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GANG OF SIX PLAN REPRESENTS USEFUL STEP FORWARD, DESPITE TROUBLING ELEMENTS

by Robert Greenstein

Some describe the Senate Gang of Six's budget plan as a kind of fiscal Holy Grail. Others denounce it as a deeply unjust plan that cuts heavily into vital programs for the poor and the middle class while shielding the wealthy. Neither characterization withstands scrutiny. The plan is something of a mixed bag, with both very positive elements and some quite troubling ones, especially in health care.

Any assessment, however, needs to consider the current policy and political context. In that sense, the plan overall represents a significant step forward.

The Gang of Six plan is closely patterned on the recommendations that a majority on President Obama's National Commission on Fiscal Responsibility and Reform ("Bowles-Simpson") set forth. When commission co-chairs Erskine Bowles and Alan Simpson issued that plan, our assessment of it was critical.[1] Only weeks before, a Bipartisan Policy Center commission chaired by former Senate Budget Committee Chairman Pete Domenici and former Clinton budget director Alice Rivlin had produced a deficit-reduction plan evenly split between budget cuts and revenue increases: every dollar in budget cuts was matched by a dollar in increased revenues. The Bowles-Simpson plan essentially moved the goal posts, calling for $2 in budget cuts for every $1 in revenue increases.[2]

In addition, Bowles-Simpson featured a highly unbalanced and deeply flawed Social Security plan that ultimately would have cut $4 in Social Security benefits for every $1 it raised in Social Security revenues. And, while Bowles-Simpson laudably called for protecting the vulnerable and reducing the deficit in ways that did not increase poverty or inequality, it was somewhat short on specifics as to how to enforce this principle.

[1] "Statement: Robert Greenstein, Executive Director, and James Horney, Director of Federal Fiscal Policy, on the Final Report of the Co-Chairs of the Deficit Commission," Center on Budget and Policy Priorities, December 1, 2010, http://www.cbpp.org/cms/index.cfm?fa=view&id=3336.

[2] James R. Horney, Paul N. Van de Water and Robert Greenstein, "Rivlin-Domenici Deficit Reduction Plan Is Superior to Bowles-Simpson in Most Areas," Center on Budget and Policy Priorities, November 30, 2010. http://www.cbpp.org/cms/index.cfm?fa=view&id=3333.

The political context, however, has since shifted to the right of where it was in December, when Bowles and Simpson issued their plan. The deficit-reduction framework that the President presented in April adopted the Bowles-Simpson 2:1 structure for budget cuts to revenue increases. The $4 trillion plan that White House and congressional leaders were discussing before Speaker Boehner walked away from it 12 days ago appeared to have something more like a 6:1 ratio of budget cuts to revenue increases, when measured on a comparable basis. The considerably smaller McConnell-Reid option discussed over the past week apparently consists entirely of budget cuts, without a revenue contribution.

The only exception to this rightward shift of more spending cuts compared to revenue increases is the plan that Senate Budget Committee Chairman Kent Conrad developed but never fully released, which calls for a 1:1 ratio (like the Domenici-Rivlin plan).

By largely adhering to the Bowles-Simpson architecture, the Gang of Six plan remains close to 2:1. As a result, it may have the potential to serve as a restraint on the headlong rush to highly unbalanced plans that would largely shield revenues while cutting heavily into vital programs for Americans of modest means. (Note: all of the ratios of budget cuts to revenue increases discussed here do not count interest savings as a budget cut, because interest savings result from both budget cuts *and* revenue increases.[3] If reductions in interest payments are counted as a spending cut, then the ratio of spending cuts to revenue increases would be about 3:1 under both the Bowles-Simpson and Gang of Six plans.)

The Gang of Six plan also calls for nearly $900 billion in savings over ten years in discretionary security programs (primarily defense). It secures a larger share of its budget cuts from the Pentagon than the Obama April budget framework, or anything that emerged from the Biden negotiations. As a result, the Gang of Six appears to have more overall balance across revenues, domestic programs, and defense than the other major plans under consideration (except for the Conrad plan).

Finally, the plan apparently ties its cuts in entitlement programs and its revenue increases together. They either rise or fall in unison. If Congress fails to produce the revenue-raising measures, the legislation containing most of the cuts in mandatory programs falls as well. This is designed to prevent Congress from enacting the budget cuts while killing the revenue-raising measures.

The Revenue Component of the Plan

The revenue component of the Gang of Six's plan merits particular attention, because it is being widely misunderstood in several respects. For example, reports that the plan calls for $1 trillion in revenues over ten years have led some to assume that its revenue component is the same size as the $4 trillion package that Speaker Boehner derailed 12 days ago. In addition, some observers have criticized the plan as paving the way for tax increases on the poor and middle class to pay for tax cuts for the wealthy. Such perceptions are off-base:

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[3] To understand why counting interest savings as a spending cut is problematic, consider a deficit-reduction plan that only increases tax rates. That would increase revenues, but the increase in revenues would also *reduce* the federal debt (relative to what it otherwise would be) and the amount of interest that has to be paid on the debt. Yet it surely would not make sense to describe such legislation as including both spending cuts and tax increases.

- The magnitude of any plan's revenue increases or decreases depends on the *baseline against which the change in revenues is measured*. The Gang of Six uses the same revenue baseline as the Bowles-Simpson commission did (and as President Obama's 2012 budget and his April budget framework did). This is the so-called "plausible" baseline, which assumes that policymakers make permanent the Bush tax cuts for people with incomes below $250,000, while letting the tax cuts for people over $250,000 expire on schedule at the end of 2012.

- One trillion dollars in added revenue over the "plausible baseline" is quite different than $1 trillion in added revenue over a baseline that assumes that *all* of the Bush tax cuts are made permanent, including those for people who make over $250,000 a year. The $1 trillion in revenues in the $4 trillion deficit-reduction plan that Speaker Boehner walked away from *used this lower revenue baseline*. Measured against the baseline that the Gang of Six, the Bowles-Simpson plan, and the Obama budget used, the $4 trillion plan of 12 days ago would have generated only about $300 billion in added revenue (because the $700 billion in "savings" from letting the upper-income tax cuts expire already was in the baseline).

- In addition, the Gang of Six includes $1.2 trillion in increased revenue, not $1.0 trillion. Following Bowles-Simpson, the Gang of Six plan assumes more than $100 billion in new revenue for the transportation trust fund (the plan does not specify the source but rules out an increase in the gasoline tax) to support badly needed infrastructure improvements in a fiscally responsible manner. The plan also would raise close to $100 billion in revenues from adopting a different measure of inflation, the "chained Consumer Price Index," to adjust various parameters of the tax code annually (see below for further discussion of the chained CPI).

Despite its target of raising $1.2 trillion in increased revenue, the Gang of Six plan (like Bowles-Simpson) calls for lowering marginal income tax rates, including dropping the top income tax rate to below 30 percent. The plan calls for reductions in "tax expenditures" (deductions, credits, preferential rates, etc.) that are big enough both to offset the costs of lowering tax rates *and* to contribute significantly to deficit reduction. These provisions have led some to conclude that the Gang of Six plan raises taxes on lower- and middle-income families to finance tax cuts for the wealthy. Such a conclusion is not correct.

Under the plan, the Senate Finance Committee would be directed to produce a package that meets the revenue-raising targets *without* cutting the Earned income Tax Credit or the Child Tax Credit — the two principal refundable tax credits for low- and moderate-income working families with children — and that "maintain[s] or improve[s] the progressivity of the tax code." The plan apparently would include specific legislative language setting forth standards to determine whether the Finance Committee has complied with this directive.

These provisions are extremely important. They ought to become basic standards of *any* deficit-reduction plan that seeks to raise revenue through a tax reform measure that would lower tax rates and broaden the tax base. This is an area in which the Gang of Six plan makes a significant contribution. Although policymakers adhered to principles such as these relating to low-income working families and the progressivity of the tax code in the Tax Reform Act of 1986, it is highly unlikely that the current Congress will honor them unless such standards are explicitly set forth and are enforced. With these standards, policymakers cannot raise taxes on low- and middle-income families in order to finance tax cuts for those at the top of the income scale.

Social Security

The Social Security component of the Gang of Six plan is controversial because it essentially links Social Security solvency to deficit reduction. Even so, it represents a marked improvement over the deeply flawed Social Security component of the Bowles-Simpson plan.

The Gang of Six plan calls for the Senate Finance Committee to produce a plan that restores Social Security's solvency over the next 75 years. The need to restore long-term solvency is widely accepted across the political spectrum; the intense differences are over *how* to do so. The Gang of Six plan leaves that up to Congress to determine. It wisely does not include the specifics of the flawed Social Security component of the Bowles-Simpson plan, with one exception.

The Gang of Six plan calls for shifting the annual cost-of-living adjustment in federal benefit programs — including Social Security — and in the federal tax code from the regular Consumer Price Index to an alternative measure of inflation, known as the chained Consumer Price Index, which the Bureau of Labor Statistics also produces. Analysts generally regard the chained CPI, which rises about a quarter of a percentage point more slowly per year, on average, than the regular CPI, as a more technically accurate measure of inflation for the population as a whole.

Adoption of the chained CPI would raise some issues for elderly people, because a larger share of their consumption than of the average person's consumption consists of out-of-pocket health care costs. Since health care costs rise faster than the overall inflation rate, the fact that older people have larger health care cost burdens modestly raises the level of inflation they experience. As a result, both the regular and the chained CPI somewhat understate inflation for the elderly population as a whole.

On the other hand, policymakers will agree to switch from use of the conventional CPI to the chained CPI only if they make this change *government-wide* — in benefit programs and the tax code alike. And doing so would produce substantial deficit reduction over time, and also would somewhat narrow Social Security's long-term financing shortfall. We have long favored this policy change, provided that policymakers couple it with measures to soften the impact on the very old and people who have been disabled for an extended period of time (since the effects of moving to the chained CPI mount with the number of years that an individual receives benefits).

This is an area where the Gang of Six plan needs improvement. It contains measures to mitigate the impact on low-income beneficiaries, but some of those measures are not well targeted, and they would expire after five years.

Impact on Low-Income Families

In general, the Gang of Six plan improves upon Bowles-Simpson in the low-income area by providing concrete measures to honor the Bowles-Simpson principle of reducing the deficit in ways that protect the vulnerable and do not increase poverty. (As explained below, however, this does not apply to health care, where key aspects of the Gang of Six plan are very troubling.)

As noted above, the plan specifies that tax reform may not be done in a way that cuts the core refundable tax credits for low-income working families. In a similar vein, the plan specifies that the Agriculture Committee may not substitute cuts in SNAP (formerly known as the Food Stamp Program) for the modest cuts the plan requires in farm programs. The Gang of Six plan also specifies that if an authorizing committee fails to approve the amount of cuts in mandatory programs that it is directed to produce and the Budget Committee then adds across-the-board cuts in programs under the offending committee's jurisdiction to fill the gap, those across-the-board cuts must exempt the core low-income assistance programs — just as budget laws going back to the Gramm-Rudman-Hollings law of 1985 have exempted these programs from across-the-board cuts.

The Serious Problems with the Plan's Health Care Component

The Bowles-Simpson plan, on which the Gang of Six modeled its plan, called for close to $400 billion in savings over ten years in Medicare and Medicaid.[4] It would use some $300 billion of this amount to pay for a permanent "fix" to the flawed provision of current Medicare law that triggers extremely deep cuts each year in Medicare payment rates to physicians; Congress acts every year to override this provision and prevent the physician payment cuts from taking effect.

Over the long term, quite a large share of the deficit-reduction savings the nation needs will have to come from slowing the rate of growth in health care costs throughout the U.S. health care system, since those rising costs are a key driver of long-term deficits. However, policymakers enacted, as part of the health reform law, most of the steps we know how to take now to restrain Medicare and Medicaid cost growth without increasing the ranks of the uninsured or the underinsured or lowering the quality of health care.

It is dubious whether policymakers could secure as much as $400 billion in additional savings *in the next ten years* without causing serious damage to people who have significant health problems and limited resources. Unfortunately, the Gang of Six plan opens the door to making cuts in Medicare and Medicaid that significantly exceed $400 billion.

This is the one area where the Gang of Six could not agree among themselves. Senator Coburn insisted on $500 billion in Medicare, Medicaid, and related health care cuts over the coming decade, walked out of the Gang largely over this issue, and returned only when the Gang agreed to show his $500 billion in cuts as one of two competing options. The other option calls for $383 billion in cuts in this part of the budget.

The Coburn $500-billion cut level is one of the few areas in the entire plan where the level of savings departs markedly from the level in the Bowles-Simpson plan.

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[4] This reflects a revised estimate of the savings in the Bowles-Simpson proposal, which calculates those savings relative to the Congressional Budget Office's March 2011 baseline projections and includes the effects of the proposal in 2012 through 2021 (the same baseline and time period used for estimates of the fiscal effects of the Gang of Six proposals). The original estimate of the Bowles-Simpson plan was relative to CBO's August 2010 baseline projections and covered only 2012 through 2020. See "Updated Estimates of the Fiscal Commission Proposal," Moment of Truth Project, June 29, 2011.

The Gang of Six plan also contains a misguided provision calling for repeal of the CLASS Act, a component of the health reform law designed to have no cost to the federal government. CLASS (which stands for Community Living Assistance Services and Supports) addresses a significant hole in the current safety net: neither private health insurance nor Medicare protects people against the risk in old age (or after becoming severely disabled) of needing extensive help with fundamental tasks of daily living like eating, bathing, or getting dressed. The costs of such care can be enormous — over $75,000 per year for a nursing home, on average, and close to $20 per hour for care at home. With costs so high and no widespread insurance protection, it's no surprise that so many people who need long-term care either get inadequate help or exhaust all of their resources and turn to Medicaid for support.

Under the CLASS program, working-aged adults will be able to pay premiums now, while they're working, on a voluntary basis. If they contribute for five or more years and continue to contribute when they retire, they will qualify to receive a benefit if serious illness or injury renders them unable to perform basic tasks. The benefit will be meaningful but limited — an average of $50 or more per day that recipients can use to pay for home-based or institutional care services.

The financing of the CLASS Act stands out because it departs sharply from the approach that the 2003 Medicare prescription drug law used. The 2003 drug law was deficit financed. Similarly, in the 1990s, President Clinton proposed a tax credit for long-term care costs, while Republicans proposed a tax deduction for the costs of private long-term-care insurance; those proposals would have reduced revenues.

By contrast, the Affordable Care Act requires the Secretary of Health and Human Services to design benefits and set premiums for CLASS at levels that assure that the program fully covers its costs over the next 75 years, without adding to the deficit.

To be sure, there are significant questions as to whether this can be done. If only relatively sick people sign up and pay the premiums, can the premiums cover the costs? But HHS Secretary Kathleen Sebelius has made a firm commitment: "The program will not start unless we can absolutely be certain that it will be solvent and self-sustaining into the future." It is highly premature to kill off this important new program, given the commitment to ensure it is fully self-financing, as the law intends.

The Gang of Six provision calling for repeal of the CLASS Act is thus misguided and unwarranted. It goes beyond the Bowles-Simpson plan, which recommended repealing CLASS only if it could not be reformed to assure its financial sustainability.

Conclusion

Overall, the Gang of Six plan marks an important step forward. It contains a number of positive elements and appears to be the most balanced of the major plans now on the table. However, its option for $500 billion in health care cuts and its call for repeal of the CLASS Act raise serious concern; they are ill-advised provisions that the plan would be much better off without.