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COOPER-LATOURETTE BUDGET SIGNIFICANTLY TO THE RIGHT OF SIMPSON-BOWLES PLAN

Proposes Much Smaller Tax Increases, Smaller Defense Cuts, and Deeper Domestic Cuts than Original Simpson-Bowles

by Robert Greenstein

Reps. Jim Cooper (D-TN) and Steven LaTourette (R-OH) unveiled a budget plan on March 27 that they call the "Simpson-Bowles Budget." It departs significantly, however, from the Simpson-Bowles commission plan in key respects — raising taxes much less, cutting much more from *non*-security discretionary programs and less from defense and other security programs, and, as a result, providing a blueprint that's significantly to the right of the Simpson-Bowles commission plan.

The Senate's Gang of Six proposal last summer showed that policymakers can design a balanced, relatively well-designed deficit-reduction package using the framework of the Simpson-Bowles commission report. Unfortunately, the Cooper-LaTourette plans falls well short of the Gang of Six plan and does not represent the same type of balanced policy.

The key differences between the Cooper-LaTourette plan and the Simpson-Bowles commission plan are:

- Cooper-LaTourette contains *$1 trillion less* in revenue increases — it would raise revenues from tax reform by $1.2 trillion over the 2013-2022 period, compared to a "current policy" baseline that assumes *all* of the Bush tax cuts are made permanent. In contrast, the plan that a majority of the Simpson-Bowles commission approved would raise $2.2 trillion in revenues over the same period.
- It contains severe cuts in discretionary programs — cutting funding for those programs about $800 billion *below* the caps that last year's Budget Control Act[1] established, and by over *$100 billion more* than the Simpson-Bowles commission plan would have done. Its ratio of spending cuts to revenue increases thus is significantly higher than under original Simpson-Bowles.
- Moreover, the Simpson-Bowles commission report's deep reduction in total discretionary spending included substantial reductions in "security" spending. Yet while the Cooper-LaTourette proposal cuts *overall* discretionary spending more than $100 billion deeper than

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[1] In outlays, the reduction would be $625 billion below the Budget Control Act caps.

original Simpson-Bowles, it assumes that *security* programs would be cut about $200 billion *less* than Simpson-Bowles. In other words, it assumes cuts in *non*-security discretionary programs that are more than $300 billion larger than the already deep cuts in these programs under Simpson-Bowles. Funding for non-security programs would, in fact, be cut slightly more under the Cooper-LaTourette plan over the next nine years than if full sequestration were allowed to take place.

The Cooper-LaTourette proposal also poses other serious concerns. The specifics of its provision to establish a target on how much health care spending and health-care tax expenditures can grow each year are highly problematic. The provision fails to include an adjustment for increases in the number of beneficiaries over time. Even the Medicare proposal in the Ryan budget contains such an adjustment, which will become increasingly important as the population ages. As a result, this proposal could cause draconian cuts in Medicare and Medicaid in future years.[2]

Also of concern is the design of its proposal to establish a debt target and trigger certain actions if the target is missed. The provision to suspend the trigger when the economy falters suffers from severe design problems and would often force deep budget cuts or tax increases when the economy is weak, thereby likely making recessions deeper and more frequent. It would have failed to turn off the requirement to reduce the debt in a timely manner in eight of the last 11 recessions.[3]

Plan Would Raise $1 Trillion Less From Tax Reform Than Simpson-Bowles

The Cooper-LaTourette plan follows the Simpson-Bowles commission report in some areas but not others. The biggest departure comes in taxes.

Simpson-Bowles called for tax reform that would increase revenues by $1 trillion over the 2012-2021 period, relative to a baseline that assumed the Bush tax cuts for households above $250,000 would expire. This was equivalent to a revenue increase of *$1.9 trillion* over that period relative to a *current policy* baseline that assumed *all* of the Bush tax cuts would be made permanent. When one shifts from a 2012-2021 budget period to the 2013-2022 period, as policymakers now have done, the $1.9 trillion revenue increase becomes a $2.2 trillion increase.

The revenue increase in the Cooper-LaTourette plan is $1.2 trillion relative to the current policy baseline over the 2013-2022 period. This is $1.0 trillion, or nearly 50 percent, smaller than the equivalent $2.2 trillion amount that original Simpson-Bowles would have achieved.

Some proponents of the new plan may claim that the Simpson-Bowles plan and the Cooper-LaTourette plan both have about $1.2 trillion in revenue increases from tax reform. Any such

[2] The Simpson-Bowles commission report was vague about whether such a health spending target should be set on a per beneficiary basis. This aspect of the Cooper LaTourette plan is not inconsistent with original Simpson-Bowles.

[3] The Simpson-Bowles commission report suffered from the same problem. It appears that in the hurried final preparation of the report, neither commission members nor staff examined whether their provision to suspend the trigger when the economy is weak would have functioned effectively in past recessions.

claim would be deceptive. A $1.2 trillion increase from a baseline that assumes *all* of the Bush tax cuts are extended *is not equivalent* to an increase of $1.2 trillion for from a baseline that assumes that the Bush tax cuts for people with incomes above $250,000 expire. The difference, as noted, amounts to about $1 trillion.

Health Spending Target Fails to Account for Changes in Size or Composition of Beneficiary Population

The Cooper-LaTourette proposal calls for setting a target for how much overall federal expenditures for health care (including both mandatory health programs like Medicare and Medicaid and health-care tax expenditures like the tax exclusion for employer-sponsored health insurance) may grow from one year to the next. The plan would require further cuts in this area if federal health expenditures would otherwise grow from one year to the next by more than the rate of growth in the Gross Domestic Product (GDP) plus one percentage point.

Any such target, however, needs to be on a *per beneficiary* basis. The Medicare growth target that the Affordable Care Act sets, which triggers action by the Independent Payment Advisory Board if it would be missed, is GDP *per capita* plus one percentage point and is applied on a per beneficiary basis. Similarly, the Medicare growth target in the Ryan premium support proposal is GDP per capita plus 0.5 percent, on a per beneficiary basis.

Because the Cooper-LaTourette target lacks the per-beneficiary adjustment, it likely would force deep cuts over time even if major payment and delivery system reforms are successfully containing cost growth. This is because the increase in the number of beneficiaries — especially in Medicare and Medicaid as the population ages — will necessarily push up health care expenditures. Due to the retirement of the baby-boom generation, the number of Medicare beneficiaries is expected to rise from 47 million in 2010 to 80 million by 2030. If Medicare were to achieve — and maintain — very low growth in costs per beneficiary, its *total* costs still would rise faster than GDP plus one percentage point due to the increase in the size of the beneficiary population.

Further, if policymakers decide to set a target for health care expenditures, it needs an adjustment not only for the number of beneficiaries, but also for changes in the *composition* of the beneficiary population. Older people have much higher average health care costs than younger people do. Hence, if per-beneficiary cost growth for every population group — children, adults who are not elderly or disabled, people with disabilities, and the elderly — were successfully limited to GDP+1, total costs still would grow faster than GDP+1 per beneficiary as the population ages because, over time, a smaller share of beneficiaries will be in the low-cost demographic categories and a larger share will be in the high-cost categories. This issue is especially relevant in Medicaid, where the share of beneficiaries who are elderly will rise and the share who are younger will fall (once the Affordable Care Act is fully in effect), as the population ages.

Faulty Debt-Target Process Could Trigger Actions That Would Worsen Recessions

The Cooper-LaTourette plan calls for achieving primary budget balance — that is, balancing the budget except for interest payments on the national debt — by 2015 and keeping the debt-to-GDP

ratio stable after that. Actions would be triggered if these targets would otherwise be missed. Those requirements would be suspended if nominal GDP grew by less than 1 percent in the prior fiscal year.

The goal of achieving primary budget balance and a stable debt-to-GDP ratio is both laudable and important. But the specifics of this provision are seriously flawed and pose risks to the economy as a result.

The Simpson-Bowles commission plan called for achieving primary balance by 2015. But the economic recovery has not been as robust as the Congressional Budget Office projected in 2010, when Alan Simpson and Erskine Bowles were preparing their report. CBO projected at that time that the unemployment rate would be 5.1 percent in fiscal year 2015. In its latest baseline report (in March 2012), CBO projects the unemployment rate will be 7.8 percent in 2015. The much-slower-than-anticipated recovery makes it much harder to achieve the debt target in 2015 without fiscal contraction so sharp that it could jeopardize the economic recovery.

Of even greater concern, the Cooper-LaTourette proposal would automatically suspend the debt stabilization process only if nominal GDP grew by less than 1 percent in the prior year. This is supposed to avoid triggering large budget cuts or tax increases when the economy is weak —- a critical goal — but it would not accomplish that. As noted, the proposed trigger would have failed to turn off the debt requirement in a timely manner in eight of the last 11 recessions. Because of this shortcoming, the measure could require major deficit reduction just as the economy is seriously weakening and could thereby make recessions considerably more severe.

If policymakers wish to establish a debt trigger, such a trigger will need to be more sensitive to where the economy is headed than a simple test of economic growth in a prior year. Last year, the Obama Administration suggested a "recession safety valve" in order to turn off a "debt trigger" (which it proposed in deficit negotiations) during periods when an economic downturn was underway or on the horizon. The Administration's proposed mechanism was better designed. It would be based on the level and change in the *unemployment rate*, rather than on GDP growth. Such a measure has the advantage of being based on an economic indicator that is measured monthly and has an almost perfect track record over the last 60 years in signaling recessions, with no cases in which a recession was signaled but did not occur.

Tax Exemption for Foreign Profits Would Risk Encouraging Tax Avoidance and Shifting of Investment and Jobs Overseas

Another concern relates to the call in the Cooper-LaTourette plan (and in Simpson-Bowles) for shifting the corporate income tax to a "territorial" tax system, under which the foreign profits of U.S. multinational corporations would be exempt from the U.S. corporate income tax. The corporate community has mounted an intensive campaign for this change, and the Simpson-Bowles commission report included this recommendation. It did so, however, before the Treasury Department and various other tax experts had examined this issue in depth.

Since then, the Treasury Department has analyzed this issue, and its findings led the President on February 22 to publicly reject the push to move to a territorial system. The Treasury and other tax

experts have raised serious concerns that a territorial system would likely encourage multinational corporations to book more profits overseas to escape U.S. taxation on those profits (even as the corporations claimed tax deductions at home for expenses incurred in generating those profits). That could further erode what remains of the corporate income tax. Treasury and other experts have also warned that a territorial system could increase incentives for corporations to shift investment and jobs overseas.

At the time of the Simpson-Bowles commission, corporate proponents of a territorial system had promoted the idea extensively with policymakers, while opponents had largely not been heard. That has since changed. Policymakers should not rush to endorse such a sweeping policy change, which a number of tax experts now warn could increase deficits over time by further weakening the corporate tax base after a transition period, and which also risks shifting jobs and investment abroad.