THIRD WAY

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Five Deficit Reduction Ideas from One Impressive Initiative

***Annie Shuppy**, Senior Fellow, **Zach Moller**, Director of the Economic Program*

You may call it a fiscal cliff, fiscal bonanza, or a fiscal Super Bowl. Whatever phrase you prefer, the fact remains that there will be a series of high-profile moments in 2025 to address fiscal issues. Action-forcing moments include hitting the debt limit, expiration of parts of the Trump tax cuts, and government funding fights. Questions abound on how to make progress in this environment and put the country on sounder fiscal footing. But a recent effort shows how progress is possible.

Seven prominent think tanks from across the political spectrum partnered with the Peterson Foundation to develop proposals to reduce the projected debt-to-GDP ratio over the next 30 years. Notably, all proposals included both revenue increases *and* spending cuts, and they specifically addressed Social Security, Medicare, other mandatory spending, and discretionary spending. Participating groups included American Action Forum (AAF), American Enterprise Institute (AEI), Bipartisan Policy Center (BPC), Center for American Progress (CAP), Economic Policy Institute (EPI), Manhattan Institute (MI), and Progressive Policy Institute (PPI).

This initiative identified trillions of dollars in reforms across the entire federal government. For example, many proposals drastically improve Social Security's financial viability by raising the amount of wages subject to payroll taxes and adjusting retirement ages. Some tackle growing health care costs for the federal government by streamlining Medicare programs, others by raising premiums or revenue dedicated to Medicare, and many by bolstering competition in the health care industry. And all the proposals include major tax reforms, from slashing tax expenditures to reforming tax rates.

While there is a lot to unpack and all plans deserve a close read, here are five interesting components you might have missed with deficit reduction in the range of tens to hundreds of billions of dollars. Hopefully these policies are in the mix when lawmakers look for offsets or policies to make fiscal progress.

1. Site Neutral Health Care Reforms

Right now, patients pay more for services provided in hospital-owned clinics compared to doctor's offices. As a result, there has been a push—called site neutrality—to link prices to the value of care rather than the location of care. Site neutral policies, as endorsed by AEI, BPC, and PPI, seek to set the same payment for the same services across locations of care, limiting the practice of providers charging higher rates for the same services performed in a hospital outpatient clinic rather than in a physician's office.

There have been multiple bipartisan bills over the past year promoting site neutrality. [1] PPI's plan, specifically, would build upon congressional proposals by applying site-neutral standards to as many routine outpatient services as possible, such as imaging, routine check-ups, or drug prescriptions, and even surgical operations that can be safely administered in an independent physician's office. [2] PPI's approach is estimated to save $210 billion over 10 years, and BPC's version is estimated to save $178 billion over 10 years. [3] Congressional proposals are less comprehensive and/or use savings to expand other Medicare services.

2. A Defense Savings Commission

The US Government Accountability Office noted "that a number of opportunities exist for the Department of Defense (DOD) to strengthen management of defense spending." [4] A new DOD commission looking into wasteful procurement and unnecessary personnel expenses would allow Congress to find and then redirect savings back into security spending. This idea, as proposed by PPI, would have a panel composed of retired military and civilian leaders to identify "commonsense" savings. [5] The process itself would be modeled after the Base Realignment and Closure commissions (BRAC) that shut down old or unneeded military bases up until 2005 and made recommendations based on objective, transparent criteria. Like BRAC, these reforms would be automatically implemented unless stopped by Congress.

PPI notes that the defense budget is projected to shrink in terms of percent of GDP, so repurposing the funds to strengthen defense instead of setting them aside for deficit reduction makes sense. This fits within a broader mandate to "spend smarter," and it demonstrates fiscal responsibility to discontinue excess or inefficient procurement and personnel spending that may no longer be serving the national security mission.

3. Permanent IRS Enforcement Funding

The 2022 Inflation Reduction Act funded substantial modernization of the Internal Revenue Service (IRS), but the funding was only for nine years. Policymakers should consider permanent enhanced IRS enforcement funding that would keep up revenue collection and continue to modernize the IRS. CAP, BPC, MI, and PPI all suggest this policy in their proposals. [6] Although congressional Republicans have attempted to undermine these additional IRS resources in recent appropriations legislation, going after tax cheats and ensuring that taxes owed become taxes paid has policy and political merit.

The savings achieved by properly supporting the IRS vary depending on the exact parameters of the plan. PPI estimated that their proposal would save $210 billion over 10 years, while BPC estimated that their plan would save a net $165 billion over 10 years. [7] The Manhattan Institute's plan, while pushing back against the idea that fiscal stability is achievable solely by taxing the wealthy, also called for extending IRS enforcement to raise an additional 0.07% of GDP over 30 years (roughly $25 to 30 billion a year). [8]

4. Change Step-Up in Basis Rules

When a wealthy person passes away, they typically transfer assets to their heirs. But there's a loophole. Those heirs will only pay capital gains on future gains from when they received the gift—not the original acquisition value of the asset. This "step-up in basis" exemplifies tax policies that unnecessarily waste revenue, cater to the wealthy, and create bad incentives. In this case, they encourage taxpayers to hoard their assets until death so their heirs can avoid paying the difference between the sale price and the price at which it was acquired by the original owner—bypassing years and potentially millions of dollars of growth. BPC, MI, and PPI all suggest policymakers shut this loophole off. [9]

BPC estimates that its proposal would raise $217 billion over 10 years, while Manhattan Institute's estimate is comparable at 0.07% of GDP by 2054. [10] PPI's proposal to end step-up basis is estimated to raise $235 billion over 10 years, but it is part of a larger tax overhaul that includes raising capital suggests gains rates to correspond to higher individual income tax rates. [11]

5. Social Security Taxes on Benefits of High-Income Beneficiaries

Under current law, limited amounts of Social Security benefits are subject to normal income taxes—either none, half, or 85% of benefits, depending on the income threshold. Subjecting more wealthy individuals' Social Security benefits to income taxes could bolster the longevity of the program. Several of the budget plans found ways to produce savings within Social Security, and increased taxes on benefits of high-income beneficiaries may be one of the most politically practical.

BPC's proposal would raise $18 billion over 10 years while steadily growing over time. [12] PPI's proposal raises hundreds of billions in the context of other Social Security reforms and income tax changes. [13] BPC subjects all Social Security benefits to income taxes for those couples earning above $500,000 (or $250,000 if single). [14] PPI's plan would make all Social Security benefits taxable as income for individuals and couples with combined incomes above $45,000 and $58,000. [15]

In an era when both parties need to get real about fiscal responsibility, these five ideas alone would produce hundreds of billions in deficit reduction and serve as a downpayment on a path to a more sustainable debt-to-GDP ratio. But let's not stop there. Other interesting policies ranged from eliminating agriculture subsidies (proposed by AAF, BPC, MI, and PPI) to reforming TRICARE, the health care plan for servicemembers and their dependents (proposed by AAF and BPC), and a host of other policies. [16] Notably, the plans were fiscally responsible while also prioritizing the future—whether that meant raising federal domestic spending on R&D to its historical average or considering the solvency of safety net programs for future beneficiaries. For more, check out the Peterson Foundation's Solutions Initiative 2024: Charting a Brighter Future.

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