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CONFRONTING THE LOOMING FISCAL CRISIS

HEARING

BEFORE THE

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UNITED STATES SENATE

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CONFRONTING THE LOOMING FISCAL CRISIS

TUESDAY, JUNE 19, 2012

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:15 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Conrad, Wyden, Nelson, Menendez, Cardin, Hatch, Grassley, Snowe, Crapo, Cornyn, Coburn, and Thune.

Also present: Democratic Staff: Russ Sullivan, Staff Director; Alan Cohen, Senior Budget Analyst; Lily Batchelder, Chief Tax Counsel; Matt Kazan, Health Policy Advisor; Tom Klouda, Professional Staff Member, Social Security; Andrea Chapman, Detailee; and Claire Green, Detailee. Republican Staff: Chris Campbell, Staff Director; and Jeff Wrase, Chief Economist.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The hearing will come to order.

President Truman once said, "America was built on courage, on imagination, and an unbeatable determination to do the job at hand." We are here today to discuss the fiscal crisis we face at the end of this year. Overcoming this crisis is the job at hand.

We are pleased to have Senator Pete Domenici and Dr. Alice Rivlin with us. They are co-chairs of the Debt Reduction Task Force at the Bipartisan Policy Center.

In November 2010, Senator Domenici and Dr. Rivlin released a comprehensive debt reduction plan. That plan has helped inform the debate for more than a year and a half. It has been updated and, as we approach the looming fiscal crisis, it takes on new importance.

At the end of this year, our fiscal landscape is scheduled to change dramatically: the 2001, 2003, and 2009 tax cuts, the patch on the Alternative Minimum Tax, and other key tax provisions, will all expire. That would cause steep tax increases on middle-class families.

The across-the-board sequester of many Federal programs will kick in. Medicare's physician payment system will force a deep cut that threatens seniors' access to doctors. Sitting back and letting all this happen would mean a disaster for our country. In fact, the nonpartisan Congressional Budget Office projects it could throw us back into recession. It doubtlessly also would deal a blow to U.S. standing in the world community.

During the first half of 2013, GDP would shrink by 1.3 percent, according to CBO. Over the entire year, GDP would grow only half a percent. Canceling the sequester and failing to raise more revenue and maintain the status quo would also be disastrous.

It would tell the American people and the world that we are not serious about our deficit reduction. If we do not find additional revenue and we cannot agree on spending cuts, debt held by the public could reach more than 100 percent of GDP by fiscal 2022.

We need a comprehensive debt reduction plan that does not shock the system with deep, immediate cuts. Instead, we need a practical, responsible plan that gives confidence to the markets and the country.

What would such a plan look like? The plan should substantially lower deficits and debt over the next 10 years and beyond. The plan needs to be fair, and everyone must contribute. The plan needs to be balanced. This will require cuts in spending. We need more revenue to pay for America's needs. We do not just face a spending problem or only a revenue problem; it is both.

The plan must stabilize and decrease debt held by the public as a percent of GDP. The plan should ramp up slowly to allow the recovery to continue. The plan must not count any Social Security changes towards deficit and debt reduction. Social Security has not added one dime to the deficit or debt.

Finally, the plan needs to meet the political challenges we face. The Rivlin-Domenici plan we will examine today meets many of these criteria. It is balanced and fair and requires both revenue increases and spending cuts. The plan generates sizeable debt reduction to stabilize the debt held by the public as a percent of GDP by 2014. It would shrink the debt-to-GDP ratio thereafter.

However, the plan contains some proposals that concern me. The plan, for example, includes changes in Social Security which, in my judgement, should be dealt with separately and not as a part of deficit reduction.

The plan changes Medicare to a premium support program, and it turns Medicaid into a block grant. These proposals only shift costs onto seniors, States, and the disabled. Any changes made to Medicare and Medicaid should focus on saving money by making the health care system more efficient and more focused on quality of care.

Many of the Rivlin-Domenici tax changes are politically challenging as well. Some limit future opportunities. For example, the plan repeals all tax incentives that go to colleges without proposing anything in their place.

With the fiscal crisis we are facing at the end of the year, Congress needs to come together and agree on a combination of revenues and spending cuts. It is the only way forward. So let us work together to show we are serious about our deficit problem, and look to the Domenici-Rivlin plan for inspiration. Let us remember President Truman's words, and do the job at hand.

[The prepared statement of Chairman Baucus appears in the appendix.]

The CHAIRMAN. Senator Hatch?

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH

Senator HATCH. Well, thank you, Mr. Chairman. I am particularly pleased to welcome Pete Domenici—our Senator from New Mexico, who was, in my opinion, one of the all-time great Senators here—and Dr. Rivlin, for whom we have tremendous respect. Both of you have done your best to try to assist in these problems that we have. We appreciate your coming here to discuss options for addressing our Nation's fiscal challenges.

Given the enormous and growing uncertainties associated with the country's fiscal position, it is far past time that Congress and the President act to right our fiscal ship. Market uncertainty is already growing as a result of the historic tax increases set to take effect at the end of this year.

Because Federal law requires certain employers to give advanced notice to workers facing layoffs, the automatic budget cuts, or sequestration, set to begin at the start of next year, mean that we can expect major layoff notices from defense contractors and others starting this fall, should that be the case.

At a time when job growth is anemic, unemployment remains above 8 percent, and the American workers are struggling, it is unconscionable to gamble with the economy by choosing to ignore the fast-approaching fiscal cliff. This is not the time to privilege election-year talking points and political brinkmanship over economic growth and the American families and businesses that depend on it.

Make no mistake, the private sector is by no means doing just fine. Since the President took office, the unemployment rate for government workers has averaged 4.2 percent. By contrast, when you include the private sector, the unemployment rate has averaged 9.2 percent during the President's term. Overall, unemployment has been above 8 percent for 40 consecutive months, while the unemployment rate for government workers over the same period has averaged just over 4 percent.

Only someone who is entirely out of touch with the plight of Americans could read these numbers and conclude that the private sector is doing just fine. American families and workers in the private sector are hurting and have been for far too long. They cannot afford any more hits.

So Congress and the President should be working now to avert the fiscal cliff that threatens all Americans at every income level with massive tax hikes. It is long past due to begin reforms of a tax code that is a burden on families and businesses and a drag on our economy.

Over the past few years, we have seen many plans to do just that, including one our witnesses will address today. What has been noticeably absent, however, is engagement by the administration and leadership by the President.

We hear from the Treasury officials that the administration has "principles" for corporate tax reform, for individual taxes, and for Social Security and other entitlements, but I suspect, because it is an election year, they refuse to talk about the specifics.

In spite of his claim that his proposals are available for all to see, no one I know has seen the President's plan for reforming

Medicare or Social Security or the tax code. All we hear are vague principles with the only definitive characteristic being more redistribution.

But a sentiment, no matter how strongly felt, is not a plan. The lack of leadership from the President at such a critical moment for our economy is remarkable, in my opinion. He has ignored numerous fiscal plans that have been crafted by bipartisan groups like the one we will hear about today, which was originally crafted in November of 2010.

One of today's witnesses, Dr. Rivlin, expressed frustration about the President's passive stance toward our slow-rolling fiscal crisis as far back as June of last year, writing that "leadership can't be delegated to commissions or task forces. Mr. President, please get out front."

Now, I would like to echo that frustration and urge the President to get out front. Steer us away from this fiscal cliff. Work with us to tackle our unsustainable deficits and debt and entitlements, and assist us in reforming our broken, antiquated tax system, or code.

Mr. Chairman, I commend you for your continued leadership on these matters. I commend you for taking the step this month of outlining your framework and principles for tax reform, and I look forward to working with you on tax reform. I hope to work with you in addressing the fiscal cliff that is creating enormous uncertainty for families and businesses and contributing to further slowing and weakening of the economy.

I invite the President and the administration, including officials at the Treasury, to join us. While I understand that this is an election year, we cannot let that stand in the way of doing what is right for the American people.

Once again, Mr. Chairman, I want to thank you for holding today's hearing, and I want to thank these two tremendous witnesses for appearing. I certainly look forward to their testimony and appreciate all the efforts that they have made, under very trying circumstances, to come up with the approaches that they have come up with.

We just welcome both of you, and we are really happy to have you here.

The CHAIRMAN. Thank you, Senator Hatch.

[The prepared statement of Senator Hatch appears in the appendix.]

The CHAIRMAN. I would like to welcome formally and introduce our witnesses. Let me begin by saying I have the deepest regard and respect for both of you. You, Senator Domenici, former chairman of the Budget Committee, I know how hard you worked on budgets to get our fiscal house in order. I do not know of anybody who worked harder than you.

Then, Dr. Rivlin, I remember your assisting us many years ago, when I was over in the House of Representatives, with budget issues. You too have been as dedicated in public service and getting our fiscal house in order, and I thank you so very, very much. All the rest of the positions that you have held are very impressive, including former Director of the White House Office of Management and Budget and many other positions, including the one you have been serving on today, as co-chairman of the Debt Reduction Task Force.

Thank you both very much. You do not need introductions, either one of you, but I just want to tell you how much I appreciate you. I think I can speak for every member of the Senate about just how hard you have worked and just how deep our admiration is.

Senator Domenici, why don't you proceed? You know the order. Just go ahead.

STATEMENT OF HON. PETE DOMENICI, SENIOR FELLOW AND CO-CHAIR, DEBT REDUCTION TASK FORCE, BIPARTISAN POLICY CENTER, WASHINGTON, DC

Senator DOMENICI. Thank you very much, Mr. Chairman, Senator Hatch. Thank you for your kind words. Let me say to all of you, it is a pleasure to be here.

It has fallen to me since I left the Senate, for almost half of the time that I have been gone, that I have devoted time and energy to trying to come up with ways and means to help this great Nation get out of the terrible dilemma that we have in terms of our debt. It has been a real pleasure to work at the Bipartisan Policy Center with Dr. Alice Rivlin.

The two of us have done this budgeting differently because we have done it bipartisanly from the very beginning. As we worked our way through, we had to get both Democrats and Republicans to support the proposition, so it is different than others. But if indeed you intend to have a bipartisan solution, then obviously you have to do some of the things we are talking about, some give-and-take.

I would not have done it exactly the way we did, and I am sure Dr. Rivlin would not have, but, when you put it together, it is a bit more than you have indicated, Mr. Chairman. You have indicated, and I appreciate it, that we gave you inspiration. Frankly, I think we gave you a plan that is really doable.

Some of the things in the plan are different than you have stated, and we are going to try to clarify them. Perhaps we had misspoken, perhaps we had given you some wrong documents, but we believe the solutions to Medicare are here in this proposal, both fiscal and as a matter of policy.

I want to also open by saying to you—and I do not want to do this in denigration of any other committee—we no longer have to wait for a super committee. I want each one of you to know I am trying to look you right in the eyes and tell you that, in the U.S. Senate, you happen to be the super committee. We do not need to appoint one.

What am I talking about? What I am talking about is, you have all of the jurisdiction basically that is needed to solve our fiscal problem. Some of you would rather, perhaps, that it not be the case. But Medicare is within your jurisdiction. You cannot fix the budget without fixing—that is, in some way reforming—Medicare so you push the costs in the future down.

If you look at the major programs of our country, you will find that the only one that is up, up, and away is the cost of health care. All the others are controllable. We could fix them rather easily. But unless you fix Medicare, you cannot fix this deficit.

It is a blue line on our chart, and our chart is here somewhere. I never go anywhere without it. I am known as the blue line chart man, Pete Domenici. I bring that blue line with me everywhere so you will understand what it is.

You see where we have the major programs of the government. They are running almost side to side. Then you look and see the blue line, the line for health care spending, is up through the roof. We have to bend the blue line in the passage of a Medicare bill. Unless we do, we do not solve the problem.

[The chart appears in the appendix on p. 42.]

Senator DOMENICI. Now, let me repeat. Mr. Chairman, I heard you speak before on this issue, and I think you know it, but I want every member of the committee to know that you are the super committee. It falls on you to solve the Medicare problem, to solve the tax problem with a reform measure that will either be neutral in revenue or will gain revenue. We gain revenue in ours.

But let me proceed to tell you that we have done very little to solve the deficit problem during the last 18 months: a lot of talk, no action. The only thing we have done is a little bit of work on the appropriations part of this budget, but not very much. The Budget Control Act brought to us the sequester that has an automatic $1 trillion in defense and domestic cuts. They are now scheduled to go into effect January 2.

I have to take time to tell you that that sequester is already law that has been adopted. It is indefensible for any of you who think we ought to do good work around here and that we ought to not go wild in getting rid of our defense of our country, to not take seriously that something has to be done to see to it that the sequester does not take effect.

Now, you do not have total jurisdiction over that, so you are not the super committee on that, but on all the matters that have to do with long-term solutions for the budget, they belong on your two shoulders for the Democrats and Republicans on this committee. Whether you like it or not, you can solve the problem or you can let it go by.

Now, we already know that the sequester is going to be a very big drag on the economy. That is shown to us by CBO. If you can join with others who want to make sense out of that part of the activities, it seems to me you would do us all a service if you could commit yourself to fix that sequester so we could get on with some other activities and not be worried about diminishing our defenses until we do not recognize that they exist.

The sequester must be addressed. It is just one part of the looming fiscal cliff that we face. The Bush tax cuts, you know all of them, you have recited them. Believe it or not, none of those was part of solving the debt problem. They come along, and they happen to be due and payable, or due and you have to do something about them. They come into existence during the same time that we are trying to fix the debt. It makes it rather complicated for some, but that is just the way it is.

Under ordinary times, perhaps Alice, a Democrat, would not be calling for substantial changes to the entitlement programs, and I, a Republican, would be against higher revenues. But this is not a normal time, and we cannot allow ideological purity, in my opinion, to stand in the way of what is right for our country. Otherwise, we might as well admit defeat and sit back and watch it go by while the accumulation of debt overwhelms our way of life.

I, for one, will do everything I can to prevent that. We do not know what that means, but we do know that America will not be the same if our fiscal policy is permitted to go to zero and to become frigid and to become inoperative. Health care reform and tax reform that raises additional revenue are essential pieces to any serious plan.

The first one is easy to show. Many of you have seen my chart—I told you about it—with the blue line. It is imperative that you understand that it must be fixed or you cannot fix the budget. Anybody who tells you they have a budget fix and they have not reformed Medicare so it costs less money over the next 20 years and the line is bent, anybody who says, I have a solution, but does not have a solution to Medicare, you should tell them to start over, go elsewhere, sell your pot of ideas someplace else, because it will not work without Medicare reform.

We must continue to innovate and experiment with sensible cost-containment measures, but the challenge is not going to disappear overnight. You know the population is aging. The Baby Boom generation is just beginning to retire. This means that Medicare will face a flood of new beneficiaries.

In fact, roughly 10,000 people are enrolling in Medicare every business day. These are unstoppable trends, and you have to account for them and change the program to take care of them. Because of these trends, even if action is taken now to tackle health care costs, and it should be, the U.S. government is destined to increase its health care spending in the near and medium term.

In the meantime, without other changes, the government would continue running large deficits and racking up additional debt. Given the magnitude of the fiscal problem, this is an irresponsible course. So, in addition to seeking long-term solutions to the structural health care problem, the United States must employ other methods to reduce our deficit.

Federal receipts are currently at a modern-day low because of the recession. They are coming in at 16 percent of GDP. But even if the Bush tax cuts are extended, revenues are projected to recover to 18 percent of GDP by 2017, which is roughly their average historically.

I understand my time has expired, but I——

The CHAIRMAN. Go ahead, Pete. Take a few more minutes. Go ahead.

Senator DOMENICI. Well, I looked around, and I looked at your schedule, and you do not have any other witnesses besides the two of us, so I asked Alice by just poking her here like this, and she said, "Proceed, finish," so I will. I am almost there.

I want to say to all of you that what we have produced by way of a budget, a plan, should really be taken seriously by all of you. I think, Senator Coburn, we have been to see you, within the past 12 months, about the Medicare proposal.

It is now refined and suggested, and, if it is adopted, or something close to it, you will have fixed, in our opinion, a major problem with Medicare. Hard to do, but if you look at it, it has to be done. We have to convince the seniors that their programs may not be around, if we do not fix them, to cover them in the out-years.

In terms of taxes, it cries out for reform, even if we did not have a fiscal crisis. It cries out for reform. It is a mess. We were lucky in our committee. We had tax experts who were on our committee. It was bipartisan and had a lot of professionals. They have put together a major reform of our tax system that will make it clean, sharp, and productive. It will be a growth budget.

The rates will come down, all the things you have been talking about, and we will structure it where it will, over the years, increase revenue somewhat to match up with the entitlement restraint, and you have a good budget. That is what we have done, and it is a very good plan. Alice is an expert at it and she has worked hard, and I want to now, with your permission, ask her to take her time and tell you about the major proposals that we have in our budget.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

[The prepared statement of Senator Domenici appears in the appendix.]

The CHAIRMAN. Dr. Rivlin, welcome to the committee.

STATEMENT OF HON. ALICE RIVLIN, CO-CHAIR, DEBT REDUCTION TASK FORCE, BIPARTISAN POLICY CENTER, AND SENIOR FELLOW IN THE ECONOMIC STUDIES PROGRAM, BROOKINGS INSTITUTION, WASHINGTON, DC

Dr. RIVLIN. Thank you, Mr. Chairman.

Senator Domenici has explained our two major messages, which are, first, the fiscal cliff is a real one—it is more a wall than a cliff. If you allow all of these things to happen on the tax side and the spending side that would happen automatically, you will endanger the recovery.

But the other looming crisis is the debt crisis, and the responsibility of this committee, we believe, is to help find a way to avoid the fiscal cliff, but substitute a grand bargain that will put our budget back on a sustainable track so that the debt is not rising faster than our economy can grow.

The two key elements of such a plan, as Senator Domenici has said, are Medicare reform that reduces the rate of growth of that program in the future in a sensible way that preserves the program, and tax reform that gives us a fairer, simpler tax code that raises more revenue in the future.

So let me talk briefly about those two proposals; first, on Medicare. Medicare is a hugely successful program. We need to preserve the Medicare guarantee of affordable health care for older and disabled people, and we need to do that, not in a way that will shift costs to the private sector or to vulnerable beneficiaries, but by making Medicare a leader in improving the efficiency and the effectiveness of health care delivery for everybody while reducing the rate of growth of health spending.

Our plan would preserve traditional Medicare permanently as the default option for all seniors. It would strengthen the efforts which are embodied in the Affordable Care Act to identify improvements in cost-effectiveness of traditional Medicare through innovations in delivery and reimbursement incentives. But it would also offer seniors a choice, on a well-regulated exchange, between traditional Medicare and an array of private, comprehensive plans that offer at least the same benefits and which are required to accept everybody, no cherry-picking, but guaranteed issue and community rating.

Those plans and traditional Medicare, in our view, should compete on a well-regulated exchange which would provide information on the prices and the outcomes of the plan. The government contribution, we believe, should be set at the second-lowest price established on those regulated regional exchanges.

Now, an individual senior could stay in traditional Medicare, could choose the lowest-priced plan. If they chose the lowest one, lower than the second lowest, they get some money back. If they chose a plan with more benefits, they would have to pay more.

We believe that competition on an exchange among those plans would achieve considerable savings over time; we estimate, conservatively, $300 billion over the next 10 years. But you cannot be sure of that, so as a fail-safe we would impose a cap on per capita cumulative Federal expenditures that would be at the rate of per capita GDP plus 1 percent, so you would know it would not increase faster than that.

If, which we would not expect, the Federal expenditure reached that cap, then we would impose a means-tested premium but protect low-income seniors. Congress could, of course, decide to do it some other way.

On the tax plan, we would propose, respectfully, to this committee that you adopt a new procedure. Instead of approaching tax reform by reviewing the current complexities of the tax code—all the exclusions, deductions, and credits—one by one and deciding how to change them, we would recommend that the committee take the radical approach of starting over.

Assume that all income from whatever source is taxable, which would enable you to raise more revenue at much lower rates, and then go about deciding which modifications are absolutely essential even though they would raise the rates.

We would urge you not to revert to excluding the employer-paid health and other benefits from income, but to limit and phase out this exclusion that encourages both employers and employees to choose fringe benefits over wages as compensation.

If you decide to encourage home ownership, then do it in a way that will help the middle class most rather than giving benefits to the high end. To this end, we would recommend a 15-percent credit for mortgage interest, paid up to a limit, rather than the current deduction.

Our plan is detailed in our longer testimony. It would have only two rates: 15 and 28 percent. It would have a corporate rate of 28 percent. It would tax capital gains and dividends as ordinary income. It would have a refundable child credit and a refundable earnings credit, and it would have a refundable tax credit for charitable contributions and mortgage interest, up to a limit.

Despite these low top rates, this plan would be more progressive and raise considerably more revenue than the current tax code; we would estimate about $2.6 trillion over the next 10 years. Those are our two principal proposals, and we would be delighted to answer questions on these or other parts of the plan. Thank you.

The CHAIRMAN. Thank you both very much.

[The prepared statement of Dr. Rivlin appears in the appendix.]

The CHAIRMAN. How does your plan differ from another major one that is out there? What is the major difference?

Dr. RIVLIN. Well, since I was on Simpson-Bowles, along with at least three members of this committee that I can see at the moment, let me answer that one. The basic structure is the same. You cannot stabilize the debt any other way except by reforming entitlements and raising more revenue from a reformed tax system.

The tax approach is very similar because Simpson-Bowles did exactly what I suggested: they started over and said, let us tax everything and then add back in certain provisions. So the tax proposals are similar.

Our health care proposal for Medicare, however, is different. Simpson-Bowles did not have a serious discussion—although Representative Ryan and I tried—of premium support, and so Senator Domenici and I are quite proud of this compromise premium support plan. It is not like the original Ryan plan at all. It preserves traditional Medicare, but it does give an option of going to an exchange.

Other aspects of Simpson-Bowles are similar, I think, to what we are proposing. Both Simpson-Bowles and Domenici-Rivlin placed limits on discretionary spending over the next decade. You have already done that in the Budget Control Act, so that part is done.

The CHAIRMAN. Clearly your plan and Simpson-Bowles both suggest discretionary spending and entitlement cuts, as well as revenue increases. Could both of you explain the need for not only spending cuts, but also the need for revenue increases?

I obviously ask the question because there is so much resistance in the Congress to additional revenue. How important is the need for additional revenue, and how strongly do you support additional revenue? What do you tell those who say "no additional revenue"?

Senator DOMENICI. Let us both comment on it.

The CHAIRMAN. All right.

Senator DOMENICI. I want to say to you first, as a former Republican Senator, remember that we put our plan together starting with bipartisan membership. So we were not a group of Republicans gathered to fix the budget and a group of Democrats gathered to fix it; we were a mixture, and we had to get an "aye" vote for the plan so that we could present it to the public.

So for starters, the partisan issue is one where Democrats say, if you are going to have significant tax increases attributable to tax reform, you have to—let me put it the other way.

Republicans say, we will take that only if you reform health care so that we are not looking at a forever-increasing tax to pay for an ever-increasing health care. Together, you go with a tax proposal and a proposal that reforms Medicare. When you combine the two, you get bipartisan support.

Now, there is another reason you need it, and that is, when you are finished with this product and you have done all you can, you are short money to get to the place where you have a fiscal policy that can survive. For it to survive, you have to end up putting revenue into the mix.

The CHAIRMAN. How much revenue did you recommend?

Dr. RIVLIN. How much did we recommend?

The CHAIRMAN. Yes.

Dr. RIVLIN. We, as I think I said of the plan that we would propose, we think, would raise about $2.6 trillion more over the next 10 years.

The CHAIRMAN. And why is that so important? What do you tell members of Congress who say "no revenue"?

Dr. RIVLIN. I think the basic reason is, we have a lot more seniors. We will have, in the relatively near future, twice as many seniors who are claimants for Medicare, Medicaid, and Social Security. The historic level of spending has been around 20 to 21 percent of GDP, 20 percent at the last time we balanced the budget.

But that was before we had all these seniors. So, if we are going to accommodate twice as many people, even if we do a good job of bending the health care cost curve, we are not going to bend it to zero. If we do a good job on that, we are still going to have this tsunami of retirees, and we cannot accommodate those within the same level of revenue without cutting out everything else that the government needs to do.

From a practical point of view, when you are in a bipartisan commission—and I have been in two of them now—you start with, what can we do on the entitlements, and then you go to discretionary spending, and then you realize you have not gotten there yet.

I think that was a hard moment for Senator Coburn and Senator Crapo especially in the Simpson-Bowles debate, but they are among my heroes because they stepped up to the plate and said, yes, we are going to need more revenues as well as to cut spending.

The CHAIRMAN. My time has expired.

Senator Hatch?

Senator HATCH. Thank you, Mr. Chairman.

Dr. Rivlin, the original 2010 version, as I see it, of the Domenici-Rivlin plan called for a value-added tax, which I think you called a deficit reduction sales tax. Now, that national sales tax was intended to apply to around, as I recall, 75 percent of consumer expenditures and would apply to home sales, purchases of food, and purchases of clothing.

Now, according to your plan, the tax would have generated over $3 trillion between 2012 and 2020, and over $17 trillion between 2012 and 2040, if I have it right. Subsequently, as I understand it, you have chosen to drop the VAT—value-added tax—from your plan, citing likely lack of general support for a national sales tax in conjunction with an income tax.

In place of the VAT you have decided—again, as I understand it—to increase the corporate tax rate from your initial proposed 27 percent to 28 percent, and to increase the upper tax rate on your income tax schedule also from the initially proposed 27 percent to 28 percent.

Yet, I am not sure that your fiscal arithmetic adds up. I am not sure that those tax hikes would generate enough revenue to replace what your initial plan's national sales tax generated, or was proposed to generate.

Now, would an increase in upper rates from 27 percent to 28 percent generate the trillions of revenue that your initial plan relied on from a national sales tax, or have you also decided to make other changes to your plan in order to get more revenue?

Dr. RIVLIN. You are absolutely right, Senator Hatch. We did not make up all the revenue. The original plan had the debt reduction sales tax. We did not detect vast enthusiasm in this body or the other for a broad-based consumption tax, although we still think it is a good idea. So we revamped the plan and made the changes that you suggest, but our current plan does not raise as much revenue as the original one did.

Senator HATCH. Now, this question is for either or both of our panelists. Your joint testimony identifies severe economic risks stemming from the fiscal cliff, including a strong likelihood that the economy would slip again into recession next year.

You also highlight that effects from the fiscal cliff and other aspects of existing fiscal uncertainty begin to hit this year, and you identify CBO's projection that these fiscal uncertainties will lower GDP growth by at least another half of 1 percent in the remainder of this year.

Now, as a consequence, you conclude—correctly, in my view—by saying that "we urge Congress to act quickly" and go on to say that "waiting until an always-difficult lame duck session may establish inaction as the default position, which could lead the Nation directly over the fiscal cliff."

Now, recently an economist at the Center on Budget and Policy Priorities wrote an article in which he argued that the economy would not be thrown immediately into recession early next year because of the fiscal cliff, and that there would be relatively modest negative effects over the first couple of months of next year. The idea was that it would be relatively painless to defer resolution of the fiscal cliff into the early months of next year, and fear of the cliff should not prod anyone into making ill-conceived budget deals during the remainder of this year.

Rather, the author argues that pressures would mount early next year to strike a deal under the gun of an impending debt limit breach, and the short-term pain from a couple of months with no resolution would hurt, but it would not be a full-blown, year-long recession.

Now, Dr. Rivlin and Senator Domenici, I believe that it would be difficult to be more wrong than the recommendation I just described. Growing fiscal uncertainty from the fiscal cliff, sequestration, and the long list of other undone business during the year—as officials from the Federal Reserve and CBO warn—will negatively influence hiring, investment, business decisions, and the economy well before we hit the fiscal cliff at the end of the year. I believe we need to act well before the end of this year, preferably before autumn when we are likely to see layoffs in defense and other industries begin.

I wonder if either or both of you would comment on whether you agree or disagree with that option proposed by the Center on Budget and Policy Priorities of gambling with the economy and waiting until next year to deal with the fiscal cliff and other fiscal matters. Do you agree or disagree that waiting until early next year to confront our fiscal uncertainties, including the fiscal cliff, really would not hurt that much?

Dr. RIVLIN. That is a pretty loaded question, Senator.

Senator HATCH. Well, it is, deliberately.

Dr. RIVLIN. I think we made clear in our testimony that we think the Congress should act as quickly as possible. If, in the face of the election, you could possibly get yourselves together to act immediately, or had acted last year, we would be very enthusiastic about that.

It is true that the cliff does not hit all at once, but we should not create an image of an America that cannot even avoid this quite cataclysmic set of self-imposed problems—after all, nobody wanted the sequester to happen, and it imposes deep cuts in a mindless way on both defense and domestic programs, and no one wants the AMT to go into effect for more people, and I think no one wants all the tax cuts to expire at once.

So letting that all happen would be an admission that our government is not working, and that would, I think, have serious repercussions in the markets, as some have pointed out.

Senator HATCH. Thank you.

Senator DOMENICI. Mr. Chairman, I just want to comment briefly. Thank you for your great answer, Alice. I believe you have to consider in your question the fact that we are talking about lame duck. I think it is very important, for some of you who have gone through lame duck, to make sure that you know it is not the best choice of an arena to which you would assign the solution of major problems, nor is it an arena that you would assign two problems to and say, that is all we are going to do, because that never happens. So, I just add that.

Mr. Chairman, I want to make an observation, if you would permit me.

The CHAIRMAN. Sure.

Senator DOMENICI. We talked together, all three of us—Dr. Rivlin, you, and I—about revenues and reform of entitlements. We have to start—which I did not do—with, what are we trying to accomplish? It used to be we would talk about a balanced budget, and that was the operative approach.

We are now talking about something different. We are talking about the ratio of debt-to-GDP, debt being the accumulation of deficits. We are looking to get to a point where we can live with a debt and would have a stable economy, and we are looking for somewhere around 60 percent.

You note that some of those countries that are going down already are passing 100 percent. We are positive that our great country cannot survive 100 and 150 percent before something happens. We only did that once for the second World War, for a few years to win the war, but then we immediately dropped down to a much more stable ratio.

We have to get back there. To get back there, you have to do something to the two tillers that push it, and that is, what kind of revenues are you going to have, and what do you do with entitlements?

So what we had to do in a bipartisan way was say, how much can you get out of reform and restraint and cuts, put it over here, and then, what is left by way of debt? Where are you going to get it from? We said, we have to reform the tax code. Alice has explained how. I think it is the best reform around, and you all ought to look at it. It is simple. How you vote on it would be simple too. It would be much easier.

So what we are saying is, when you have those two pillars and you are going to reform the taxes and say, how much do we have left that we have to solve for for our 60 percent, 65 percent ratio, you cannot do it without some revenue. That is how it comes about. I did not do a very good job explaining it to you, and I thought I ought to try again. I probably did no better, but I feel better about it. [Laughter.]

I thought you would care about that.

The CHAIRMAN. Both are accurate. All right.

Senator Conrad?

Senator CONRAD. Thank you, Mr. Chairman. Thanks for holding this hearing. Thanks to our witnesses, Senator Domenici, with whom I served for many years on the Budget Committee and whom I have deep respect for, and Alice Rivlin, who is a legend. We appreciate the extraordinary work you have done.

I think, frankly, you have it about right. I served on Simpson-Bowles. In many ways I think your work product is actually somewhat superior to ours. I say that because, while there are a lot of similarities, you did take on fundamental reform of Medicare.

My own conclusion is, we are going to have to do it. How we do it, that is critically important. We do not need to throw the baby out with the bath water, we do not need to shred Medicare in order to save it, but we do need to change some of the elements of how it functions in light of health care inflation and this gigantic growth in the Baby Boom generation. These are undeniable facts.

The growth of the Baby Boom generation is not a projection. These people have been born. They are alive today. They are going to be eligible for Social Security and Medicare, and the trustees have told us we are headed for the cliff.

So I mean, any prudent person, I think, would say, we are going to have to make some changes. Part of it is going to have to be done on the revenue side as well because, as you point out in your chart, in addition to the chart Senator Domenici referenced that shows Medicare as being the driver on the cost side, you also show, on the revenue side, that trying to do this with the ordinary level of revenue that we have had, 18 percent of GDP, is not going to be enough in this context and that the times we have balanced the budget, we have not been at 18 percent of GDP in revenue, we have been at 20 percent of GDP. Your chart shows that very clearly.

I think one other thing that is so important and has not been said here today is, Director Rivlin, you have indicated that your plan calls for a $2.6-trillion revenue increase. But that is compared to current policy—current policy. If we would compare your plan to current law, it is actually a tax cut. It is a tax cut, my calculation is, of about $1.6 trillion.

So when we use these words—and words matter a lot—and we say there is going to be more revenue, compared to what? Compared to current policy, it is more revenue. Compared to current law, it is less revenue. Is that not the case?

Senator DOMENICI. Yes, it is. Yes, it is the case.

Dr. RIVLIN. Yes, absolutely.

Senator CONRAD. And you are talking about a revenue level, in 2022, of 20.6 percent of GDP. Is that correct?

Dr. RIVLIN. I think so.

Senator CONRAD. And that is exactly what the revenue level of the country was in the year 2000.

Senator DOMENICI. That is right.

Senator CONRAD. That is exactly what it was, and we balanced the budget, and we quit taking Social Security money to finance the general operations of government. So I think you have it about right with respect to the revenue side of the equation. I think you are headed in the right direction on entitlement reform.

I have a little bit of time here left. I would like to go to a question. One of the great vulnerabilities, obviously, of the Medicare reform that you are proposing is this question of cherry-picking. How do we prevent cherry-picking by those who offer insurance coverage?

Dr. RIVLIN. You enforce the rule that they cannot do it. You have a regulated exchange with rules. If they are going to offer their wares on the exchange, they have to take all comers and at the same price, and they have to offer what Medicare offers. There are certainly ways of throwing off the exchange anybody who does not abide by those rules. In the early days of Medicare Advantage there was a lot of cherry-picking, but even in Medicare Advantage the CMS has managed to get rid of that.

Senator CONRAD. Can I just say in conclusion, Mr. Chairman, to me one of the biggest challenges we confront in Medicare reform is dealing with this risk of cherry-picking. You are quite right, you do it through regulation. But I think we all know there are geniuses in this country at getting around rules. That is going to be, I think, one of the biggest tests.

I thank the Chair.

The CHAIRMAN. I appreciate that, Senator. I do not have time, but that is an excellent question. If the benefits are the same under insurance policies offered under the exchanges, and the benefits are the same as traditional Medicare, I just do not see how a private insurance company is going to make any money and get the same benefits, if they are required to give the same benefits, when administrative costs are going to be a lot higher than a private policy. But that is just a question in my mind that we can get to later. I do not want to take other Senators' time.

Next is Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman. Thank you for this hearing.

Let me join the bouquet-tossing contest. We all so appreciate the tremendous commitment you both have made to public service. I think what I am going to do is, because time is short, I am going to ask you a question on the health care front and then you, Senator Domenici, one about tax reform.

Dr. Rivlin, it seems to me that there are now conservative people who oppose the Affordable Care Act, which includes health insurance exchanges so that Americans can compare policies, tight regulation to prevent the kind of cherry-picking that Senator Conrad was talking about, and generous subsidies for low-income people. But some of those conservative folks who oppose that in the Affordable Care Act want to bring just that approach to Medicare reform.

Then we have some liberal folks who do just the reverse. They support the President's approach in the Affordable Care Act for those under 65, but oppose it for those over 65.

So you listen to all this, and it just is a philosophical head-scratcher. I mean, you wonder what it is going to take to bring people together. You have made a very constructive contribution, not just in the past but today, because I believe what I hear you saying is you permanently want to protect traditional Medicare, with its purchasing power, and in effect see that as a public option, while at the same time allowing for the private choices. Is that a fair description of what it is you are trying to do?

Dr. RIVLIN. It is, Senator Wyden. I think it is an anomaly. I have teased Congressman Ryan about this: why are you in favor of exchanges for Medicare but want to repeal the Affordable Care Act? I think the anomaly is equally true on the liberal side. Liberals wanted a public option in the Affordable Care Act. We already have it in Medicare.

Senator WYDEN. I think you have stated it very well.

Senator DOMENICI. Senator Wyden?

Senator WYDEN. Yes, please. Senator Domenici?

Senator DOMENICI. Might I just say, you cannot imagine being on my side of the aisle now, where I cannot do what you do. I can just talk, I cannot vote. When we announce what our plan is on Medicare, those who oppose it immediately say, this is a plan to do away with Medicare.

So we wrote it in. In fact, we called the bill, at my suggestion, the Protect Medicare Act so that you would find, in the very language up at the top, it says Medicare is preserved, et cetera. Yet, they will stand right there and say, this does away with Medicare. You say, well, how does it? Here it says we keep it as a program.

So, I am glad you raised the point so we get a chance to say that is something we did, and it will work. They say it will not work. It will work. They say there will not be any people on Medicare, they will be elsewhere. But that is just the rhetoric. We have no evidence of that.

Senator WYDEN. Let me ask you both a question about tax reform. This is something I have felt strongly about for years. Senator Coats and I have a bipartisan tax reform proposal. We build on a number of the elements that you all offer and the Simpson-Bowles report does. But I want to ask you a question about simplicity because I think this is a part of the tax reform issue that gets missed.

Now, our numbers indicate that one taxpayer in five reports pass-through business income. These are essentially business owners or principals. So that is 27 million tax returns that claim pass-through income. In effect, 94 percent of those tax returns, about 25 million, are businesses with pass-through income of less than $250,000.

If we simplify the tax code and get rid of some of these one-category-after-another approaches with scores and scores of forms, is this not going to be a real shot in the arm to the cause of small business growth, given those numbers that I just outlined? Either one of you. Both of you took Medicare so well, I will let you both take tax reform also.

Dr. RIVLIN. Yes, I think so. Having the same top personal rate as a corporate rate is desirable because it gets rid of incentives to do your business one way or another, corporate or not, for tax reasons. That would help.

Senator WYDEN. Senator Domenici can respond quickly.

Senator DOMENICI. I think without a doubt there is an awful lot of restraint in this economy because people have to spend all their time doing things that are unproductive—like filling out tax forms. We take those out if you add positives. I think it would be a big plus for the small business people.

Senator WYDEN. Thank you both. I look forward to working with you.

Senator Cornyn?

Senator CORNYN. Well, let me join those who express our appreciation to both of you for your leadership on this important issue. My sense is that the needle is moving in Congress, and members on both sides of the aisle understand what you have so eloquently expressed in terms of the dire nature of our current circumstances and what the pragmatic solutions are, going forward.

That, perhaps, leads to more frustration, but not because—if we have bipartisan consensus as to the nature of the problem and sort of the 80/20 rule, agree to 80 percent of what the solution should look like, maybe we could discard the 20 percent we disagree on, and we can make great progress.

But I just would like to get both of you to talk about the status quo, the sequester, the $1.2 trillion in cuts that will take place unless Congress and the President act. I am told by major defense contractors that they are going to be obligated, by collective bargaining agreements or other law, to begin sending notices to their employees in October that there will be layoffs.

There have been some projections that as many as a million people in private sector jobs would lose their jobs in national security industries if in fact this sequestration takes effect as currently written, with half a trillion dollars out of defense spending.

So Senator Hatch was asking you about the combination. I like your analogy: it is not so much a cliff but a wall we are getting ready to run into, and quite predictable.

But the combination of the sequestration and its impact on private sector employment, beginning in October—not in the lame duck, not in January—combined with the prospect of the single-largest tax increase in American history unless Congress acts, I am sure people are scratching their heads, as I am, wondering, why is the President not sitting down with top congressional leaders and saying, how do we avoid this, as opposed to, I am sad to say, the President does not seem very engaged in this.

But I do not want to engage in politics, but I do want to ask you about the current path we are on unless something changes.

Senator DOMENICI. Well, I appreciate the question, and I want to tell you that we will get to you, for you and your staff's perusal and use, the report that was done, a white paper report, over at the Bipartisan Policy Center. I was co-chair of the group, along with the former head of the House Intel Committee—Dan Glickman—and former National Security Advisor Jim Jones, who is now over at our center.

We took about 3 weeks or 4 weeks, with an excellent staff, and we analyzed that bill. The analysis of that bill shows that something broke when that was put together. It is not a typical bill. It is very difficult to understand. When you get right down to number crunching, it is not a 10-percent cut, it is a 15-percent cut.

When you get down to the bottom, who is doing what, you find that every program, every agency, every act, they are all cut, and there is no flexibility. When you have something that big with that much impact, it cries out for flexibility to save money, to do things right, to prevent harming people when they do not have to be. So whoever did that, we thank them for a rotten, terrible bill.

The problem is, I do not know how Congress gets rid of it. I do know the Secretary of Defense has spoken eloquently about it. He got to use his budget hat a little bit from back in the days when he started there, and he says he cannot live with it. I think he will be working hard, but some of you have to take the lead in trying to find a legislative way to get rid of it or modify it.

I hate to just kick the can on that one because it is everything you said: it is causing people not to invest, it is causing layoffs, it is causing uncertainty of a high magnitude. When that happens, it costs money, and it costs growth, and it costs jobs, and it costs businesses their business.

Senator CORNYN. Senator Domenici, thank you very much. No one around here is claiming credit for the Budget Control Act and the sequester, as it was written.

My time is just about up. I need to pass it off to Senator Grassley. But would you just let me ask this question that I think calls for a succinct answer: would you agree with me that if the sequester, as currently written, remains the law of the land and takes effect in January, together with the expiring tax provisions on December 31, if they are allowed to take effect without Congress and the President acting, that it is more likely than not that the United States' economy will be thrown into a recession?

Senator DOMENICI. Well, I am not an economist, but I think that is the case. We are going to go negative. We are going to go negative, and we are going to lose jobs.

Senator CORNYN. Dr. Rivlin?

Dr. RIVLIN. Well, I am an economist, and I would agree with you. But I also agree with the Senator that the answer is not just to postpone it. Do something better.

Senator CORNYN. Thank you.

Senator Grassley?

Senator WYDEN. Next is Senator Grassley, then Senator Nelson.

Senator GRASSLEY. Yes. Thanks to both of you for being here and for your expertise in this area, and more importantly your energy for it.

I have two questions dealing with Medicare. One of them partly covers Medicaid as well. This 10-year budget window that we have to operate under is a problem because it is extremely difficult to find health care savings that CBO will agree save money in that window without using one of two tools. Congress either has to reduce provider payments or ask beneficiaries to pay more.

While I agree that we need to make structural reforms to our health care entitlements to reign in their long-term costs, I think we need to temper our short-term expectations.

Do you think that there are ways that we can achieve short-term, scorable savings in health care through structural reforms?

Dr. RIVLIN. I think you point to a very real problem. In the short term, it is very difficult to do that. We do not make big claims for our plan saving a lot in the first 10 years. It is the second 10 years and the third 10 years that you ought to be worrying about.

Now, there are some things that can be done in the near term, and we have proposed a few of them in Medicare: bundling payments and modernizing the structure of benefits a bit. But the long-run structural reform will take time, but that is fine. The threat is out there in the long run.

It is not that we are so afraid that Medicare spending is going to rise very rapidly in the near term. That is partly because these new seniors that we are talking about, the ones who are just retiring, are younger than the average Medicare recipient. So, the pressure is not going to be as great in the near term.

Senator GRASSLEY. All right. If you wanted to add something, otherwise I will go on to my second question.

Senator DOMENICI. Well, I would just say that, sometimes when we are working on trying to solve this fiscal problem, the recognition that a long-term fix is what is needed puts many people in the position that they do not know how you do that and do it now.

Well, if you write a law that brings the cost curve down like this, if the law reads that way, you have changed the expectation, and that counts and that helps you with your fiscal soundness that you are trying to work out. So the long-term is what we are looking for, yet it is hard to get scorable credit over the 10-year window, as you said. But we have to work with those people who do the scoring and get it done.

Senator GRASSLEY. My second question deals with long-term support services. This is a significant driver of cost of our entitlements, particularly for those who are dually eligible for both Medicare and Medicaid. Are there any structural reforms to those programs that you would recommend Congress consider to better organize spending for long-term support services that will be more efficient, as you suggest Medicare acute care reforms will in the end be more efficient? So in other words, you have a model that you argue will save money through more efficient spending for Medicare acute care services. How about the dual-eligibles, Medicaid, and long-term support services?

Senator DOMENICI. I do not know.

Dr. RIVLIN. I think the dual-eligibles are the most difficult population that we have to deal with. They are elderly, and they are poor. We would recommend continuing to try to move the dual-eligible population into managed care in the framework of Medicare.

You also raised the question about long-term care. That is a really tough one, and it is a big expenditure for Medicaid, as you know. One suggestion we considered—we did not actually recommend this because we were not sure—was a division of responsibility between the Federal Government and the States with respect to Medicaid, one taking the acute care and the other taking the long-term care. It could go either way, but we thought a clearer division of responsibility there and getting rid of the gaming that the Federal match often incents would be something worth considering.

Senator DOMENICI. I want to say we debated it a long time, but we could not come to a conclusion, so we just told you the options there; we did not conclude with one of them.

Senator WYDEN. Senator Nelson?

Senator NELSON. Thank you, Mr. Chairman.

Do you think the political atmosphere will have changed sufficiently after the presidential election that, were the super committee to be sitting again, that it would not be deadlocked in a partisan 6:6 vote?

Dr. RIVLIN. He is the politician.

Senator DOMENICI. Well, look, from my standpoint it seems to me so obvious that you have to act for your country. I mean, you have to put your mind-set almost like it is a war. I mean, you could lose it, and with it you would lose your status, your way of life. The very existence of the country could go flopping around for 20 or 30 years. Our money could have problems.

So I think there has to be more evidence to more members that that really is right around the corner. It cannot be delayed forever; it is there. I believe this committee will still have the power to get most of it done. I do not think we are going to need a super committee; this will be the super committee.

But I think the votes will be there to report something out either from this committee, or a super committee will be formed. I hope we do not form one. I hope we encourage this committee to do its job. You have most of the jurisdiction, and the rules are set. You have staff, and everything is kind of permanent. That is much better than inventing a committee, in my opinion.

Senator NELSON. Well, I agree with you. The way I understand it, the sequester was never supposed to go into effect. It was such a meat cleaver coming down, that it was going to get the 12 people on the super committee to come to agreement. And here we are.

Where in your plan does the 15-percent tax rate jump to the 28 percent?

Dr. RIVLIN. We will find it. Go ahead.

Senator NELSON. All right.

Dr. RIVLIN. I am not sure exactly what the income cut-off is.

Senator NELSON. Well, while you are finding that, I assume a driving factor in your plan was—and it is excellent, and of course I say the same thing everybody else has said: thank you all for your long, long public service. You are great, both of you. You continue that public service.

You have it?

Dr. RIVLIN. It is $51,000. That is presumably for a joint return?

Senator DOMENICI. Individual.

Senator NELSON. Individual, $51,000. That would——

Dr. RIVLIN. It is $102,000 for a couple.

Senator NELSON. And that is what we think of today as adjusted gross income——

Dr. RIVLIN. Right.

Senator NELSON [continuing]. Although you are not going to have all those deductions, save for the charitable and the mortgage interest. All right.

Well, what is your general feeling about your work product, which is a considerable, simplified tax code? What does that do to stoke up the economic engine of the country?

Senator DOMENICI. Well, again, I am lucky I work with an economist who has been through everything Washington has to challenge an economist with: CBO, OMB, et cetera. But I will answer first——

Dr. RIVLIN. Go ahead.

Senator DOMENICI [continuing]. And she will say whatever, she will fill it in. It seems to me that sooner or later something has to be done. The economy is suffering from an awful lot of people not knowing what is going to happen. Some big things have to get solved because big things are tied in with small things. When you add it all up, there is just no vibrancy, not as much vibrancy as we need.

We need something that will give us that. It seems to me a reformed tax code like the one we suggest, captured by the leadership and pronounced by them over and over to the American people as a solution to a difficult problem—here came a terrible problem, some good is going to come out of it, and here is the good. It might be the driver solution.

Senator NELSON. Well, I agree with you.

I want to get in one more question before my time runs out. I certainly agree with you there. Yours is a very simplified tax code, considerably.

If the Supreme Court strikes down the individual mandate, the penalty, can you fix part of it with legislative statute solutions, such as a limited enrollment period, such as late enrollment fees, such as public campaigns to get into the health insurance exchanges?

Dr. RIVLIN. Yes. I do not think the mandate was a necessary part of the Affordable Care Act. You could have done it different ways, by penalizing not having insurance without actually mandating it.

But to go back to your previous question, the other important thing is, we have lower marginal rates in our plan. I think that is conducive to higher economic growth.

Senator NELSON. Thank you, Mr. Chairman.

Senator DOMENICI. Might I say, Senator Nelson, I forgot, and I want to second the motion that the best way to get growth in an economy is to have lower marginal rates. That is the best way, and we have done about as good as anyone with ours in terms of that fact.

Senator NELSON. Fifteen and twenty-eight. That is simple, and that is lower.

Senator WYDEN. Senator Thune?

Senator THUNE. Thank you, Mr. Chairman. I want to also echo what has already been said and thank both of you for your great body of work and service. Mr. Chairman, it is always nice to have you back here. I wish we could get your biennial budget proposal through Congress. I think it would do a lot to improve the way things work around here.

I wanted to ask a couple of questions. You assume $2.6 trillion in revenue from the new revenue system and tax code that would be created under your proposal. According to the CBO, I think, for a 1-percent increase in economic growth, they assume about $310 billion in additional tax revenue.

That, I assume, would be under the current, existing tax code. But I am wondering, of that number, how much of that revenue—or is there any of that, I should say maybe as a better way to ask it, that is assumed increased economic growth? Do you see, with a simpler, flatter tax code that is more competitive, that it would generate growth, and did you factor in what might happen as a result of that?

Dr. RIVLIN. We do believe that, but we did not factor it in.

Senator THUNE. All right. So yours is all static in terms of the scoring with regard to the tax component.

Dr. RIVLIN. Well, we use, roughly, CBO methods.

Senator THUNE. All right.

Senator DOMENICI. I do want to say that we had a lot of discussion about what level of taxation is right, and nobody knows the answer as to what is the best for America. I guess we would start by saying, from the vantage point of this Senator, the lower the tax, the better in terms of the economy and its capability to produce and grow. But is 20 percent too much? Is 20 percent too low, just right? Nobody knows that. If you have the right mix elsewhere, it would seem to me you can thrive. That is what we hope we have gotten in this tax code.

Senator THUNE. Yes. Well, I think that, based on historically the way you have pegged that, as a percentage of GDP, it is about in the right place. The times when we have balanced the budget since 1969, which have been a handful of times, spending as a percentage of GDP has been significantly below where it is today too, I want to say somewhere on the order of 18.7 percent of GDP. So, obviously we have to get the spending issue addressed. That comes back to your other issue of entitlement reform.

The only thing I question a little bit is the wisdom of having the gains rate the same as the ordinary income rate, or treating capital gains as ordinary income. It seems like whenever we have had a lower capital gains rate, we have seen a significant increase in revenue just from the economic activity and turnover that occurs with that. I like the simplicity of having the two rates, obviously.

Dr. RIVLIN. I do not think the actual record bears that out, Senator. We have looked carefully at the revenues from the capital gains tax and compared them to the rate, and that actually does not show that we have had less revenue from higher rates, except very temporarily when you announce in advance that you are going to raise the rate.

Senator THUNE. Right.

Dr. RIVLIN. Of course, a lot of people sell that higher rates produce less revenue. But for the long haul, the evidence actually does not say that.

Senator THUNE. All right.

Let me ask quickly as well here about the Medicare reform component of this. I think the chairman asked how yours differed from Simpson-Bowles in terms of how it treats Medicare. I am interested in knowing, because I have seen this reported on. You sort of pioneered the whole idea of premium support. The House adopted, in the Ryan budget, a premium support plan, but I think, Dr. Rivlin, you have indicated in some of the things that I have seen, that that is not consistent with what you all had proposed.

So I guess I am curious as to, how is the House budget proposal with regard to premium support in Medicare different from what you all put forward?

Dr. RIVLIN. Well, it depends which House budget you are talking about. The original Ryan budget of 2 years ago had a very severe version of premium support which did not preserve traditional Medicare and had a very punitive cap on the allowable increases in support, which was only at the cost-of-living rate of increase. That would have ended traditional Medicare as we know it.

However, in the meantime, Chairman Ryan has moved to the middle, under the influence of Senator Wyden among others, but especially embodied in the Ryan-Wyden/Wyden-Ryan version of premium support, which does have some differences from ours but is basically the same idea, that you preserve traditional Medicare as the default option and you allow seniors to choose on a well-regulated exchange among private plans.

So it does not end Medicare. It gives a choice, and we think a competitive situation which can lead to savings.

Senator THUNE. So we call that the Wyden effect?

Dr. RIVLIN. I call it the Wyden effect. [Laughter.]

Senator THUNE. All right. I see my time has expired, Mr. Chairman. Thank you all very much for your testimony.

The CHAIRMAN. Thank you, Senator.

Senator Menendez? Oh, he is not here. Senator Cardin?

Senator CARDIN. Thank you, Mr. Chairman. I, too, echo the comments of all of our colleagues. Thank you very much for your long years of public service, including on these recommendations that you have brought forward.

First, I want to encourage you to at least keep on your personal agendas the national consumption tax. I understand the popularity issues, but I tell you, I am concerned, even if we are able to pass tax reform, about how long that will last before it gets complicated again because of the desires of the political system to make adjustments in that base. A national consumption tax, I think, can be done in a fairer way than our current income taxes. It is border-adjusted, and it has a lot of advantages.

So I understand the reasons for your change, but I just really want to go on record to encourage you to continue that debate. I think we will get to it one of these days.

On the recommendations for Medicare and health care costs, let me just give you my concern and get your response to it. It is not the exchanges. As a Democrat, I understand putting exchanges in Medicare. It is the concern that, to bring down cost with the premium support, you are assuming that there will be savings from the institutional players or consumers that will bring about delivery system reforms that will make our system more cost-effective.

I am concerned about that. We have tried that once with Medicare+Choice, and it did not work. In my own State of Maryland, we had the insurance companies ultimately abandon it in our State. We then paid the private insurance industry a premium in order to get private insurance. Under your exchanges, you do have a fall-back of fee-for-service, but you do not really have a public insurance option that may be competitive. I welcome your thoughts on a public insurance option on managed care.

I think the alternative is to look at direct delivery system reforms with accountability, with some form of enforcement. You have enforcement on your overall numbers based upon caps, and how they are enforced we are not exactly sure.

I understand we have to get scorable savings, but I would feel more comfortable if we did it on direct involvement of delivery system reforms, particularly working with physician groups and hospitals in some form dealing with the more difficult and costly patients rather than trying to put the whole system in jeopardy where we may just be shifting costs from the Federal Government or from the State governments to the private sector or individuals, which may not, at the end of the day, really help our economy.

Dr. RIVLIN. First, on the consumption tax, I appreciate that. I think on somebody's agenda also ought to be still a carbon tax. I just wanted to get that in.

Senator CARDIN. Good.

Dr. RIVLIN. But on——

Senator DOMENICI. Before you go on, let me say I agreed with the choice that we not continue on with the consumption tax. I see it as nothing but an obstacle—and we have plenty already—to getting things done. The carbon tax seems like, for some people, a good tax. To me, it does not, so I want to make sure I am on the record.

The CHAIRMAN. I am sorry. You like the carbon tax or not?

Senator DOMENICI. No, I do not.

The CHAIRMAN. All right.

Dr. RIVLIN. We differ on that.

Senator DOMENICI. We did not get it through our Task Force, either.

Dr. RIVLIN. Yes. We did not put it in our plan.

The CHAIRMAN. All right.

Dr. RIVLIN. But let me come back to Senator Cardin's concern. First, we would encourage and keep all of the reforms that are embodied in the Affordable Care Act to try to do exactly what you are talking about with existing Medicare, Accountable Care Organizations, and innovations in payment systems. I think probably fee-for-service Medicare, whether you go with premium support or not, is likely to evolve in the direction that you suggest, and we would encourage that.

We think it ought to be encouraged in the private sector as well. Although Medicare Advantage, as you point out, was badly structured at the beginning, and the history in Maryland was bad——

Senator CARDIN. No plans remained at the end of the day.

Dr. RIVLIN [continuing]. It has been improved and is actually working much better in a lot of places, including, I understand, Oregon. But you could think of what we want to do as a considerable improvement in Medicare Advantage by creating exchanges and having real competition, which has only slowly evolved in Medicare Advantage.

Senator DOMENICI. I would like to comment and make sure that we do not overstate our case. The entirety of reform in the Medicare health delivery system, we did not do that. We did not have enough time, nor enough staff. We just proposed a reform for the overall structure of the system. Alice and I have a work in progress examining other healthcare reforms with ample staff who are trying to get at the whole package of problems and see how we can come up with solutions.

Dr. RIVLIN. Meaning the whole system, not just Medicare.

Senator DOMENICI. Yes, the whole system. So that is a few months away from reality. We were not able to do that in our original efforts.

Senator CARDIN. Thank you.

The CHAIRMAN. Thank you.

Senator Snowe?

Senator SNOWE. Thank you, Mr. Chairman. I want to welcome both of you here today. Senator Domenici, having served with you on the Budget Committee when you were chairman, I certainly found that one of my best experiences here in the U.S. Senate. I want to thank you both, Dr. Rivlin as well, for your legendary and exemplary contributions and commitment to this effort in underscoring the urgency associated with these issues that these times demand.

Hopefully we are going to address them in some way. That is one of my first questions, because I think, when it comes to tax reform, as you are recommending as part of entitlement reform, how do we go about this without the presidential leadership that is so essential to this debate?

We had a witness testify before this committee last night from the Treasury Department, indicating that there were no plans in the works for comprehensive tax reform. So how does this effort get under way without strong support from the President at some point?

I well recall when President Reagan delivered his State of the Union address back in 1984. He mentioned that one of his top priorities was tax reform. There was some laughter in the House chamber by members. He said, “What, did I say something funny?” So I think he was truly committed to it.

That is what it is going to require in this instance, irrespective of the demands of the time. We are at a tipping point. I am not so sure that we are going to see the kind of drive that is necessary to get this accomplished in the time frame in which we should accomplish it.

So, one, how essential is presidential leadership in this undertaking? Two, what is the time frame that you foresee, in the lame duck session or beyond, and what will the impact be on the economy if we fail to do this sooner rather than later?

Senator DOMENICI. Well, I will lead off and then let Alice comment. I guess I would say to you, Senator, before I get on the substance, that I am sorry to see you leave. I read about your departure soon.

Senator SNOWE. Thank you.

Senator DOMENICI. I left for different reasons than you. I think you know why I left.

Senator SNOWE. Yes.

Senator DOMENICI. It turns out I did not have the exact illness that the doctors thought I had, so I am still able to function somewhat adequately, and I am feeling all right. I am hoping for you the very best in whatever you choose to do.

Senator SNOWE. Thank you.

Senator DOMENICI. I wanted to say that we cannot, in my opinion, accomplish what must be done for this great country in terms of fiscal responsibility without the direct and total commitment of a President. That has to be there.

I do not see how we can take on tax reform and things like Medicare reform without a President telling the American people why it is necessary. You can tell them, other people can tell them, but when it comes right down to it, when we have to change basic things to save the country, you have to have the President helping.

I believe that that has to happen. I guess the rest is, I hope it happens, and the sooner the better, in my mind. I assume lame duck is not adequate time. Even the next session might not be adequate for the big package. But sooner rather than later ought to be the adage around here that we are following. "Without the President we do not get it done" ought to be the hue and cry from the Congress and the people of this country.

Senator SNOWE. Thank you.

Dr. Rivlin?

Dr. RIVLIN. I agree with that. I think, with respect to the lame duck, which is sooner than we think, it is probably impossible to do the whole job in the lame duck. It is just too hard to reform the tax code and the entitlements and do everything in such a short time with a lame duck session. But I believe you could lay the groundwork, the framework that would require the next Congress to fill in the details and get it done by a date certain, and you really need to do that. I, too, will be sorry to see you leave the Senate.

Senator SNOWE. Thank you. Thank you.

Well, CBO indicated that between the impact of the sequester and the failure to extend the current tax rates, there could be an effect on economic growth, anywhere from 1.5, 1.7, to 3.5 percent on economic growth. So given that, what would you be proposing for the Congress to do with respect to those tax rates if we cannot achieve any kind of tax reform in the lame duck session?

Dr. RIVLIN. Well, I think you have to postpone the tax increases, but with a requirement to fold it into tax reform and entitlement reform that has some teeth in it in the next session. That would not be easy to design, but if there is the sense of urgency, which we feel there ought to be, then everybody has to be committed to doing that.

Senator DOMENICI. I agree with that in substance and with reference to the genuine need to do something. I wholeheartedly agree.

Senator SNOWE. Can I just ask one other question? When do you expect the level of taxes as a percent of GDP to hit 20 percent, under your proposal?

Dr. RIVLIN. Not soon, because it is way down.

Senator SNOWE. Right.

Dr. RIVLIN. And that depends on how fast the economy recovers.

Senator SNOWE. Yes. And your target for spending as a percentage of GDP?

Dr. RIVLIN. It is ultimately a couple of percentage points above our revenues. The answer I am told, to when, under our revenue projections, you would get to the 20 percent would be around 2019, but that, as I said, depends on how fast we recover.

We are not, as Senator Domenici said earlier, aiming for a balanced budget, not because we would not like it but because we think the first thing you have to do is stabilize the debt, make sure that it is not growing faster than the GDP, and that would imply a deficit of around 2 percent. That is about what we achieve under our plan.

Senator SNOWE. Thank you.

Yes?

Senator DOMENICI. I want to remind the committee again, and I will say it to you, Senator Snowe, remember, our package was put together by Democrats and Republicans, so we do not come here starting with one side or the other. We have already gone through the compromises, and how much is enough to cut, how much is too much.

People on each side going their own way can find fault with this because it is not theirs, but we cannot do theirs unless Democrats have the power, or the Republicans, to take over everything. The problem is there, and it must be solved by Senators, not by parties, it seems to me, so everybody has to understand that.

Senator SNOWE. Well, congratulations. I commend you. It is a great example to set for the Congress to pursue and, again, reinforces the notion of the fiscal calamity that awaits us if we fail to address these over-arching issues sooner rather than later.

So, thank you.

The CHAIRMAN. Thank you, Senator.

You both say that the tax cuts should be extended into next year. I think if I heard you, Dr. Rivlin said we should then work to enact some kind of tax reform process which presumably generates revenue, but some kind of reform which has teeth in it.

There are some who say if we extend the tax cuts to next year, 2013, that we are just kicking the can down the road, that Congress will not do what it needs to do to raise revenue, and that is, raise taxes, as you suggest you have to do in your plan. If the tax cuts are extended into next year, then the argument is, you are just kicking the can down the road. We are not going to do our work.

On the other side of that coin, people say, let them all expire, let the rates all go back up, and then we will start to cut taxes next year. Then the pressure is on the Congress to actually do something by cutting taxes in a way that is consistent with tax reform.

What do you say to those who have a little problem with your recommendation? Your recommendation is to let all the tax cuts be extended another year. That is easy to do politically. What do you say to those who charge that that is just kicking the can down the road?

Senator DOMENICI. Well, Mr. Chairman, I am not sure—on the record they can check—but I do not think I have said verbally that I favor the extension.

The CHAIRMAN. Oh, I misunderstood.

Senator DOMENICI. It is all right. I mean, I do not think there is any alternative, so I think we have to do that. But I want you to know that our Bipartisan Policy Center has not left this issue, the one you raise, unattended. We are currently working on a process which would assure that we could have the vote on the tax cuts that you say must occur, but require it to be part of a process change that would force action on tax and entitlement reform in the next Congress.

In other words, it would be a mechanism for assuring that it would happen, and the kick-the-can effect would not be real because there would be a process adopted that would stop the kick-the-can, because the next thing would force the necessary reform.

The CHAIRMAN. Well, what would some of the real teeth be?

Senator DOMENICI. Well, we are not through with it yet. It is just our best effort to try to solve that, or come up with something that would help you solve that problem. It is not ready yet.

The CHAIRMAN. So when do you think you might have these teeth?

Senator DOMENICI. I do not know. I remember getting a briefing from the staff. It is hard as can be. It has our smartest people on it, and it is tough, but they have convinced me that it is worth a try. It would relate in some way to the process that you and I have learned and call reconciliation, that is for sure, and there is one other comment. Yes, the continuing resolution would be the vehicle through which you would attach that, and we would have it ready by then.

The CHAIRMAN. All right. Well, frankly, if you could have it ready before then—— [Laughter.]

We are all in this together. We are all on the same team. We are just trying to figure out how to address the cliff.

Senator DOMENICI. Thank you.

The CHAIRMAN. We can help each other, frankly.

Dr. RIVLIN. But the basic point is, we are not in favor of just extending the tax cuts. You have to imbed it, as I said to Senator Snowe, in some kind of process that forces you to come to grips with the real problem.

The CHAIRMAN. Yes. And I am just trying to determine what that process is that is credible, credible to the markets, credible to the country, and so forth.

I would like to return a little bit to Medicare and ask whether you have cranked the new CBO estimates into your projections, your Medicare projections, if nothing is done. It is my understanding that CBO has just come out with a new report saying basically, over the next 10 years, Medicare will grow at the same rate as the economy, and long-term it will grow about 1.6 percent above GDP. Historically, Medicare grew at about 2.5 percent above GDP.

The point being, health care costs, on their own, are starting to rise a little less quickly than they were earlier. I hear a lot of this anecdotally, too, talking to hospitals moving toward integrated systems. They are becoming much more efficient. Many American companies are trying to cut their health care costs and are doing a pretty good job, in some respects, of cutting their costs.

It is true there will be more seniors who will be retiring at age 65, although I vaguely remember a CBO report roughly a year or two ago that said, if you look at the composition of the rate of growth of Medicare costs, about one-third—I will be very charitable—or 20 percent to 30 percent is really because of additional seniors.

Senator DOMENICI. Is what?

The CHAIRMAN. Because of the additional number of seniors, the Baby Boom retiring. But the rest of it, the bulk of it, is health care costs going up for everybody.

Senator DOMENICI. Right.

The CHAIRMAN. Not just for seniors, but for everybody. It is true, if these CBO numbers are accurate, even if the current trend continues—trends never do, but if it does continue—that that would seem to me to indicate that there is not quite the urgency to address entitlements with quite the same aggressive attack mode as you have indicated in your report. Times have changed a little bit.

I honestly believe part of that change in the rate of growth of health care costs is due to the health care law we passed. The United States' providers and consumers realize we are in a new era, and the new era is getting more control of our costs and delivery system reform. So both the U.S. Government—under CMS, say—and the private sector are working, and with the Innovation Center too, working together in joint public projects to find more efficiencies through greater innovation in cutting health care costs. So I just wonder again. My first question is, have you cranked in those new projections by CBO in your estimates?

Dr. RIVLIN. Yes, and they are encouraging, I agree with you. It is one of the reasons why one should have faith, I think, that the health care delivery system is improvable. We are seeing some improvements now. But we still believe that it would be a sensible thing to do, to offer seniors a choice on an exchange where the private sector would also be competing by virtue of some of these same changes to offer better product at lower cost.

The CHAIRMAN. I am not challenging you, but I am just trying to get some information here.

Dr. RIVLIN. All right.

The CHAIRMAN. If the benefits are the same, if an insurance policy offered in an exchange provides the same benefits as are currently provided under Medicare, where are the savings?

Dr. RIVLIN. Well, actually the evidence shows that in some cases the competition produces still lower costs than Medicare. In some parts of the country it does not, but having the competitive situation there would tend to move the whole system toward more efficient and more cost-effective care.

The CHAIRMAN. Yes. I know that is the theory, but I am just curious because Medicare's administrative costs are so low. Commercial health insurance administrative costs are quite a bit higher.

Dr. RIVLIN. They are, but——

The CHAIRMAN. The benefits are going to be the same. I am just curious where the savings are going to be.

Dr. RIVLIN. Much of the waste, I think, in Medicare comes from the fact that it is primarily now a fee-for-service system with little opportunity to have incentives for coordination of care and all of the things that we think are conducive to better care at lower cost.

The CHAIRMAN. That is true, somewhat. But there is such a trend now, and there is such momentum to move away from fee-for-service and more toward other forms of reimbursement, whether it is—as you know much better than I, Dr. Rivlin—bundled payments, ACOs, medical homes, and all the different ways to get off this fee-for-service reimbursement-in-volume kick.

We had right where you are sitting, or virtually where you are sitting, in this room last week health insurance companies and medical groups describing all the efforts they are taking, moving toward compensation based on outcomes, and it is teamwork and getting costs much lower than they were before. That would apply to the private sector as well as to Medicare. So, we are moving directly toward what you are just suggesting, that is, away from fee-for-service. Very clearly, that is what is happening here.

Dr. RIVLIN. Yes, I think that is right.

The CHAIRMAN. But that is going to help reduce the costs, frankly. At least, that is the theory. Already, the rate of reduction is going up.

Dr. RIVLIN. I think it is more than a theory; I think it is happening.

The CHAIRMAN. Yes. I think it is, too.

Dr. RIVLIN. We would like to accelerate it happening.

The CHAIRMAN. And so would we.

Senator DOMENICI. I am not sure it is happening. We have to wait a little bit longer.

The CHAIRMAN. All right.

Senator DOMENICI. You speak of anecdotal—I will not burden you. I would not. But I am clearly a senior, right?

The CHAIRMAN. No, you are not a senior.

Dr. RIVLIN. Me too.

Senator DOMENICI. I just celebrated my 80th, you know. People think 60, but they forget that I was here 36 years of my life.

But anyway, I was going to tell you just what the doctors choose to do to make me stay well leads me to believe that there is an infinite amount of money that they can spend on the human body to try to make sure things work. I have had more spent on me; I do not want to add it up and give it to you because it would be a case study for you.

But what I would like to say with reference to our answers, we are glad that you have talked with us and you see our—on Medicare and health care, we studied it from the standpoint of fiscal responsibility. That was our job. We now have another group of people who are working day and night on the entire system, and that is not us, that is others.

Dr. RIVLIN. We are part of it.

Senator DOMENICI. Yes. We are part of them, as members of a group. All I am getting at is, we may not know all the answers that you seek of us because we did not have a lot of time to study in detail the more intricate health care issues.

The CHAIRMAN. Well, I appreciate that. I think we are all concerned about personal responsibility too, because very often doctors prescribe medication and prescribe something to patients, and the patients do not do what they are supposed to be doing or take the medications they are supposed to be taking. You kind of led briefly into the question of personal responsibility, and that is something else that we have to address.

Senator DOMENICI. Well, that is clearly a part of it, no question.

The CHAIRMAN. I will finish here with one point. In reading this morning's paper, I was just struck with a chart that is showing, even adjusted for inflation, how, since 2001, median hourly wages are basically constant, or have fallen slightly.

But the bigger drop was in employer-provided health insurance, and there was also a bigger drop in employer-provided retirement benefits. If that is happening, I think that is private sector. I am sure it is private sector. If that is happening, that there are fewer and fewer benefits, and employees have less health insurance today than 10 years ago, I am just a little concerned about what changes it might make in Medicare and addressing the entitlements question in a way that does not decrease benefits to seniors.

Now we, in the health care bill, as you know, reduced the reimbursement rate that goes to providers, whether it is pharmaceuticals, hospitals, et cetera, et cetera, as a way to get at the health care problem. But that did not reduce any beneficiaries' benefits, it just cut the amounts that providers were otherwise getting. They went along with it. They did not love it, but they went along with it. Why? Because they would get lower margins and get greater volume under the mandate.

I raise this because I saw this chart today. Given the semirecession that we are coming out of, and because fewer people have health insurance today than before, I wonder how wise it is, when we attack entitlements, to do something that reduces seniors' benefits.

Dr. RIVLIN. Mr. Chairman, I think you have pointed to one of the reasons why we needed the Affordable Care Act. It was a response to the fact that, over time, employers have been dropping health insurance and we have more and more people at relatively low wages—wages have not been increasing very much—who do not have health insurance. The health reform was a response to that.

Fortunately, seniors are covered by Medicare, and everybody has that who is over the age of 65. We do not read anything that we are proposing as undermining Medicare. We hope that it will make it more efficient. But it is not any attempt to reduce the benefits to seniors.

The CHAIRMAN. Thank you very much.

Senator DOMENICI. I think you raise a good point. We have to be careful about the issue you raised. It is a serious one. We certainly are not—to my knowledge as we worked on this, there was no effort to try to reduce benefits. I think that we were addressing ways to save on costs that should not be in the system, and we worked hard on that and gave you the best we could.

The CHAIRMAN. Thank you.

Are you ready, Senator Menendez? Do you want to take over?

Senator MENENDEZ. Mr. Chairman, I would never want to take over from you. [Laughter.]

The CHAIRMAN. Senator Menendez.

Senator MENENDEZ. But I am happy to be recognized next.

The CHAIRMAN. The great Senator from New Jersey.

Senator MENENDEZ. Thank you.

Let me thank both of you for your great work. I appreciate, Dr. Rivlin, your service. Senator Domenici, it is great to see you again back here with us.

Senator DOMENICI. Thank you.

Senator MENENDEZ. I may not agree with every decision that you made; I do not think anybody ever will in any of these plans. But I think you have made some enormous service to getting a lot of the critical issues that are important to address out there, and I think that is a great service to both the Congress and to the American people.

I want to pursue one or two things to get your thinking on them. One is, I understand under your plan, while lowering the top income tax rate, you would effectively end the tax break for investment income. That is, tax rates would be lower but the government would basically no longer pick favorites between a worker's salary and an investor's profit.

In addition to your report, several other deficit reduction plans and President Reagan's 1986 Tax Reform Act all included this trade-off, which would go a long way to ensuring that those who make the most pay a similar amount of tax as middle-class families do.

Can you explain how you came to this trade-off, and do you believe that equalizing the tax treatment of ordinary and investment income is key to a bipartisan success in finding a deal of the type of magnitude that you both outlined?

Dr. RIVLIN. It was key to our finding an agreement. I think it is a sensible way to construct a new tax code.

Senator DOMENICI. Before you came here, I said that we are fortunate, and we want to make sure you know that what you get, the work product you get, is bipartisan. We took votes on the issue that you have raised, and that is the way that the overwhelming majority wanted this package to be. So, they put a good deal of bipartisan thinking into the package.

Actually, for a couple of members of the group, tax reform was the most important part of this bill, without which they would not have supported the recommendations. So I assume that, taken separately, a number of those—one or two that I can think of—probably would have been against what you are talking about.

But to get the whole package, including tax reform and lower rates, Republicans joined Democrats in our meetings, so we come to you with that established. I do not know what theory was in their minds about it, but they were for different treatment for investment, as you have explained it and as Alice has indicated our cause to be.

Senator MENENDEZ. Your testimony underscores a critical need for Washington to remember that our first project must be, as you put it, to accelerate economic growth and job creation. I understand that you are still supporting a payroll tax cut as the primary job creation measure in your proposal.

Can you explain how your proposal compares to the President's payroll tax cut from his jobs plan, and do you believe, given the current uncertainty, particularly in the European crisis, that it would be important to move forward with a similar proposal for 2013?

Dr. RIVLIN. When we put this plan together, which was actually at the end of 2010, the President had not yet proposed, or the President and the Congress together had not yet proposed, a payroll tax cut, a payroll tax holiday.

We believed that it was really important to focus on job creation in the near term, so we put in our proposal a full year tax holiday, for both sides, employer and employee, as an indicator of that importance. That is a lot of stimulus. Some of that was picked up in the agreement made subsequently, but not all of it.

We have not re-thought what you would do with the payroll tax rate right now, but the basic message is, we believe that it is important to keep the recovery going, that the fiscal cliff would stop that recovery, and therefore you need to avoid the fiscal cliff and do the long-term reform at the same time.

Senator DOMENICI. I think it is little-known, but the truth of the matter is that a good stimulus approach would have been a payroll tax—we call it a payroll tax holiday. We put it in our plan for a full year, as indicated, and still it had not caught on with anyone.

Although a small piece of it was enacted for the past couple years, we went through a year when the entire holiday still had not caught on, and it was still in ours. We recommended it. It seemed to this Senator that, for all the stimulus people were talking about, the payroll tax was far more simple and probably far more effective. But I do not think we ought to do it at this point. It is very expensive, and we ought to get on with the next stage of our plan—the deficit reduction—which is what we are talking to you about.

Senator MENENDEZ. One final comment, if I may, Mr. Chairman. I appreciate the way in which you approach the challenges, the fiscal challenges, because I get concerned when I see some of our colleagues in the other body and their suggestion of how we meet those fiscal challenges. You cannot put this all on the back of the middle class in this country, which in my mind is the core of what upholds our ability in terms of the Federal Government and its resources.

There is a disproportionate effect upon the middle class in the context of some of the provisions, like the House budget. In your proposal, while the middle class shares in the responsibilities, it is not disproportionate. I am wondering if you were thinking about that in the context of how you fashioned this, or is that just how it came out? Was there a focus there in that respect?

Dr. RIVLIN. Yes, we certainly focused on it, and, particularly in the tax proposal, we wanted it to be at least as progressive as the current tax code, and we made that happen.

Senator DOMENICI. I think that the last point that Dr. Rivlin made you can find in the report: that our plan is more progressive than the tax code we are replacing. We worked very hard to make sure that we confirmed with the experts that that is what we were doing.

For some, it was a real shock when the experts said, yes, our plan is progressive and it is better than we are now. That is because it really is made progressive when you close loopholes and lower the rates, and we also had something in there that took care of the working poor. It started way back under President Ronald Reagan. That model is embedded in this, although taxes will be computed in a different, more simple way than before.

But that is in there, and that helped us get more progressivity. I think we are substituting the word "progressive" for the broad-scope effect on the American working people. I think progressiveness is what we found to satisfy that yearning on our part that would be fair.

Senator MENENDEZ. Thank you both.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman.

Dr. Rivlin, let me follow up on an important point I think the chairman was getting into there with respect to the trajectory of the health care costs. I think the chairman is right: these numbers that are coming out have been encouraging over the last year or so. I think we have a pretty good sense of what it is about. We are moving towards more coordinated care and away from fee-for-service.

I think the chairman's roundtable that we had just a week or so ago was also very constructive in this regard. It was essentially talking about bringing private innovation to other parts of government, to Medicare in particular.

What I think you are talking about is, let us say "no" to coupon care. Let us say "no" to this idea of just a voucher, where you are going to give people some flat sum of money and it is never, for the senior, going to keep up with their actual health care costs.

What you would like to do in order to build on some of these positive developments that we have seen recently is, in effect, keep the purchasing power of traditional Medicare, try to say that, when the private sector choices are good and they have been certified by government, you put them into an exchange for the first time, and in effect then traditional Medicare and the private sector would hold each other accountable and improve each other and in effect allow us to take the next steps in encouraging the trends that the chairman has correctly pointed out. Is that a fair recitation?

Dr. RIVLIN. Yes, I agree with that. It has sometimes worried people who have looked at our plan. They said, would the oldest and sickest recipients not remain in traditional Medicare and the younger, healthier ones go into the private sector? We do not think so.

We think there is some evidence now that private plans are getting themselves together to figure out, how do you deliver care to people who have, say, multiple conditions that many older people have, like diabetes and heart problems, and figure out, how do you deliver care effectively to them in a coordinated way and compete for that business?

Now, they would not, as you say, get just a sum of money, a voucher. They would get a risk-adjusted payment, which would compensate them for taking older and sicker people, but we believe that the competition there could result in benefits to people who have really quite difficult situations.

Senator WYDEN. Well, thank you both.

Mr. Chairman, I think the point you made with respect to those promising trends coming out of, particularly the Accountable Care Organizations and the demonstration projects, is spot-on. I think the debate that we are going to obviously have is, what else can come after that? But I certainly share your view on that point. I thank our witnesses, and thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

If I might ask——

Senator DOMENICI. Mr. Chairman, could I comment on his question?

The CHAIRMAN. Sure.

Senator DOMENICI. Let me say to you, Senator, we appreciate the analysis and the way you explained this system we are studying, because much of the rhetoric to it is hard for us to handle because people just say, this is going to lead to the sickest getting the worst treatment and those who are well getting the best treatment.

We just have to say, that is not what is going to happen. Now we have refined it where we can do what you described here, and it is obvious we can make it right, make it fair, and make it do its job. As you explained it, that helps everybody, and we thank you for your interest in it.

The CHAIRMAN. I have to leave here, so I would appreciate a short answer. As I understand it, you project about a $2-trillion savings over 20 years for your optional premium support recommendation. I am just curious how you arrived at $2 trillion and what the basis for the $2 trillion is. Where does that estimate come from, and so forth? Is it an estimate, or is it a cold calculation, a cold data set and you just grind it out? I am just curious where it comes from.

Dr. RIVLIN. It is a projection. As you point out implicitly, we do not get much savings—we get some savings—in the first 10 years, but more in the second. The reason for that is that the CBO baseline to which we are comparing this goes up much more rapidly in the second 10 years.

The CHAIRMAN. Yes. I am just curious. I do not have many opportunities to ask you questions. How did you arrive at that number?

Dr. RIVLIN. By projecting the——

The CHAIRMAN. What did you use to make that projection?

Senator DOMENICI. We have to get people to help us, if you do not mind.

The CHAIRMAN. All right. Right.

Dr. RIVLIN. Well, a lot of the analysis that we did depended on looking at what is already happening in Medicare Advantage, that in many places—in fact, in more populous places where more people live—Medicare Advantage plans are already cheaper than the fee-for-service plan. So, it depended partly on projecting that kind of benefit.

The CHAIRMAN. Well, that is helpful. I appreciate that.

Dr. RIVLIN. The analysis of the savings is the same for the first 10 years as the second 10 years. It is the baseline that is different. I thought that was what you were referring to.

The CHAIRMAN. Right. No, you answered my question in the first part of your answer, namely by looking at Medicare Advantage competition.

Dr. RIVLIN. Right.

The CHAIRMAN. There are results under Medicare Advantage.

Dr. RIVLIN. Yes, and other competitive systems.

The CHAIRMAN. Right. I have to run. I am way late. Go ahead. Yes, Pete?

Senator DOMENICI. But there is also a cap in there.

The CHAIRMAN. Sure. All right.

Dr. RIVLIN. Yes.

The CHAIRMAN. Good. Thank you very, very, very much. We look forward to your updated analysis with the trigger and the vehicle in tax reform. Thanks a lot. I appreciate it very much. This is an issue we obviously care deeply about. I think if we will increase our analysis and focus, we will get the result that we all want. Thank you very much.

Senator DOMENICI. Very good.

The CHAIRMAN. The hearing is adjourned.

[Whereupon, at 12:22 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding the Rivlin-Domenici Deficit Reduction Plan and the Fiscal Crisis
As prepared for delivery

President Truman once said, "America was built on courage, on imagination, and an unbeatable determination to do the job at hand."

We are here today to discuss the fiscal crisis we face at the end of this year. Overcoming this crisis is the job at hand.

We are pleased to have Senator Pete Domenici and Dr. Alice Rivlin with us. They are the co-chairs of the Debt Reduction Task Force at the Bipartisan Policy Center. In November 2010, Senator Domenici and Dr. Rivlin released a comprehensive debt reduction plan.

That plan has helped inform the debate for more than a year and a half. It has been updated. And as we approach the looming fiscal crisis it takes on new importance.

At the end of this year, our fiscal landscape is scheduled to change dramatically.

The 2001, 2003 and 2009 tax cuts, the patch on the Alternative Minimum Tax, and other key tax provisions will expire. That would cause steep tax increases on middle class families. The across-the-board sequester of many Federal programs will kick in. Medicare's physician payment system will force a deep cut that threatens seniors' access to doctors.

Sitting back and letting all of this happen would mean disaster for our economy. In fact, the non-partisan Congressional Budget Office projects it could throw us back into recession. It would doubtlessly deal a blow to our standing in the world.

During the first half of 2013, GDP would shrink by 1.3 percent. And over the entire year, GDP would grow only half a percent.

Canceling the sequester and failing to raise more revenue – maintaining the status quo – would also be disastrous. It would tell the American people and the world that we are not serious about our deficit problem.

If we do not find additional revenue and we cannot agree on spending cuts, debt held by the public would reach more than 100 percent of GDP by fiscal-year 2022.

We need a comprehensive debt reduction plan that does not shock the system with deep, immediate cuts. Instead, we need a practical, responsible plan that gives confidence to the markets and the country. What would such a plan look like?

The plan should substantially lower deficits and debt over the next ten years and beyond. The plan needs to be fair, and everyone must contribute.

The plan needs to be balanced. This will require cuts in spending. But we need more revenue to pay for America's needs. We don't just face a spending problem or only a revenue problem. It's both.

The plan must stabilize and decrease debt held by the public as a percent of GDP. The plan should ramp up slowly to allow the recovery to continue.

The plan must not count any Social Security changes towards deficit and debt reduction. Social Security has not added one dime to the deficit or debt.

Finally, the plan needs to meet the political challenges we face.

The Rivlin-Domenici plan we will examine today meets many of these criteria. It is balanced and fair. It requires both revenue increases and spending cuts.

The plan generates sizeable debt reduction. It would stabilize debt held by the public as a percent of GDP by 2014. It would shrink the debt-to-GDP ratio thereafter.

However, the plan contains some proposals that concern me. The plan, for example, does include changes to Social Security. But my judgment is that should be dealt with separately, not as part of deficit reduction.

The plan also changes Medicare to a premium-support program, and it turns Medicaid into a block grant. These proposals only shift costs onto seniors, states and the disabled. Any changes made to Medicare and Medicaid should focus on saving money by making the health care system more efficient and more focused on the quality of care.

Many of Rivlin-Domenici's tax-related changes are politically challenging. Some limit future opportunities. For example, the plan repeals all tax incentives to go to college without proposing anything in their place.

With the fiscal crisis we're facing at the end of the year, Congress needs to come together and agree on a combination of revenues and spending cuts. It's the only way forward.

So let us work together to show we're serious about our deficit problem. Let us look to the Rivlin-Domenici plan for inspiration. And let us remember President Truman's words, and "do the job at hand."

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BIPARTISAN POLICY CENTER

TESTIMONY BY SEN. PETE V. DOMENICI AND DR. ALICE RIVLIN
CO-CHAIRS, BIPARTISAN POLICY CENTER DEBT REDUCTION TASK FORCE
TO
THE UNITED STATES SENATE COMMITTEE ON FINANCE
JUNE 19, 2012

Chairman Baucus, Ranking Member Hatch, and Members of the Committee, thank you for inviting us to testify on the comprehensive budget plan that the Bipartisan Policy Center's (BPC) Debt Reduction Task Force, which we co-chair, has developed.

The testimony we have submitted summarizes more than two years of deliberation by a nineteen-member Task Force representing a diverse cross-section of the nation from different sectors of the economy and with differing political views. It included former senior policy makers, ranging from former mayors of large cities to former governors of both parties, former Cabinet secretaries representing both parties, budget experts, and persons with backgrounds in business and labor.

As we have testified several times during the past two years before various congressional committees, the United States continues to face two monumental challenges. Both are more critical than ever, as we see mounting tension in the global economy, highlighted by the financial challenges confronting Europe.

First, the United States must accelerate economic growth and job creation. The recovery continues to be anemic, especially compared to recoveries from past recessions. We recognize the need for additional growth-enhancing policies to accelerate the economy's return to health and put people back to work.

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Second, federal deficits and accumulating debt must be stabilized so that our national indebtedness grows more slowly than future gross domestic product (GDP). Our ratio of debt to GDP is too high and must come down to a less-risky level.

These objectives reinforce each other. Faster growth will reduce deficits, and stabilizing the debt will cut future interest rates, reduce uncertainty, and enhance domestic economic growth. The Senate Finance Committee, with its wide-ranging jurisdiction, will be a key player in addressing both imperatives.

We recognize three realities: discretionary spending through the appropriations process has already been cut approximately to the levels recommended by the BPC plan; no progress has been made on the critical tax and entitlement reform elements of our plan; and, in less than six months, Congress and the American people will face a very serious economic blow, which Fed Chairman Ben Bernanke has characterized as "the fiscal cliff."

Let us look more closely at each of those realities.

The levels for discretionary defense and domestic spending set by the Budget Control Act of 2011, before any action triggered by the looming sequester in January, 2013, are approximately what our Task Force recommended. In short, we believe that further significant cuts in discretionary spending will do little to improve long run fiscal sustainability and risk harming investment, recovery, and future growth. So far, Congress has imposed virtually 100 percent of deficit reduction on less than 37 percent of the budget.

The main drivers of future deficits and debt remain, as they have been for many years now, (a) Medicare, Medicaid, and to a lesser extent Social Security, all of which are within the jurisdiction of this committee, and (b) revenues, also within this committee's purview. We are heartened by the resolve that the leadership of this committee has shown in setting out a path to address fundamental reform in both areas. We hope that our Task Force recommendations prove useful to the committee as it tackles these difficult questions. We believe strongly that without fundamental reform in the tax code and in future entitlement benefits, America cannot avoid continuing the steady increase of our federal debt toward 100 percent of GDP in the next decade and 200 percent of GDP a decade later. These are clearly unsustainable levels and normally associated with serious economic and financial difficulties for any nation that strays so far from fiscal responsibility.

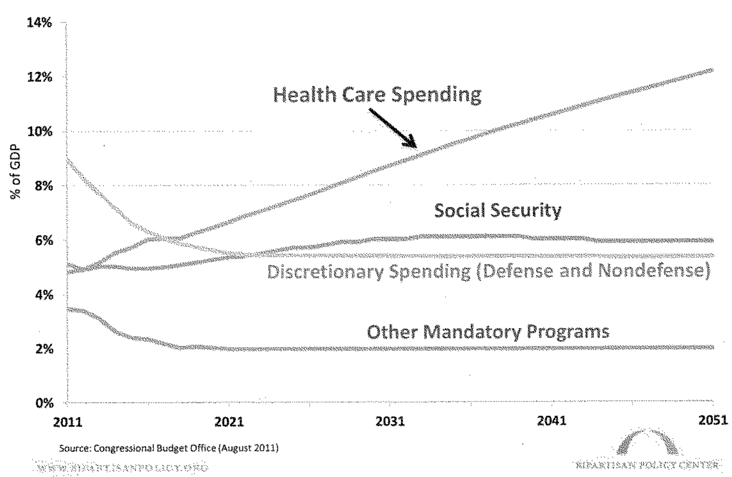
Fundamental Health Care Reform

The fundamental problem to be addressed by this committee is that federal spending is both greater and projected to rise faster than revenues for the foreseeable future, leaving a widening gap to be financed by borrowing. The primary drivers of increased spending are the health care programs, including Medicare, Medicaid, and the subsidies to be provided by the Affordable Care Act (ACA). Huge projected increases in the number of older people and persistent increases in health care spending per person account for this upward pressure on spending. Hence, reducing the rate of growth of these programs is essential to any long run debt stabilization plan. (See Chart)

Spending on mandatory healthcare programs is projected to increase from 23 percent of non-interest federal spending in 2012 to 34 percent by 2021. No other programs conceivably could shrink enough to make budgetary room to accommodate health care's growth.

Rising federal spending on health care is, of course, a part of the more general increase in spending for health care in the economy as a whole. Over time, national health spending has grown about 2 percentage points per year faster than GDP. Health care spending nationally is nearly 17 percent of GDP and rising. The objective of reforming federal health programs should not be to shift federal costs onto the private sector but to use the federal programs to lead the way toward more effective and less wasteful delivery of health care, no matter how that care is paid for.

HEALTH CARE COSTS ARE THE PRIMARY DRIVER OF THE DEBT



The Task Force plan includes both demand- and supply-side approaches to slowing the growth in overall health spending and federal spending specifically. Some aspects target the health system in general, while others focus specifically on Medicare and Medicaid.

The major demand-side strategy is to cap and then phase out the tax exclusion of employer-sponsored health insurance (ESI) benefits. This policy will result in more cost-conscious choices by purchasers of health insurance.

Also on the demand side is a proposal to modernize patient cost sharing in the Medicare program. The modernized benefit structure will include a combined annual deductible for Parts A and B, more-uniform cost-sharing, and catastrophic coverage – protection that is sorely lacking today – thereby more closely matching recent trends in private health care plans.

The key supply-side strategy is to reform provider payment incentives. Moving payment away from fee-for-service and toward broader payment units will encourage providers to seek more efficient delivery systems. Health reform – i.e., the ACA – took some very important steps toward reforming provider payments in Medicare. The Task Force proposes to build on this by bundling payments for post-acute care into the payment for inpatient care. Many other options for supply-side reform have received bipartisan support – this committee would be wise to select from some of those as well.

For Medicaid, in the short term, the Task Force proposes to remove barriers to greater use of managed care for those dually eligible for Medicare and Medicaid. For the long term, significant changes to the program are needed – both narrowly-targeted and fundamental reform proposals should be given serious consideration.

Although each of these proposals will have beneficial effects for the national healthcare system and help control federal costs, much of the long-run savings in the Task Force plan will come from transitioning Medicare from limited beneficiary choice to a defined support option. This new system will marshal both demand- and supply-side leverage to transform the national healthcare infrastructure into a more efficient and effective vehicle. As such, the Domenici-Rivlin Protect Medicare Act is the proposal on which we primarily will focus today, details of which can be found below.

Finally, in addition to the health reforms proposed by our Task Force, we plan to collaborate with Senators Tom Daschle and Bill Frist on a complementary project over the course of the coming year. The BPC Health and Debt Joint Project will explore, discuss and analyze various health care cost containment policy options and strategies.

Domenici-Rivlin Protect Medicare Act

(Released November 1, 2011)

(Updated June 15, 2012)

The principal driver of future federal deficits is the rapidly mounting cost of Medicare. The huge growth in the number of eligible seniors over the coming years is due to both increasing life expectancies and the retirement of the baby boomers. Then, that beneficiary growth is multiplied by continuing increases in the cost of health care per enrollee. Without a significant change in this trend, the cost of Medicare will continue to rise faster than the economy can possibly grow. Even if revenues are raised and other spending is restrained (both of which the Bipartisan Policy Center supports), the exploding cost of Medicare is unsustainable.

Simply put, there can be no lasting solution to the U.S. debt crisis without structural changes in the Medicare program to slow its cost growth. This can be accomplished through our proposal to transition Medicare to a "defined support" plan in 2016. Such a system would provide strong incentives to increase the efficiency and effectiveness of health care delivery to seniors, without abolishing current Medicare, or forcing any beneficiary to move to a different plan.

The Domenici-Rivlin defined support proposal would preserve Medicare for future generations. It would allow beneficiaries who wish to stay in traditional Medicare to do so, but also would present them with competing private plans as alternative options. It would restrain the growth in total Medicare spending while protecting low-income beneficiaries from any increases in their cost above current law. In short, the Domenici-Rivlin plan both would preserve Medicare as a choice and also save money by flattening the steeply-rising projected Medicare cost curve.

The Domenici-Rivlin proposal restructures Medicare to achieve fiscal soundness in two ways:

1) New federally-run Medicare exchanges would provide beneficiaries with a truly competitive marketplace in which they can choose among private healthcare plans and traditional fee-for-service (FFS) Medicare. Participating

private plans would be required to accept all applicants and would be prohibited from "cherry picking" the youngest or healthiest seniors. Every private plan would be required to provide benefits that have at least the same actuarial value as FFS Medicare. The plans would have to include a specific base set of services, and the federal support that each plan is provided with would be adjusted for the age and health status of its enrollees. The exchanges would provide understandable information about the costs and quality of plans so that beneficiaries could choose options that are best for them. Beneficiaries would have the opportunity to change plans in an annual open season.

2) Through competitive pricing by all plans, the federal contribution in each market area would be tied to the cost of the second-least expensive approved private plan or FFS Medicare, whichever is less expensive (subject to the two lowest-price plans combined having enough capacity to handle expected enrollment). Thus, the government would no longer have to pay extra to private healthcare plans in areas where the public FFS Medicare plan provides lower-cost coverage, nor would the government have to overpay to provide FFS Medicare in areas where two or more approved private plans offer equivalent care at a lower cost. These competitive enhancements would incentivize healthcare plans to innovate in every facet of their operations and benefit designs — subject to regulations – to keep premiums down and quality of care up.

These two features should significantly curb Medicare costs. We have every confidence that they by themselves would slow the growth of Medicare spending significantly – sufficiently, in fact, to make Medicare's full contribution to overall budget stabilization that we prescribe in the complete BPC debt-reduction plan.

However, the savings from competition are very difficult to prove to the satisfaction of the scorekeepers who must estimate the impact of budget legislation on deficits. So, to provide verifiable budget savings – which, to repeat, we do not believe will prove necessary in actual operation – the Protect Medicare Act also would cap the increase in the federal contribution per beneficiary. The new legislation would strengthen the enforcement mechanism for the cap on Medicare growth that was introduced in the Patient Protection and Affordable Care Act (PPACA). For Parts A, B, and D of Medicare combined, the cap would continue to limit the cumulative annual growth in per-beneficiary federal support to one percentage point faster than the per capita growth of the economy – "GDP+1%" – although, under current law, costs are projected to grow more slowly than that rate, on average, for the next two decades. However, if costs rise faster than the established limit and the Independent Payment Advisory Board's (IPAB) reforms are inadequate, Medicare beneficiaries with incomes above 150 percent of the federal poverty level (FPL) would pay higher premiums. (Those with incomes below 135 percent of the FPL would continue to receive zero-cost coverage paid for by Medicaid, and enrollees with incomes between 135 and 150 percent of the FPL would be protected from any premium increases.) Additionally, to smooth the transition to the defined support system, current beneficiaries with incomes below 150 percent of the FPL would be guaranteed access to either traditional Medicare or a private plan of the same cost – at their choice – with no additional premiums. This "hold harmless" provision would phase out at higher income levels.

How the Exchanges Work

In each regional market – be it a metropolitan area, or a multi-county rural area – each private healthcare plan and traditional FFS Medicare would submit its price to provide a benefit package equal in actuarial value to that of FFS Medicare for Parts A and B, including a specific base set of services, to a standard (average-risk) beneficiary for a year. The FFS "price" would be based on average FFS Medicare costs for the same standard beneficiary in the market area. The amount that the government contributes to premiums in that region would then be based on the second-lowest private plan price or FFS Medicare's price, whichever is lower (subject to the two lowest-price plans combined having enough capacity to handle expected enrollment). This would be referred to as the "benchmark" price.

Beneficiaries who choose to enroll in a plan that is more expensive than the benchmark – even if that plan is FFS Medicare – would be required to pay the incremental additional cost. A beneficiary who enrolls in the plan with the lowest price would be rebated the full difference in cost from the benchmark. Private plans also could offer additional products with expanded benefits (as they do now), subject to review concerning the premiums having an appropriate relationship to their price for a plan with standard benefits.

The exchanges would be federally run (either by the Centers for Medicare and Medicaid Services (CMS) or a separate entity), require guaranteed issue and community rating (under which insurers must offer coverage to every senior in the geographic area for the same price, regardless of age, gender, or health status), and enforce guidelines for the structure of the benefit package. The exchanges also would utilize a risk-adjustment mechanism to distribute the government subsidy among insurers according to the age and health status of those whom they enroll. Methods used in Medicare Advantage (MA) would be a starting point, but efforts to develop tools that do this more effectively should be ongoing.

The MA risk adjustment is the most sophisticated method in use, but it is not perfect. To further mitigate adverse selection by private plans, the Domenici-Rivlin proposal would require all plans on an exchange to offer a specific core set of benefits and have an actuarial value at least as high as traditional Medicare's. This would preclude the possibility of "bare-bones" plans attracting healthier people in ways not fully offset by the risk adjustment. Moreover, the federal government would enforce rules on plans' reserves for solvency, accuracy of promotional materials, and network adequacy. The administrating agency also would be able to block benefit designs that it deems likely to disproportionately attract healthy people – just as the Office of Personnel Management (OPM) does for the Federal Employees Health Benefits (FEHB) program.

Why is this proposal an improvement over the current Medicare system?

Currently, Medicare benefits are predominantly delivered through the traditional fee-for-service plan, which allows patients to see nearly any doctor they choose so long as that doctor accepts Medicare's payment rates. Because FFS pays separately for each service, providers have an incentive to provide more services, driving up program costs. This is a significant issue for traditional Medicare.

Medicare FFS has some promising pilots to reform provider payment under way, such as Accountable Care Organizations, per-episode payment, and patient-centered medical homes. Because the traditional program continues under this proposal, success from initiatives such as these will be influential in determining future market shares of FFS and private plans.

Medicare also offers private Medicare Advantage plans, which receive a fixed monthly payment from the government to care for each enrollee. MA plans, therefore, have a strong incentive to work with doctors and hospitals to manage care efficiently. Although this incentive structure helps to mitigate the overtreatment (i.e., "paying for quantity") problem faced by FFS, the current MA system has certain structural flaws.

Most significant is that MA uses administered pricing rather than competitive pricing to set the amount of government support. As the result of years of changes in the pricing formula, MA plans, in the aggregate, were paid more than FFS Medicare. When administered prices are high, incentives for plans to become more efficient are reduced. PPACA phased out much of this overpayment, but many private plans continue to be paid more than FFS Medicare. Another flaw is that MA plans with premiums below the level of this support are currently taxed between 25 and 50 percent on any rebate that they offer to beneficiaries. Taxing low prices discourages the plans from offering them.

Instead, the new Medicare exchange would utilize a competitive pricing process, and would present information on the various plan offerings in a clear, concise manner. Setting the federal contribution at the cost of the second-least-expensive health plan or FFS in an area also would increase the connection between the price charged and enrollment. By increasing the reward for a low price, the defined support system provides strong incentives for healthcare plans to manage care delivery efficiently, innovate in their benefit designs, and to offer evidence to the public that they achieve quality outcomes at low cost.

The Congressional Budget Office, in a 2006 report, hypothesized that competitive pricing as structured in the Protect Medicare Act could lead private health plans, on average, to lower their current prices by 5 percent, which would greatly increase the savings and effectiveness of this proposal.

While MA plans are paid more than the cost of FFS Medicare in some areas, in other regions, even if multiple private plans are able to provide the same services as FFS for less money, the government still must contribute the full cost of the public FFS plan. Moreover, in these areas where FFS Medicare is relatively costly, beneficiaries who enroll in private plans receive a host of free supplementary benefits or generous rebates, financed by the government. There is no policy justification for selectively offering free, government-financed supplementary benefits to beneficiaries in some geographic regions but not others.

The Protect Medicare Act would change this. The government would no longer have to pay extra to private healthcare plans in areas where FFS Medicare provides lower-cost coverage, nor would they have to overpay to provide FFS Medicare in areas where approved private plans offer equivalent care at a lower cost. The new system would create a level playing field for competition between FFS Medicare and private plans. The efficiencies produced would save money and improve care for enrollees. This change alone, even after providing transitional support to many beneficiaries and without accounting for any dynamic effects such as those hypothesized by CBO, would save the government roughly $20 billion in its first year of implementation and around $300 billion over ten years.

Currently in some parts of the country, at least two private healthcare plans are less expensive than FFS Medicare and the quality of care is as good.[1] In other parts of the country, FFS is cheaper. Despite the common refrain that traditional Medicare is significantly less expensive than private plans, according to MedPAC's 2011 Data Book, on an apples-to-apples basis, the private plans serving Medicare patients provide the entitlement benefit package for exactly the same cost as the traditional program. More specifically, the HMOs participating in MA, which have

[1] Robert H. Miller and Harold S. Luft, "HMO Plan Performance Update: An Analysis of the Literature, 1997–2001," *Health Affairs* 21, no. 4 (July/August 2002): 63–86.

by far the largest MA enrollment, provide equivalent coverage for 97 percent of the cost of traditional Medicare. Moreover, approximately 88 percent of beneficiaries live in regions where two or more private plans offer the Medicare benefit for less than FFS, according to a recent analysis by Robert Coulam, Roger Feldman, and Bryan Dowd based on CMS data.

While changes made to the traditional FFS plan in PPACA plus further reforms would likely make it even more competitive, the fact remains that private plans are the least expensive in some geographic areas and FFS is the least expensive in others. In such a hybrid public-private Medicare system, the Protect Medicare Act ensures that taxpayers get the best value per dollar.

Estimated cumulative savings from CBO's Current Law baseline in billions of dollars, 2016 through:

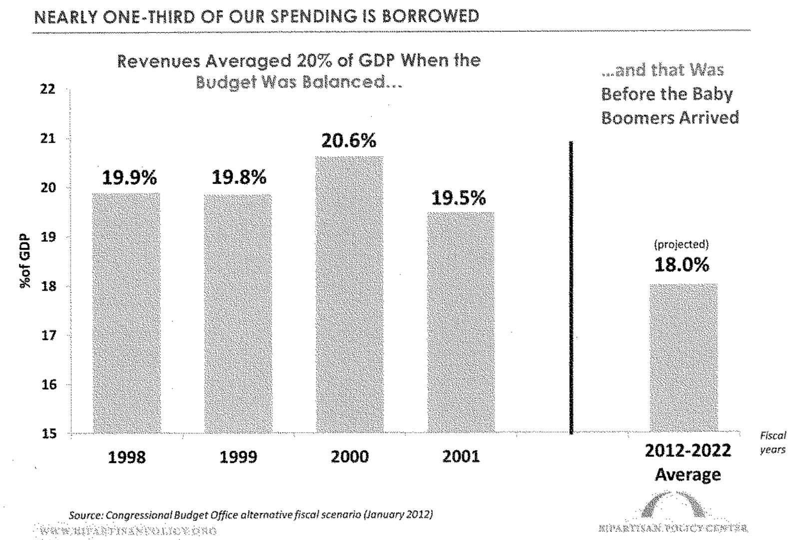
	2022	**2025**	**2032**	**2042**
Transition Medicare to a Defined Support Structure in 2016	\$187	\$369	\$875	\$2,936

Estimated cumulative savings from CBO's Alternative Fiscal Scenario in billions of dollars, 2016 through:

	2022	**2025**	**2032**	**2042**
Transition Medicare to a Defined Support Structure in 2016	\$191	\$408	\$1,475	\$5,378

Fundamental Tax Reform

In addition to reining in spending, reducing our debt will require raising additional revenue. Under current policies, CBO projects revenue to average only 18 percent over the next decade. Yet, the last time our budget was balanced, from 1998-2001, revenues averaged 20 percent of GDP, and that was before the baby boomers reached retirement, driving up costs for Medicare and Social Security just to provide the same services.



However, new revenue to help pay down our debt can be raised through fundamental tax reform that will drastically simplify the code and promote growth. Below is the plan that our Task Force created:

Bipartisan Policy Center (BPC) Tax Reform
Quick Summary

The BPC Tax Reform Plan represents a radical simplification of the current tax code and contributes to our plan's target of deficit reduction. In fact, to best explain it, forget what you know about the complexities of the current tax system, and start fresh. Outlined below are the core elements of the plan:

- A **two-bracket income tax with rates of 15% and 28%**. Because there is no standard deduction or personal exemptions, the 15% rate applies to your first dollar of income.[2]

- The **corporate tax rate will be set at 28%**, instead of the current 35% level.

- Capital gains and dividends will be taxed **as ordinary income (at the 15% and 28% rates)**, excluding the first $1,000 of realized net capital gains (or losses).[3]

- To replace the overly complex Earned Income Tax Credit (EITC) and to help offset the elimination of personal exemptions, the standard deduction and the child credit, the BPC Plan will establish:
    - A flat **refundable per child tax credit of $1,600** (higher than current law); and
    - A **refundable earnings credit**[4] similar in structure to the recent Making Work Pay credit, but substantially higher.

- Instead of the current system of itemized deductions, which disproportionately subsidizes the housing consumption and charitable giving of upper-income taxpayers, the BPC Plan will:
    - Provide a **flat 15% refundable tax credit for charitable contributions** and for up to $25,000 per year, not indexed, **mortgage interest on a primary residence**.
    - Eliminate the deduction for state and local taxes.
    - Provide a flat, **15% refundable tax credit** or a deduction (for those in the higher bracket) **for contributions to retirement saving accounts** up to 20% of earnings or a maximum of $20,000.

- Include 100% of Social Security benefits in taxable income, but:

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[2] The 28% rate applies approximately to income above $51,000 for single filers and $102,000 for couples.
[3] $500 for singles and heads of household
[4] The refundable earnings credit is equal to 17.5% of the first $20,000 of earnings.

- Create a non-refundable credit for Social Security beneficiaries equal to 15% of the current standard deduction; and
- Create a non-refundable credit equal to 15% of an individual's Social Security benefits.

- Effective in 2015, cap and then phase out over 10 years the tax exclusion for employer-sponsored health insurance benefits.

- Allow deduction of medical expenses in excess of 10% of AGI (as in current law).

- Allow deduction of miscellaneous itemized deductions in excess of 5% of AGI.

The BPC Plan achieves a massive simplification of the tax code by **aligning the top individual, capital gains and dividend tax rates, significantly reducing the corporate tax rate, and eliminating the AMT**. Additionally, **most individuals will no longer have to file an annual tax return**[5] beyond an initial declaration of status because the most commonly taken deductions have either been turned into refundable credits, determined solely based on the number of children and earnings, or can only be deducted above a substantial floor. Despite a low top rate of 28%, the new tax system created under the BPC Plan will be **more progressive than the current system** and **raise the requisite revenue to achieve our debt-reduction goal**.

Action in 2013

With the failure of the Joint Select Committee on Deficit Reduction to reach an agreement on a $1.2 trillion deficit reduction plan, current law provides that unless Congress acts, an across-the-board cut to some mandatory programs and to discretionary spending will occur on January 2, 2013. Our analysis of the sequester impact reveals that the size of the cuts will be approximately 15 percent in defense

[5] According to Tax Policy Center projections, only 50% of tax units would be required to file tax returns, as opposed to 88% under the current tax system.

spending and about 12 percent in domestic discretionary spending. If such cuts occur, the Bipartisan Policy Center's analysis, based on CBO data, is that GDP growth in 2013 will be one-half of one percent lower than projected.

Not only will the cuts be across-the-board, they will be carried out on a very detailed level, called the Program, Project, and Activity (PPA) level. While final determination of the size of the cuts, at what level of granularity, and instructions on how to carry out such reductions will be made by the Office of Management and Budget, our analysis predicts serious disruption to governmental activities and to government contractors. Our best present estimate is that about 1 million jobs will disappear from the economy just from the action of the 2013 sequester.

But, the fiscal cliff is much more than the sequester of January, 2013. The cliff contains many other elements:

1. Expiration on January 1, 2013, of the 2001, 2003, and 2010 tax cuts, which will increase revenues by approximately $3 trillion in the next decade;
2. Alternative Minimum Tax expansion will occur unless once again "patched;"
3. Expiration of the Unemployment Insurance extended benefits at the end of this year;
4. A series of so-called "tax extenders," which have already expired, will continue to lapse;
5. A reduction of approximately 30 percent in reimbursement to Medicare providers;

The fiscal cliff, in reality, starts well before the end of the year. CBO projects that the very possibility of these events occurring will lower GDP growth by another one-half of one percent in the remainder of 2012. Congress has yet to pass any FY 2013 appropriations bill, and most analysts believe that the likely outcome of the process this year will be a continuing resolution for appropriations at something near the continuing resolution level for FY 2012. Appropriations must be addressed in some fashion by Congress before October 1 of this year, which we believe is the first step toward averting the fiscal cliff.

Estimates vary, but most economic analysts believe that if Congress fails to act on the fiscal cliff early in 2013GDP growth would be negatively affected and it seems likely that the nation would fall again into a recession.

We urge Congress to act quickly, now, using perhaps the continuing resolution for FY 2013 as the legislative vehicle that would contain language to avoid the fiscal cliff and, at the same time, set in motion a process that would yield a comprehensive fiscal plan along the lines that our Task Force has recommended and those of the Simpson-Bowles Commission. Waiting until an always difficult lame duck session may establish inaction as the default position, which could lead the nation directly over the fiscal cliff.

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STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER U.S. SENATE COMMITTEE ON FINANCE HEARING OF JUNE 19, 2012 CONFRONTING THE LOOMING FISCAL CRISIS

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining ways to effectively address the nation's looming fiscal crisis:

Thank you Chairman Baucus for holding today's hearing. And welcome back Senator Domenici and Dr. Rivlin. We appreciate your coming here to discuss options for addressing our nation's fiscal challenges.

Given the enormous, and growing, uncertainties associated with the country's fiscal position, it is far past time that Congress and the President act to right our fiscal ship. Market uncertainty is already growing as a result of the historic tax increases set to take effect at the end of this year. And because federal law requires certain employers to give advance notice to workers facing layoffs, the automatic budget cuts — or sequestration — set to begin at the start of next year, mean that we can expect major layoff notices from defense contractors and others starting this fall.

At a time when job growth is anemic, unemployment remains above eight percent, and American workers are struggling, it is unconscionable to gamble with the economy by choosing to ignore the fast approaching fiscal cliff. This is no time to privilege election-year talking points and political brinksmanship over economic growth and the American families and businesses that depend on it.

And make no mistake — the private sector is by no means doing just fine. Since the President took office, the unemployment rate for government workers has averaged 4.2 percent. By contrast, when you include the private sector, the unemployment rate has averaged 9.2 percent during the President's term. Overall unemployment has been above 8.0 percent for 40 consecutive months, while the unemployment rate for government workers over the same period has averaged just over 4.0 percent.

Only someone who is entirely out of touch with the plight of Americans could read these numbers and conclude that the private sector is doing just fine. American families and workers in the private sector are hurting. And they have been for far too long. They cannot afford any more hits. So Congress and the President should be working now to avert the fiscal cliff that threatens all Americans at every income level with massive tax hikes.

And it is long past time to begin reforms of a tax code that is a burden on families and businesses, and a drag on our economy. Over the past few years, we have seen many plans to do just that, including one our witnesses will address today. What has been noticeably absent, however, is engagement by the administration and leadership by the President. We hear from Treasury officials that the administration has "principles" for corporate tax reform, and for individual taxes, and for Social Security and other entitlements.

But — and I suspect because it is an election year — they refuse to talk about specifics. In spite of his claim that his proposals are available for all to see, no one I know has seen the President's plans for reforming Medicare or Social Security or the tax code. All we hear are vague principles with the only definitive characteristic being more redistribution. But a sentiment, no matter how strongly felt, is not a plan.

The lack of leadership from the President at such a critical moment for our economy is remarkable. He has ignored numerous fiscal plans that have been crafted by bipartisan groups, like the one we will hear about today, which was originally crafted in November of 2010.

One of today's witnesses, Dr. Rivlin, expressed frustration about the President's passive stance toward our slow-rolling fiscal crisis as far back as June of last year, writing that, *[l]eadership can't be delegated to commissions or taskforces. Mr. President, please get out front!*

I would like to echo that frustration and urge the President to get out front, steer us away from the fiscal cliff, work with us to tackle our unsustainable deficits and debt and entitlements, and assist us in reforming our broken, antiquated tax code.

Mr. Chairman, I commend you for your continued leadership on these matters. I commend you for taking the step this month of outlining your framework and principles for tax reform. I look forward to working with you on tax reform. And I hope to work with you in addressing the fiscal cliff that is creating enormous uncertainty for families and businesses, and contributing to further slowing and weakening of the economy.

I invite the President and the administration, including officials at the Treasury, to join us. While I understand that this is an election year, we cannot let that stand in the way of doing what is right for the American people.

Once again, Mr. Chairman, I thank you for holding today's hearing. And thanks to our witnesses for appearing. I look forward to their testimony.

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COMMUNICATIONS

Comments for the Record

United States Senate

Committee on Finance

Confronting the Looming Fiscal Crisis

Tuesday, June 19, 2012, 10:00 AM

By Michael G. Bindner

Center for Fiscal Equity

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Alexandria, VA 22304

Chairman Baucus and Ranking Member Hatch, thank you for the opportunity to submit these comments for the record to the Senate Finance Committee.

Our looming financial crisis is simply a matter of perception. It is a created crisis which goes away when we realize that the Depression we are currently experiencing does not come from fiscal inadequacy but asset overvaluation and leverage. The solution of the economic crisis has nothing to do with our artificial fiscal crisis, which would mostly reset tax policy to the days of the Clinton Administration – which if memory serves – were not so bad. The automatic spending cuts are an attempt to offset the extension of a portion of the 2001 tax cuts – although the Republican Party would much rather use them to offset the extension of the 2003 cuts. The crisis is entirely political and it concerns which cuts are extended and which are allowed to expire.

As we mentioned during budget submission season to both the revenue and the budget committees, Congress has four options in pursuing fiscal policy this year. It can do nothing, it can play small, it can play medium or it can go big. Our comments will address each possibility.

Doing nothing is a possible solution to almost every issue. At the end of the calendar year, the tax cuts of 2001, 2003 and 2010 expire automatically, as do the recently extended payroll tax cut, extended unemployment insurance benefits and the suspension of the "Doc Fix" for doctors serving Medicare patients. Allowing these provisions to expire essentially solves the nation's fiscal problems in the long term.

If the economy is more robust in December than current forecasts suggest, which is possible if ambitious solutions are pursued by the Federal Reserve on the underwater mortgage issue (or if the Twist is adequate), this may be the most realistic option – although in our view it would be a lost opportunity for long term reform. This is not likely, however, as richest Americans (including doctors) who by and large fund the anti-tax movement, would be the hardest hit should permanent law come back into force, and would become the loudest voices for compromise to avoid this.

On the expenditure side, the Budget Control Act of 2011 contains within it spending caps which effectively serve as budget allocations for the purpose of enacting appropriations – making a concurrent budget resolution entirely unnecessary for the upcoming fiscal year. **Voices who continue to claim that the Senate has not enacted a budget in 1000 days should be silent and if they continue to make this claim, held up to public ridicule because they should know better.**

If the law included automatic enactment of the current service budget within these allocations, as we have suggested, then the only action required for this fiscal year would be extension of the debt limit, although some analysts, among them Bruce Bartlett, have suggested that the limit itself is unconstitutional and could be dispensed with, either in law or by Administration decree. Automatic enactment of the budget and dispensing with the debt limit would spur the Congress to enact timely compromise, which would end the impulse to gridlock.

There are two ways that Congress and the Administration can play small ball. Sadly, this is the most likely scenario given the state of the national economy. The most likely way is to delay action until after the election and, as a package, extend the debt limit through December 2013 in exchange for extending the expiring income, payroll, unemployment and medical payment provisions for an equal period of time, accepting the temporary pain of one year of sequestration.

A slightly more ambitious version of this scenario, which leaves less to chance as far as the impact of the election (as a lame duck President has no interest in any compromise at all) is to extend the debt limit, doc fix suspension, the payroll tax cut, extended unemployment and tax rates for middle class and wealthy taxpayers through July 2013 in exchange for making certain tax cuts for lower income Americans permanent, including the 10% tax rate and expanded Child Tax Credit – offsetting some or all of the spending cuts that have already been agreed to. This allows discourse on tax reform without holding our most vulnerable citizens hostage.

Should the President indicate that he is likely to let gridlock rule the day, a medium ball solution is more likely as opposition to a balanced solution evaporates as the likelihood of automatic tax cuts increases. The balanced solution is some combination of the cuts and tax reforms supported by the majority of the Fiscal Commission, also known as Bowles-Simpson, and the proposals of the Bipartisan Policy Center, also known as Rivlin-Domenici (after the chairs who are testifying today). Many of these proposals are similar and where they coincide seems like a fruitful place to start drafting legislation. Using the congressional budget process to begin enacting these provisions could occur in regular order, with the Department of the Treasury playing a supporting role in writing tax reform language.

Compromise is not totally out of the question. The President and the Speaker seemed to have outlined the terms of one before forces in both parties stopped them from doing so, although the possibility exists that they merely put off their agreement in principle until after the congressional primary season. The fact that this primary season has not gone well for moderate candidates who were more likely to win in the Senate may lead many of our wealthier taxpaying families to realize that their best deal might be made before the election. If this is the case, we expect a deal by the end of August.

The large ball game would be to actually balance the budget and enact radical reform in entitlement revenue and spending provisions, a shift from income taxes for most filers to consumption taxes and higher tax rates on those most ability to pay. We don't see this happening in the near future, however, we do offer one.

The Center for Fiscal Equity proposes a large ball solution with four major provisions:

- A Value Added Tax (VAT) to fund domestic military spending and domestic discretionary spending with a rate between 10% and 13%, which makes sure very American pays something.
- Personal income surtaxes on joint and widowed filers with net annual incomes of $100,000 and single filers earning $50,000 per year to fund net interest payments, debt retirement and overseas and strategic military spending and other international spending, with graduated rates between 5% and 25% in either 5% or 10% increments. Heirs would also pay taxes on distributions from estates, but not the assets themselves, with distributions from sales to a qualified ESOP continuing to be exempt.
- Employee contributions to Old Age and Survivors Insurance (OASI) with a lower income cap, which allows for lower payment levels to wealthier retirees without making bend points more progressive.
- A VAT-like Net Business Receipts Tax (NBRT), which is essentially a subtraction VAT with additional tax expenditures for family support, health care and the private delivery of governmental services, to fund entitlement spending and replace income tax filing for most people (including people who file without paying), the corporate income tax, business tax filing through individual income taxes and the employer contribution to OASI, all payroll taxes for hospital insurance, disability insurance, unemployment insurance and survivors under age 60.

We have no proposals regarding environmental taxes, customs duties, excise taxes and other offsetting expenses, although increasing these taxes would result in a lower VAT. American competitiveness is enhanced by enacting a VAT, as exporters can shed some of the burden of taxation that is now carried as a hidden export tax in the cost of their products. The NBRT will also be zero rated at the border to the extent that it is not offset by deductions and credits for health care, family support and the private delivery of governmental services.

Some oppose VATs because they see it as a money machine, however this depends on whether they are visible or not. A receipt visible VAT is as susceptible to public pressure to reduce spending as the FairTax is designed to be, however unlike the FairTax, it is harder to game. Avoiding lawful taxes by gaming the system should not be considered a conservative principle, unless conservatism is in defense of entrenched corporate interests who have the money to game the tax code.

Our VAT rate estimates are designed to fully fund non-entitlement domestic spending not otherwise offset with dedicated revenues. This makes the burden of funding government very explicit to all taxpayers. Nothing else will reduce the demand for such spending, save perceived demands from bondholders to do so – a demand that does not seem evident given their continued purchase of U.S. Treasury Notes.

Value Added Taxes can be seen as regressive because wealthier people consume less, however when used in concert with a high-income personal income tax and with some form of tax benefit to families, as we suggest as part of the NBRT, this is not the case.

The shift from an income tax based system to a primarily consumption based system will dramatically decrease participation in the personal income tax system to only the top 20% of households in terms of income. Currently, only roughly half of households pay income taxes, which is by design, as the decision has been made to favor tax policy to redistribute income over the use of direct subsidies, which have the stink of welfare. This is entirely appropriate as a way to make work pay for families, as living wage requirements without such a tax subsidy could not be sustained by small employers.

The income surtax is earmarked for overseas military, naval sea and international spending because this spending is most often deficit financed in times of war. Earmarking repayment of trust funds for Social Security and Medicare, acknowledges the fact that the buildup of these trust funds was accomplished in order to fund the spending boom of the 1980s without reversing the tax cuts which largely benefited high income households.

Earmarking debt repayment and net interest in this way also makes explicit the fact that the ability to borrow is tied to the ability to tax income, primarily personal income. The personal or household liability for repayment of that debt is therefore a function of each household's personal income tax liability. Even under current tax law, most households that actually pay income taxes barely cover the services they receive from the government in terms of national defense and general government services. It is only the higher income households which are truly liable for repayment of the national debt, both governmental and public.

If the debt is to ever be paid back rather than simply monetized, both domestically and internationally (a situation that is less sustainable with time), the only way to do so without decreasing economic growth is to tax higher income earners more explicitly and at higher rates than under current policy, or even current law.

The decrease in economic class mobility experienced in recent decades, due to the collapse of the union movement and the rapid growth in the cost of higher education, means that the burden of this repayment does not fall on everyone in the next generation, but most likely on those who are living in high income households now.

Let us emphasize the point that when the donors who take their cues from Americans for Tax Reform bundle their contributions in support of the No Tax Pledge, they are effectively burdening their own children with future debt, rather than the entire populace. Unless that fact is explicitly acknowledged, gridlock over raising adequate revenue will continue.

Unlike other proposals, a graduated rate for the income surtax is suggested, as at the lower levels the burden of a higher tax rate would be more pronounced. More rates make the burden of higher rates easier to bear, while actually providing progressivity to the system rather than simply offsetting the reduced tax burden due to lower consumption and the capping of the payroll tax for Old Age and Survivors Insurance.

One of the most oft-cited reforms for dealing with the long term deficit in Social Security is increasing the income cap to cover more income while increasing bend points in the calculation of benefits, the taxability of Social Security benefits or even means testing all benefits, in order to actually increase revenue rather than simply making the program more generous to higher income earners.

Lowering the income cap on employee contributions, while eliminating it from employer contributions and crediting the employer contribution equally removes the need for any kind of bend points at all, while the increased floor for filing the income surtax effectively removes this income from taxation. Means testing all payments is not advisable given the movement of retirement income to defined contribution programs, which may collapse with the stock market – making some basic benefit essential to everyone.

Moving the majority of Old Age and Survivors Tax collection to a consumption tax, such as the NBRT, effectively expands the tax base to collect both wage and non-wage income while removing the cap from that income. This allows for a lower tax rate than would otherwise be possible while also increasing the basic benefit so that Medicare Part B and Part D premiums may also be increased without decreasing the income to beneficiaries.

If personal accounts are added to the system, a higher rate could be collected, however recent economic history shows that such investments are better made in insured employer voting stock rather than in unaccountable index funds, which give the Wall Street Quants too much power over the economy while further insulating ownership from management. Too much separation gives CEOs a free hand to divert income from shareholders to their own compensation through cronyism in compensation committees, as well as giving them an incentive to cut labor costs more than the economy can sustain for purposes of consumption in order to realize even greater bonuses. Employee-ownership ends the incentive to enact job-killing tax cuts on dividends and capital gains, which leads to an unsustainable demand for credit and money supply growth and eventually to economic collapse similar to the one most recently experienced.

The NBRT base is similar to a Value Added Tax (VAT), but not identical. Unlike a VAT, an NBRT would not be visible on receipts and should not be zero rated at the border – nor should it be applied to imports. While both collect from consumers, the unit of analysis for the NBRT should be the business rather than the transaction. As such, its application should be universal – covering both public companies who currently file business income taxes and private companies who currently file their business expenses on individual returns.

In the long term, the explosion of the debt comes from the aging of society and the funding of their health care costs. Some thought should be given to ways to reverse a demographic imbalance that produces too few children while life expectancy of the elderly increases.

Unassisted labor markets work against population growth. Given a choice between hiring parents with children and recent college graduates, the smart decision will always be to hire the new graduates, as they will demand less money – especially in the technology area where recent training is often valued over experience.

Separating out pay for families allows society to reverse that trend, with a significant driver to that separation being a more generous tax credit for children. Such a credit could be "paid for" by ending the Mortgage Interest Deduction (MID) without hurting the housing sector, as housing is the biggest area of cost growth when children are added. While lobbyists for lenders and realtors would prefer gridlock on reducing the MID, if forced to chose between transferring this deduction to families and using it for deficit reduction (as both Bowles-Simpson and Rivlin-Domenici suggest), we suspect that they would chose the former over the latter if forced to make a choice. The religious community could also see such a development as a "pro-life" vote, especially among religious liberals.

Enactment of such a credit meets both our nation's short term needs for consumer liquidity and our long term need for population growth. Adding this issue to the pro-life agenda, at least in some quarters, makes this proposal a win for everyone.

The expansion of the Child Tax Credit is what makes tax reform worthwhile. Adding it to the employer levy rather than retaining it under personal income taxes saves families the cost of going to a tax preparer to fully take advantage of the credit and allows the credit to be distributed throughout the year with payroll. The only tax reconciliation required would be for the employer to send each beneficiary a statement of how much tax was paid, which would be shared with the government. The government would then transmit this information to each recipient family with the instruction to notify the IRS if their employer short-changes them. This also helps prevent payments to non-existent payees.

Assistance at this level, especially if matched by state governments may very well trigger another baby boom, especially since adding children will add the additional income now added by buying a bigger house. Such a baby boom is the only real long term solution to the demographic problems facing Social Security, Medicare and Medicaid, which are more demographic than fiscal. Fixing that problem in the right way definitely adds value to tax reform.

The NBRT should fund services to families, including education at all levels, mental health care, disability benefits, Temporary Aid to Needy Families, Supplemental Nutrition Assistance, Medicare and Medicaid. If society acts compassionately to prisoners and shifts from punishment to treatment for mentally ill and addicted offenders, funding for these services would be from the NBRT rather than the VAT.

The NBRT could also be used to shift governmental spending from public agencies to private providers without any involvement by the government – especially if the several states adopted an identical tax structure. Either employers as donors or workers as recipients could designate that revenues that would otherwise be collected for public schools would instead fund the public or private school of their choice. Private mental health providers could be preferred on the same basis over public mental health institutions. This is a feature that is impossible with the FairTax or a VAT alone.

To extract cost savings under the NBRT, allow companies to offer services privately to both employees and retirees in exchange for a substantial tax benefit, provided that services are at least as generous as the current programs. Employers who fund catastrophic care would get an even higher benefit, with the proviso that any care so provided be superior to the care available through Medicaid. Making employers responsible for most costs and for all cost savings allows them to use some market power to get lower rates, but not so much that the free market is destroyed. Increasing Part B and Part D premiums also makes it more likely that an employer-based system will be supported by retirees.

Enacting the NBRT is probably the most promising way to decrease health care costs from their current upward spiral – as employers who would be financially responsible for this care through taxes would have a real incentive to limit spending in a way that individual taxpayers simply do not have the means or incentive to exercise. While not all employers would participate, those who do would dramatically alter the market. In addition, a kind of beneficiary exchange could be established so that participating employers might trade credits for the funding of former employees who retired elsewhere, so that no one must pay unduly for the medical costs of workers who spent the majority of their careers in the service of other employers.

Conceivably, NBRT offsets could exceed revenue. In this case, employers would receive a VAT credit.

The Center calculates an NBRT rate of 27% before offsets for the Child Tax Credit and Health Insurance Exclusion, or 33% after the exclusions are included. This is a "balanced budget" rate. It could be set lower if the spending categories funded receive a supplement from income taxes. These calculations are, of course, subject to change based on better models.

In testimony before the Senate Budget Committee, Lawrence B. Lindsey explored the possibility of including high income taxation as a component of a Net Business Receipts Tax. The tax form could have a line on it to report income to highly paid employees and investors and pay surtaxes on that income.

The Center considered and rejected a similar option in a plan submitted to President Bush's Tax Reform Task Force, largely because you could not guarantee that the right people pay taxes. If only large dividend payments are reported, then diversified investment income might be under-taxed, as would employment income from individuals with high investment income. Under collection could, of course, be overcome by forcing high income individuals to disclose their income to their employers and investment sources – however this may make some inheritors unemployable if the employer is in charge of paying a higher tax rate. For the sake of privacy, it is preferable to leave filing responsibilities with high income individuals.

Dr. Lindsey also stated that the NBRT could be border adjustable. We agree that this is the case only to the extent that it is not a vehicle for the offsets described above, such as the child tax credit, employer sponsored health care for workers and retirees, state-level offsets for directly providing social services and personal retirement accounts. Any taxation in excess of these offsets could be made border adjustable and doing so allows the expansion of this tax to imports to the same extent as they are taxed under the VAT. Ideally, however, the NBRT will not be collected if all employers use all possible offsets and transition completely to employee ownership and employer provision of social, health and educational services.

Thank you for the opportunity to address the committee. We are, of course, available for direct testimony or to answer questions by members and staff.

100 Years Standing Up for American Enterprise

U.S. CHAMBER OF COMMERCE

Statement of the U.S. Chamber of Commerce

ON: **Russia's WTO Accession — Administration Views on the Implications for the United States**

TO: **United States Senate Committee on Finance**

BY: **U.S. Chamber of Commerce**

DATE: **June 21, 2012**

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is pleased to submit this testimony for the record on Russia's accession to the World Trade Organization (WTO) and the case for congressional approval of Permanent Normal Trade Relations (PNTR) with Russia. The U.S. Chamber is the world's largest business federation, representing the interests of more than three million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

No priority facing our nation is more important than putting Americans back to work. More than 8% of the U.S. workforce is unemployed — a figure that soars to 15% when those who have stopped looking for jobs and the millions of part-time workers who want to work full time are included. As a nation, the biggest policy challenge we face is to create the 20 million jobs needed in this decade to replace the jobs lost in the current recession and to meet the needs of America's growing workforce.

World trade will play a vital role in reaching this job-creation goal. When President Barack Obama delivered his State of the Union address in January 2010, the U.S. Chamber and the rest of the business community welcomed his call for a national goal to double U.S. exports within five years.

The rationale is clear: Outside our borders are markets that represent 80% of the world's purchasing power, 92% of its economic growth, and 95% of its consumers. The resulting opportunities are immense.

Already, more than 38 million Americans jobs depend on trade. One in three manufacturing jobs depends on exports, and one in three acres on American farms is planted for hungry consumers overseas.

Nor is trade important only to big companies. Often overlooked in the U.S. trade debate is the fact that more than 97% of the quarter million U.S. companies that export are small and medium-sized enterprises (SMEs), and they account for nearly a third of U.S. merchandise exports according to the U.S. Department of Commerce. In fact, the number of SMEs that export has more than doubled over the past 15 years.

The bottom line is simple: If America fails to look abroad, our workers and businesses will miss out on huge opportunities. Our standard of living and our standing in the world will suffer. With so many Americans out of work, opening markets abroad to the products of American workers, farmers, and companies is a higher priority than ever before.

It is within this context that we should consider the Chamber's top trade priority before the Congress this year: Approval of PNTR with Russia and Russia's graduation from the Jackson-Vanik amendment.

On December 16, 2011, trade ministers at the 8th WTO Ministerial Conference celebrated the conclusion of 18 years of negotiations for Russia to accede to the WTO and invited Russia to become the organization's 154th member. In those negotiations, Russia committed to enact a host of reforms to meet its extensive commitments to the WTO, and Moscow is expected to complete this work and formally join the WTO in July 2012.

That Russia will join the WTO is no longer in doubt. In fact, at this juncture, the United States can neither help nor hinder Russia in doing so. However, the U.S. Congress must act to ensure that the United States benefits from the reforms Russia undertakes as it joins the WTO.

Specifically, Congress must pass a short and simple bill that grants Russia PNTR and repeals the Jackson-Vanik amendment with respect to Russia. Failure to do so will put U.S. workers, farmers, and businesses at a unique disadvantage in the growing Russian marketplace and drive new sales, exports, and job-creation opportunities to our European and Asian competitors.

Joining the WTO requires Russia to implement a host of economic reforms. The multilateral trade agreement governing Russia's accession requires Moscow to open its market to U.S. goods, services, and investment; ensure greater respect for the rule of law; and protect intellectual property. A summary of the commitments made by Russia as a condition of its accession to the WTO appears in Exhibit 1 (next page).

One little understood aspect of this process is that Congress does not vote on Russia's accession to the WTO and has no authority to block it. Rather, Congress must approve PNTR and repeal the Jackson-Vanik amendment with respect to Russia if American companies, workers, and farmers are to benefit from Russia's new openness as it joins the WTO.

Under WTO rules, every WTO member must grant all other members unconditional Permanent Normal Trade Relations (also known as "most-favored nation" status). This obligation originated in the WTO's predecessor, the 1947 General Agreement on Tariffs and Trade (GATT), and it mandates that any advantage granted to one WTO member by another member must be accorded unconditionally to all other members.

The United States will be in clear violation of this rule if it fails to repeal Jackson-Vanik with regard to Russia. Russia would thus be fully within its rights to withhold the benefits of its accession-related reforms from U.S. companies.

The Jackson-Vanik amendment to the Trade Act of 1974 was devised to press the Soviet Union to allow the emigration of Soviet Jews, prisoners of conscience, and victims of religious persecution. With respect to Russia, Jackson-Vanik has fully accomplished its objective. With the collapse of the Soviet Union two decades ago, Russia established freedom of emigration for all citizens. Since 1992, U.S. presidents of both parties have issued annual certifications of Russia's full compliance with the Jackson-Vanik amendment.

Because no other WTO member has a law similar to Jackson-Vanik, all of Russia's trading partners except the United States will immediately benefit when Russia joins the WTO in July. If Jackson-Vanik remains applicable to Russia, the United States will be in violation of WTO rules.

Failure to approve PNTR and repeal Jackson-Vanik with regard to Russia would allow Moscow the right to discriminate against U.S. companies and the workers they employ and deny them the full benefits of Russia's market-opening reforms. Meanwhile, European and Asian companies will be able to build on their already significant head start in tapping the growing Russian market.

Exhibit 1:
What Does PNTR Mean for the United States and Russia?
For the United States, all the benefits
For Russia, all the concessions

Which To-Do List Would You Rather Have?

United States of America TO DO:	Russian Federation TO DO:
▪ Approve legislation providing PNTR and graduating Russia from the Jackson-Vanik certification process.	▪ Cut tariffs on manufactured products from 10% to 7%, with steeper cuts on priority goods: o *Eliminate duties on IT products.* o *Cut duties on wide body aircraft from as high as 20% to 7.5%.* o *Slash average tariff on chemicals to 5.3% from as high as 20%.* o *Cut tariffs on combine harvesters from 15% to 5%.* ▪ Reduce duties on farm products to 10.8% from 13%, with notable gains for key products: o *Expand market access for beef, poultry, and other products at reduced tariffs.* o *Require use of international standards and enforceable disciplines against trade restrictions that are not science based.* o *Cap farm subsidies at $9 billion in 2012 and cut them in half by 2018.* ▪ Open services markets to U.S. firms: o *Allow 100% U.S. ownership of companies in banking, securities, nonlife insurance, telecommunications, audiovisual, wholesale, distribution, retail, and franchises.* ▪ Meet intellectual property commitments of the WTO TRIPS Agreement: o *Enhance enforcement on the Internet and new copyright and patent protections.* ▪ Cut the maximum customs clearance fee by two-thirds. ▪ Allow trade disputes to be taken to the WTO dispute settlement system.

Russia is the world's ninth largest economy and the last major economy to join the WTO. Even ahead of Russia joining the WTO, it has already emerged as a market of great promise: Of the top 15 U.S. trading partners, Russia was the market where U.S. companies enjoyed the fastest export growth last year — a robust 38%.

Furthermore, the President's Export Council estimates that U.S. exports of goods and services to Russia — which, according to estimates, topped $11 billion in 2011 — could double or triple once Russia joins the WTO. Many U.S. companies are already active in Russia; to illustrate, the American Chamber of Commerce in Russia has more than 700 members. For many of these companies, Russia has proven to be a lucrative market for high quality goods and services.

Business opportunities in Russia are significant and are expected to grow substantially after Russia finalizes its accession to the WTO. For instance, the total cost of needed infrastructure spending over the next five years is conservatively estimated at $500 billion, according to the American Chamber of Commerce in Russia. Private-sector participation in this building boom could offer significant opportunities for U.S. companies.

The World Bank forecasts WTO accession could increase Russian GDP by 3.3% in the medium term and by 11% over a longer period as greater openness and competition in the marketplace compel the Russian economy to become more efficient. Russia's economy has been dominated by natural resource extraction and state-owned and state-influenced enterprises; joining the global rules-based trading system will foster diversification and openness and directly benefit consumers.

One often-posed question is: What happens if Russia fails to meet its commitments? In the area of intellectual property protection, for example, Russia continues to present significant challenges to U.S. innovators and creative artists. The Chamber will continue to urge the U.S. government to remain vigilant in ensuring that Russia implements its intellectual property commitments in full and makes greater progress with respect to combating online piracy.

However, addressing these challenges will be easier once Russia joins the WTO. Other countries will for the first time be able to use the WTO dispute settlement process to hold the Russian authorities accountable should they fail to fulfill their commitments as a new member of the organization. The WTO dispute settlement process affords graduated responses to the arbitrary imposition of trade barriers, including the possibility of WTO-sanctioned retaliation. At present, no such recourse exists, and U.S. authorities have few options to respond to Moscow's arbitrary trade actions. However, the United States cannot avail itself of WTO dispute settlement unless it grants Russia PNTR.

Russia's accession to the WTO has been a bipartisan American foreign policy goal for many years. In 1993, Russia applied to join GATT, the precursor to the WTO. After years of talks, the Bush Administration took a big step forward in 2006 when it signed a bilateral agreement with Russia to address particular trade concerns. (Any WTO member may insist that an acceding nation negotiate such an agreement as a condition for accession.) The Obama Administration concluded the multilateral negotiations for Russia's accession in December 2011.

The longstanding bipartisan goal of bringing Russia into the global rules-based trading system is finally within reach. The only question now is whether U.S. companies, workers, and farmers will be able to secure the benefits of Russia's accession to the WTO. The answer rests with the Congress, which must approve PNTR and repeal Jackson-Vanik with respect to Russia. The U.S. Chamber of Commerce looks forward to working with the members of the Committee on this important task.

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