints are filed on 5 to 7 percent of projects. Because of this, costs have also been lower than expected, allowing the administration to fund an additional 3,000 projects. The Recovery.gov model could certainly be expanded for other purposes.

Information technology can also help close the roughly \$300 billion "tax gap," or the amount of federal taxes that go unpaid every year due to noncompliance. The Internal Revenue Service could incorporate nontax databases to identify noncompliant taxpayers, as recommended by the Government Accountability Office and the Treasury Department's inspector general.¹³

Government contracting is another area where large savings are possible. The Obama administration is committed to reduce the annual cost of federal contracting by \$40 billion a year by 2011. The Center for American Progress recently released a savings estimate that confirms this number is possible. ¹⁴ To reach its goal, the administration has reigned in no-bid contracts, promoted competition, and increased oversight and public transparency.

Some contract bids are now submitted through an eBay-like tool that encourages contractors to underbid their competition. The Obama administration also created a public web site called the IT Dashboard that tracks the progress of IT contracts. Federal agencies have achieved \$19 billion in savings through these and other reforms, according to the Office of Management and Budget. The Veterans Administration, for one, identified \$200 million in overdue or over-budget projects using the IT Dashboard.

The federal government now spends about \$76 billion a year on information technology. Yet government fails to realize the dramatic productivity gains seen in the private sector. Billions of dollars have been wasted on ill-conceived and poorly executed IT contracts. Recognizing this, the Obama administration halted \$20 billion worth of IT projects involving financial management, and began a review of other struggling IT projects worth \$15 billion to see whether they should continue or be revised. The administration's Chief Information Officer, Vivek Kundra, also conducts regular "TechStat" reviews of other IT projects to make sure they are on time and on budget and deliver what government needs.

The administration has also moved to coordinate IT purchasing to obtain lower prices. The website Apps.gov was created to provide commonly used software to agencies at pre-negotiated rates. Multiple agencies no longer have to negotiate multiple purchases for this software and the federal government can better leverage its buying power as a bulk purchaser. Similar steps are being taken within agencies to coordinate IT purchasing. The Department of Homeland Security projects \$87.5 million in savings by using the same software agency-wide.

Cloud computing provides another way to break down barriers across federal agencies and achieve savings. There are about 1,100 data centers across the federal government, each comprised of expensive server units that consume large amounts of electricity. Cloud computing allows separate servers such as these to be networked together to form a shared "cloud." This would allow government to reduce the total number of data centers, electricity, and storage facilities it now requires. The British government predicts it could cut its IT budget by 20 percent by adopting cloud computing and other related IT improvements. The U.S. government would save \$16 billion a year if it could do the same. 15 The Obama administration announced in September 2009 an initiative to begin the transition to cloud computing.

There are also opportunities to reduce overhead associated with information collection and service delivery. Online forms and other information-gathering tools, such as health care IT, environmental sensors, and satellite technologies, can replace paper reporting and reduce the need for data entry and person-to-person service.¹⁶ "There are more than 10,000 government forms in 173 different agencies that could be automated to allow citizens and businesses to conduct their business with government online," according to the IBM Center for the Business of Government. "Reducing the citizen-related field operations of the federal government and automating the government's form processing could generate \$30 billion." ¹⁷

Successfully implementing these and other cost-saving measures is of vital importance as we move into austere times. The challenge is that achieving these efficiencies requires sustained dedicated leadership in a major effort to fundamentally change the way government operates on a day-to-day basis. Such things are not, in their nature, to be counted on in official projections of budget deficits. For this reason, we do not count on these things for addressing our fiscal challenge. Instead, we reserve these savings for the unmet needs our country faces even at current levels of spending—let alone the levels to be found as deficit reduction takes hold. In this way, we can get deficits under control while still beginning to address all of our national priorities.

Conclusion

Getting to primary balance

The projected budget deficits of the next decade are not the only problem that the country immediately faces. Persistent unemployment, rising poverty, climate change, keeping the country and Americans safe around the world—these are all pressing challenges, some with the threat more imminent than that posed by budget deficits and, arguably, some more important. But gaining control over our long-term fiscal path is intertwined with all the issues the nation faces. Short-term deficits may be necessary to address some of these challenges, but long-term deficits will be a hindrance that will undermine the long-term economic success that underpins everything we hope to achieve.

Getting the budget onto a more sustainable path is a vital task that we must start to engage. The cure, however, should not be worse than the disease. Deficit cutting is not merely an exercise in making various numbers add up. These budget balancing efforts, whether cutting spending or raising revenue, have real-world consequences. And when trying to achieve primary balance in 2015, we ignore them only at our collective peril.

That is why we sought to provide concrete plans, so that the public and policymakers could clearly confront the trade-offs that will affect every American family and every American business. Each of the plans offered here would get us to primary balance in 2015, but that does not mean that each plan is equal in virtue.

Cutting \$255 billion from the budget without a single new dollar in revenue, even if done with great care, would mean severe cuts to popular, beneficial services and programs. Raising \$255 billion in new revenue, without a single dollar in spending cuts while economically achievable is equally untenable. After much deliberation and after taking these kinds of trade-offs head on, we have determined that a 50-50 split between spending cuts and revenue increases makes the most sense, both substantively and politically.

Even with a viable plan in hand, the task ahead will be difficult. There will be those who seek to protect their one little slice of the federal pie to the exclusion of all else. There will be those who scream to the high heavens that even with all the evidence to the contrary one more dollar of taxes on rich people will cause economic ruin. And there will be no shortage of political opportunists whose only goal is to derail the process in the service of their ambitions. But even with all that, we can do it. There are avenues of progress available to us. We only have to choose to travel them.

Endnotes

- 1 Because these deductions reduce taxable income rather than directly reducing tax liability, their actual benefit depends directly on the applicable tax rate. So, for example, if a taxpayer in the top tax bracket gets to deduct one dollar from his income, he saves 35 cents in taxes (the current top rate is 35 percent). If a taxpayer in the bottom bracket wants to deduct the same dollar, it ends up being worth only 10 cents to him (the bottom bracket is 10 percent).
- 2 Dean Baker and others, "The Potential Revenue from Financial Transactions Taxes" (Washington: Center for Economic and Policy Research, 2009).
- 3 See, for example, Eric Toder, Joseph Rosenberg, "Effects of Imposing a Value-Added Tax to Replace Payroll Taxes or Corporate Taxes" (Washington: Tax Policy Center, 2010).
- 4 Michael Ettlinger, "The Wealthy Don't Need Tax Cuts," (Washington: Center for American Progress, November 15, 2010).
- 5 Michael Ettlinger and John S. Irons, "Take a Walk on the Supply Side: Tax Cuts on Profits, Savings, and the Wealthy Fail to Spur Economic Growth" (Washington: Center for American Progress, 2008).
- 6 The cap on taxable earnings rises each year by the growth rate of average wages. In years in which inflation is very low, however, the cap is frozen until the inflation measure, CPI-W, recovers to its highest point before the decline. Because inflation has been extremely low recently, the Congressional Budget Office projects that the Social Security payroll tax cap will stay at its current level of \$106,800 through 2013. Our calculation of the 2015 cap is based on CBO's assumptions of wage growth in 2014 and 2015.
- 7 U.S. Social Security Administration Office of Retirement and Disability Policy, "Annual Statistical Supplement, 2009, Table 4.B1" available at http://www.ssa.gov/policy/docs/statcomps/ supplement/2009/4b.html#table4.b1.
- 8 U.S. Energy Information Administration XXX NEED MORE XXX
- 9 Distributional analysis of the incremental effects of allowing the 2001 and 2003 tax cuts to sunset, compared to current policy. Tax Policy Center, "Incremental Effects of Allowing the 2001 and 2003 Tax Cuts to Sunset Maintain Current Law Estate Tax Distribution of Federal Tax Change by Cash Income Percentile, 2012" (2010), available at http://taxpolicycenter.org/numbers/displayatab.cfm?DocID= 2753&topic2ID=60&topic3ID=66&DocTypeID=2.

- 10 Brian Riedl, "How Farm Subsidies Harm Taxpayers, Consumers and Farmers, Too" (Washington: The Heritage Foundation, 2007).
- 11 American Society of Civil Engineers, "2009 Report Card for America's Infrastructure" available at: http://www.infrastructurereportcard. org/sites/default/files/RC2009_full_report.pdf.
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- 13 See Government Accountability Office, "IRS Has Modernized Its Business Nonfiler Program but Could Benefit from More Evaluation and Use of Third-Party Data" (2010); Treasury Inspector General for Tax Administration (TIGTA), "Better Use of Available Third-Party Data Could Identify and Prevent More Than One Billion Dollars in Potentially Erroneous Refunds" (2010).
- 14 Raj Sharma, "A \$400 Billion Opportunity" (Washington: Center for American Progress, 2010).
- 15 Ian Millhiser, "Improving Government Efficiency," (Washington: Center for American Progress, 2010), available at http://www.americanprogress.org/issues/2010/03/improving_efficiency.html.
- 16 See Daniel C. Esty and Reece Rushing, "Governing by the Numbers: The Promise of Data-Driven Policymaking in the Information Age" (Washington: Center for American Progress, 2007), available at http://www.americanprogress.org/issues/2007/04/data_driven policy.html.
- 17 Charles L. Prow, Debra Crammer Hines, Daniel B. Prieto, "Strategies to Cut Costs and Improve Performance" (Washington: IBM Center for the Business of Government), available at http://www.businessofgovernment.org/report/strategies-cut-costs-and-improveperformance.

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