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Return to Fiscal Responsibility II

by Paul Weinstein Jr. and Katie McMinn Campbell

America is at a fiscal crossroads. In the last six years, the Bush administration has turned a surplus projected to be $5 trillion over 10 years into a deficit projected to be more than $2.8 trillion.[1] It would be one thing if all this new debt was being racked up to finance public investments that would expand economic opportunity for the middle class. But the surplus has instead been squandered on tax cuts for the wealthiest slice of American society and a wasteful governmental spending spree. Some of the least defensible expenditures in that spending spree have been well publicized—egregious pork-barrel projects, midnight earmarks, and the like—but the profligacy has actually gone well beyond that. Among many other things, the administration has frittered away taxpayers' money by building up a massive new shadow government of private contractors that is now four times the size of the career civil service. What ever happened to fiscal responsibility?

The president claims that his 2008 budget proposal will return the government's books to balance in five years. But there is no reason to believe him. At this point, his credibility as a fiscal conservative is as solid as Jell-O. In six previous attempts, his administration has consistently failed to submit a budget that holds water. In keeping with that pattern, its latest effort is full of rosy economic scenarios and strategic spending omissions. It doesn't take full account of the real costs of the war on terror, for example, or the cost of reforming the alternative minimum tax (AMT), which nearly everyone concedes is essential.

Three years ago, in a progressive deficit-cutting proposal entitled "A Return to Fiscal Responsibility," PPI predicted that if the country's fiscal policies were not changed, "the coming decade is likely to rank as the most fiscally irresponsible in our nation's history." Unfortunately, that statement has turned out to be all too prescient. With three years still to go in the president's second term, the first decade of the 21st century has already set a new record for the most debt generated

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> *"One person with a belief is a social power equal to ninety-nine who have only interests."*
> —John Stuart Mill

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in a ten-year period. This fiscal recklessness is both an economic albatross for the country and an abdication of Washington's responsibility to the citizens and taxpayers it represents.

The economic rationale for restoring fiscal discipline today is different than the one the Clinton administration embraced in the 1990s. Then, cutting the enormous Reagan deficits and balancing the budget were rightly seen as integral to economic growth. Reducing government borrowing kept long-term interest rates down, unleashing new private investment that spurred record-breaking economic growth.

But global capital markets have grown much larger today. An abundance of ready lenders with relatively cheap capital has made it easier for the Bush administration to run large budget deficits without driving up long-term interest rates. As a result, many Republicans—and some liberals—have stopped worrying about fiscal discipline and learned to love deficit spending.

But they are wrong. A balanced budget may no longer be as potent a stimulant to growth as it was in the 1990s, but as University of Chicago and PPI economist Austan Goolsbee argues in a companion paper to this one, deficits still matter.[2] Goolsbee illustrates how the big Bush deficits amount to a triple whammy: They place an unfair financial burden on future generations, they weaken the government's ability to respond to national crises, and they expose America to the whims of foreign lenders and central banks. Conversely, whittling the Bush deficits down to manageable proportions would provide a national insurance policy against global financial shocks and reduce the leverage that foreign lenders exercise over America's economic health.

While the economic consequences of deficit financing have changed somewhat, the political and moral case for fiscal discipline has not. Spending the taxpayers' money with wisdom and restraint remains an important marker of political responsibility and accountability. Just ask the Republicans, whose reckless spending contributed to their losing control of Congress in the 2006 midterm elections. Today, just as in the early 1990s, it is up to the Democrats to restore fiscal sanity in Washington and thereby rebuild public confidence in progressive government.

Eventually, we need return to a period of sustained surpluses that will allow us to begin paying off our national debt and ensuring the long-term financial viability of Social Security. However, it took the Bush Republicans six years to dig the nation into a deep fiscal hole, and it will take some time to climb back out again. Therefore, at least in the short term, it may make sense, as Goolsbee has suggested, for the United States to run small deficits—on the order of 1 percent of gross domestic product (GDP), instead of the 3 percent or 4 percent of recent years.

This paper shows how. It lays out a detailed blueprint for reducing the Bush deficits by $1.88 trillion over the next 10 years with a hit list of spending cuts, steps to restore budget discipline, and tax reform that will make a down payment on restoring progressivity and fairness.

Fortunately, the newly elected Democratic leaders of the House and Senate have already made fiscal restraint and budget reform cornerstones of their agenda. We applaud their efforts and commend them for the actions they have taken so far, including the House of Representatives' vote to restore pay-as-you-go budget rules, known as "Paygo." But if Congress is to succeed in reining in the deficit and returning the country to fiscal sanity, it will have to make many more tough choices over the coming year and beyond.

Even if Democrats can hold the line on new tax breaks and entitlements, structural deficits will remain and the national debt will grow. Last year brought greater revenues than in years past, yet more than $500 billion was added to the public debt. Looking ahead, the picture only gets worse. Factoring in realistic projections for war costs and AMT reform, the country's total debt will rise to approximately $11.6 trillion by 2011—roughly double the level when President Bush took office.

Why the big disconnect between the size of the deficit and the increase in the debt? Because Social Security and Medicare trust funds, which are in temporary surplus, are being used to pay other bills. This makes the deficit look lower than it really is.

Unfortunately, with the baby boom generation heading into retirement, the current fiscal policy of raiding the Social Security and Medicare trust funds could not be happening at a worse time. Economists project that Social Security will become insolvent by 2041, and the number of beneficiaries will climb to 82 million people by 2050. Medicare faces even bigger problems. If health care costs continue rising at the current pace, the Medicare shortfall will be seven times the projected Social Security shortfall. By 2050, based on the current trend lines, the federal government will spend more than 20 percent of the U.S. GDP on Medicare and Medicaid alone—which would be equal to today's *total* government spending.

The longer we wait to correct the fiscal damage wrought in the last six years, the more painful the budget choices will be. For example, according to the General Accounting Office (GAO), if we do not rein in the deficits now, we can expect that:

- by 2024, Social Security, Medicare, Medicaid and net interest on the national debt will consume all revenues collected from taxes;
- a year later, net interest on the debt will exceed Medicare expenditures and the public debt itself will exceed the country's GDP; and
- by 2035, net interest on the debt will exceed Medicare and Medicaid expenditures, and the debt will be twice the size of the GDP.

Unfortunately, there is no silver bullet to solve all of these deep fiscal woes. Instead, we must tackle the causes most responsible for the structural deficits: the proliferation of special interest tax breaks and loopholes; the collapse of the budget rules and accountability measures put into place in the early 1990s; the explosion of pork and wasteful spending; uncontrolled growth in entitlement spending; and the fatally flawed Bush tax cuts.

This PPI plan is a progressive alternative to the borrow-and-spend policies of the Bush administration. Included is a list of more than 50 politically feasible and fiscally sound spending cuts, government reinvention proposals, budget reforms, and tax reforms that spread the pain of deficit reduction fairly. The budget savings are achieved in five major areas:

- cutting the size of the government, including eliminating unnecessary programs, slashing the number of consultants on the federal payroll, and reducing the federal government's travel budget;
- creating a commission to reduce corporate welfare expenditures, including both tax breaks and spending programs that aid companies that do not need or deserve the government subsidies;
- reinventing and consolidating government programs and agencies;
- restoring real budget controls, including stronger versions of Paygo and discretionary budget caps and a constitutionally viable version of the line-item veto; and
- reforming the tax code to restore fairness and progressivity, rolling back the Bush tax cuts for the super rich, and still ensuring continued tax relief for middle- and low-income families.

Table 1 shows the top-line savings that can be achieved. Table 2, in the appendix, provides a list of 53 different budget reforms that would together cut the 10-year projected deficit by $1.88 trillion. Depending on whether one uses a Congressional Budget Office (CBO) baseline or a more realistic one that includes, among other things, the cost of reforming the AMT and the true price tag of the war on terror, the savings could reach more than $2 trillion. Moreover, depending on how much deficit reduction is achieved, additional savings would result from reductions in net interest payments on the national debt.

Table 1: Top-line Savings by Type
(Figures in Millions of Dollars)

CATEGORY	SAVINGS
Spending Cuts	337,713
Government Reinvention	151,279
Budget Reform	500,000
Tax Reform	892,327
TOTAL	**1,881,319**

(Author calculations)

Because the policies of the last six years have sunk the country so deeply into debt, this plan will not balance the budget by itself. But if implemented, it will put America back on the road to fiscal responsibility without wreaking havoc on the economy; it will enable the country to deal more effectively with the coming retirement of the baby boom generation; and it will make government more efficient and responsive.

Part One: Spending Cuts

❒ Reduce the number of federal contractors by 750,000

10-year savings: $284 billion

According to a recent study by Paul Light of New York University, not only is the number of federal civil servants on the rise, but so are the numbers of employees working for government-funded contractors and for organizations that receive government grants.

During the Clinton-Gore administration, the total size of the federal workforce was reduced by over 402,000 full-time employees, to a level not seen since the Eisenhower administration.[3] At the same time, there was only a marginal increase in the number of contract jobs, producing considerable savings for taxpayers.[4]

Yet, from 2002 to 2005, the federal government experienced a marked increase in the number of contract positions. By the end of 2005, according to Light, more than 2.4 million new contractors had been added to the federal payroll, which is more than the total number of civilian employees.[5] As a result, there are approximately three times more contractors working for the federal government than the total number of military personnel and civil servants combined.

What has driven this growth in contract positions? A large source of the increase is due to the war on terror. Of the total increase, 75 percent, or 1.8 million contractors, are defense-related positions.[6] But the Bush administration has also placed an emphasis on outsourcing civilian government positions to private contractors through its "competitive sourcing" initiative, ostensibly as a means of saving costs. Unfortunately, it is difficult to assess whether or not any savings have been achieved, because there is no adequate accounting for the number of consultants, how much they typically cost, and what tasks they are fulfilling.

While contractors and consultants provide useful services—sometimes at a lower cost than the federal government—their numbers are too high in light of the current budget deficit. Policymakers in Washington should get the burgeoning size of government under control, and they should start by reducing the number of contractors by 750,000 over the next 10 years.

With our role in the war in Iraq expected to decrease over the next couple of years, and hopefully, greater success in the war on terror, it would be reasonable to assume that we could cut the total number of contractors employed by the federal government by 10 percent.

Congress should enact legislation that requires federal contractors to provide a precise headcount of how many of their employees are working on government contracts and what jobs they are fulfilling. Congress should then use its budgetary power to mandate the administration to cut the number of contract slots by 750,000 while holding the size of the federal civil service constant. This cut could be done across the board, or on an agency-by-

Table 3: Federal Contractors
(Savings in Millions of Dollars)

10-Year Decrease in Contractor Positions	Savings
500,000	189,916
750,000	284,874
1,000,000	379,832

(**Calculations by Jessica Milano**)

agency basis, so the agencies most responsible for the recent spike in contract positions bear most of the burden of the reductions.

Savings from this proposal would be significant, as Table 3 illustrates. The numbers assume the cuts are allotted in 10 percent decreases annually, with contractor pay rising at 2 percent annually. The median income of federal contractors is assumed to be $65,000, based on surveys conducted in the private sector.[7]

❒ Repeal add-on subsidies in the Medicare drug bill

10-year savings: $19.9 billion[8]

Older Americans were not the only ones who benefited from the new Medicare drug legislation signed into law at the end of 2003. A number of special interests have been able to cash in on the new law, too.

For example, the law calls for huge payments to insurers and rural hospitals. Those payments went a long way toward explaining how, after several failed attempts, the Republican architects of the Medicare drug bill put together a coalition that established the first prescription benefit under Medicare.

The law increases payments to rural hospitals by $19.9 billion over the next 10 years, locking in support from rural legislators.[9] But the logic of that provision had nothing to do with prescription drugs; it was more a case of political horse trading. Now that the law has been enacted, Congress should go back and ensure that payments to all types of providers are results-based, not politically driven.

❒ Reduce the federal travel budget

10-year savings: $18.5 billion

One of the first things companies cut when faced with budget problems is travel. Yet, despite our record deficits, government expenditures for travel have grown by leaps and bounds. For example, in FY 2000, federal agencies spent more than $9 billion on travel for mission-related business around the world.[10] In 2006, that figure reached $14 billion—an increase of 55 percent.[11] Some of the recent increases may be due to rising oil prices. But the fact is that year in and year out, agencies spend more on travel than they project. This is particularly odd considering that the last decade has witnessed remarkable improvements in telecommunications technology, which should cut these face-to-face meetings and create greater possibilities for virtual conferences and communication. The federal government should create a hard cap on travel expenditures and cut the expected rate of growth in half. To ensure that emergency travel needs are met, agencies should be required to hold 10 percent of their travel budget in reserve until the last month of each fiscal year.

❒ End payments to wealthy farmers

10-year savings: $5.7 billion

A report by the General Accounting Office (GAO) found that the primary beneficiaries of more than 80 percent of U.S. agricultural subsidies are large and medium-sized farms. Other studies by the Environmental Working Group[12] have also found that the top 10 percent of big farmers and agribusinesses consumed about 80 percent of farm benefits, leaving small farmers out in the cold. Agricultural subsidies should only be targeted to small and family farms.

In theory, the maximum subsidy payment to a farmer, through multiple entities, is now $360,000 a year. But growers have found many legal ways to get around that limit. Some managed to collect several times that amount. (One type of aid, which involves marketing assistance loans, is not subject to any limit.)

Bipartisan recommendations, including some from the administration, have proposed reducing the annual farm subsidy cap from $360,000 to $250,000 and closing the loopholes that allow farmers to bypass these limits altogether.[13]

It is estimated that this proposal would save over $5.7 billion in the next 10 years and would target the majority of farm benefits to family farms.[14]

❒ Cut the Economic Development Administration's budget by 50 percent and require a state/local match

10-year savings: $2.6 billion

Originally established to provide assistance to distressed communities, the Economic Development Administration (EDA) long ago became a favorite conduit for members of Congress to funnel pork projects to their districts. A typical example was an award of $500,000 to Wofford College in Spartanburg, S.C., for an athletic stadium that was used for training by the Carolina Panthers professional football team.[15]

Congress should cut EDA's budget by 50 percent and require a state and/or local match of an equal amount for future grants. This state/local match would help ensure that new EDA grants are both needed and supported by the communities receiving the grants. By leveraging state and local resources, the program should improve in quality and impact, while saving federal taxpayer money.

❒ Cut congressional staff by 10 percent

10-year savings: $1.7 billion

In the 1990s, the executive branch cut its workforce by approximately 402,000 full-time employees. This reduction saved U.S. taxpayers billions of dollars. Yet, while the executive branch dramatically reduced the size of its workforce, Congress' continued to grow. Between 1995 and 2006, the number of congressional staffers grew by 5 percent.[16] With burgeoning deficits, Congress should share the pain of future reductions in the federal workforce. Cutting congressional staff by 10 percent over the next 10 years will save taxpayers $1.7 billion.[17]

❒ Trim the federal vehicle budget by 5 percent

10-year savings: $1.5 billion

The government owns more than 500,000 cars and trucks, and it spends more than $3 billion annually to operate them.[18] Moreover, the number is getting bigger. For example, from 2004 to 2005, the cost of the total federal vehicle fleet cost rose by 21.7 percent.[19] While some of these increases may be justified as part of the war on terrorism, especially with increased fuel costs, others are not. Experience from the private sector underscores that there is always waste in administrative expenditures, and savings can always be found, even when new needs arise. The federal government should follow the lead of states like Michigan, which recognized it had too many automobiles for government use and trimmed its vehicle budget by 5 percent.

❒ Eliminate the Oil Technology Program

10-year savings: $780 million

The U.S. Department of Energy's (DOE) Oil Technology Research and Development Program focuses on the exploration and production of crude oil in the United States. The program's goals include the promotion and enhancement of oil drilling in the Alaskan Arctic and the Powder River Basin in Wyoming. The Office of Management and

Budget (OMB) classifies the program as "not performing," saying that "actual additional oil reserves attributable to technology developed by the program have been relatively small."[20] With the price of gas reaching record highs, the oil and gas industry has a significant market incentive to invest in new technologies without the help of taxpayers. This program should be eliminated.

❒ Cut the number of political appointees

10-year savings: $707 million

According to Paul Light of New York University, "the past half century has witnessed a slow, but steady thickening of the federal bureaucracy as Congress and presidents have added layer upon layer of political and career management to the hierarchy." The past six years of the Bush administration have been no different. They have been marked by a significant expansion in the federal hierarchy. There have never been more layers at the top of government—where political appointees are a substantial percentage of the workforce—nor more occupants at each layer.[21]

The term "political appointee" generally refers to employees of the federal government who are appointed by the president—some subject to Senate confirmation, some not—and to certain policy advisers hired at lower levels. In this proposal, the term refers to Cabinet secretaries, agency heads, and other "Executive Schedule" employees at the very top ranks of government; top managers and supervisors who are non-career members of the Senior Executive Service; and confidential aides and policy advisers referred to as Schedule C employees. In 2001, the CBO estimated that if the number of political appointees was reduced from an average of 2,800 over 10 years to an average of 2,200, the savings would total more than $700 million. Since that report came out, the average salary for political appointees has increased roughly 7.5 percent to $99,583. Thus, the potential savings from this proposal has grown to $760 million over 10 years.[22]

Reports from several groups, including the National Commission on the Public Service and the Twentieth Century Fund, have called for cuts in the number of political appointees. The National Commission on the Public Service, also known as the Volcker Commission, called for setting a limit similar to the one described here. In addition to the problem of excessive organizational layering, the Volcker Commission expressed concerns about many appointees' lack of expertise in government operations and programs.

❒ Freeze funding for the Market Access Program

10-year savings: $531 million[23]

The Market Access Program, run by the Department of Agriculture's Foreign Agricultural Service, provides funds to trade associations, commodity groups, and for-profit firms to help them build markets for U.S. agricultural products overseas. The Market Access Program promotes a wide range of products, including fruit, tree nuts, vegetables, meat, poultry, eggs, and seafood. About 20 percent of its funding goes to promote brand-name goods.

That type of activity goes well beyond the program's stated goal of building markets for U.S. agricultural products. For the most part, taxpayers' money should not be spent to advertise brand-name products. Program participants—especially those with name brands—should bear the full cost of foreign promotions, since they directly receive the benefits. Furthermore, the Market Access Program is redundant, since the Foreign Agricultural Service's Foreign Market Development Program also provides funds for overseas marketing.

❒ Eliminate subsidies for special agricultural products

10-year savings: $458 Million

Despite efforts to kill them on numerous occasions, subsidies for wool, mohair, honey, and other specialty crops continue. For example, the Honey Loan program was terminated in 1996 with great effort on the part of the Clinton administration. Yet, the 2002 Farm Law created a marketing assistance loan program for honey similar to that provided to other commodities. Assistance for wool and mohair is another example of the fact that no unnecessary program goes away quietly. Of greater concern is that the 2002 farm legislation qualified a laundry list of other specialty agriculture crops for federal assistance. For example, the bill created price floors for lentils and chickpeas. (When the market price falls below $11.94 for 100 pounds of lentils, or $7.56 for 100 pounds of chickpeas, the government makes up the difference.)

With such "deficiency payments," farmers are assured of a certain income and can obtain the loans they need to stay in business. In the past, many lenders discouraged farmers from growing lentils and chickpeas because the government provided no price supports for them.[24] These programs, including those supporting lentils and chickpeas, are up for reauthorization in 2007. As a down-payment on reducing unnecessary agriculture subsidies across the board, Congress should not extend these support programs.

❒ Suspend the acquisition of new federal office space

10-year savings: $351 million

If we are going to reduce the size of the federal workforce, there is no reason to continue purchasing or leasing new office space. Yet, federal spending on the construction and acquisition of facilities continues to rise rapidly. In 2004, the government spent $659 million on new space. The estimated spending for FY2006 was more than $1 billion—a 75 percent increase in just two years.[25] While some increases may be justified by real need, a 75 percent increase in just two years is excessive.

The General Services Administration (GSA) should cap spending on new office space at $800 million per year. This would halt the exponential spending increase for new space and create $351 million worth of new savings over the next 10 years.

❒ Reduce federal media contracts by 10 percent

10-year savings: $88 million

During the Bush administration, federal spending for public relations and has more than doubled. In fiscal years 2003 through 2005, the federal government spent more than $1.6 billion on media related contracts and public relations campaigns.[26] In 2004 alone, the administration spent over $88 million on contracts compared to $39 million in the last year of the Clinton administration.[27] As the number and value of media contracts rise, the standard practice of competitive bidding for these contracts has decreased. Today, more than 40 percent of public relations contracts (worth $39 million) are awarded on a noncompetitive basis.[28]

Not only has the number of media contracts increased, but on the Republican watch many have been viewed as unethical. A 2005 Government Accountability Office report found that the Department of Health and Human Services and the Office of National Drug Control Policy distributed prepackaged news stories about agency activities that were designed to be indistinguishable from news stories produced by private broadcast journalists, and were therefore deemed "covert propaganda."[29] One of the most notorious cases of questionable federal media spending involved television talk show host Armstrong Williams. The Bush administration paid the prominent pundit $240,000 to endorse the No Child Left Behind law on his nationally syndicated talk show.[30]

Not all spending on public relations and media contracts is illegal or even inappropriate. However, at a time of increased budget deficits, the federal government must ensure that agencies spend tax dollars wisely. Many of these media contracts and campaigns should not qualify as national priorities. For example, the U.S. Patent and Trade Office spent $2 million in 2005 to educate businesses about the importance of intellectual property rights, something private businesses should learn on their own.

❒ Ban bonuses for political appointees

10-year savings: $15 million

Since he became president, George Bush has reinstituted a policy of providing bonuses to political appointees, despite the fact that his administration has put forward budgets that have produced record deficits. In 2002, his administration doled out $1.44 million in bonuses to 470 political appointees.[31]

The Clinton administration ended the practice of giving such bonuses to most political appointees in 1994 after questionable payments to some outgoing aides in the final days of the previous administration. (In January 1993, outgoing Attorney General William Barr approved more than $100,000 in bonuses, with two $7,500 bonuses going to close political aides who would later join the law firm where he was a partner.) In March 2002, Bush administration Chief of Staff Andrew H. Card Jr. overturned the Clinton-era ban on annual cash awards for political appointees in a memo sent to Cabinet members and agency heads. A 1994 law still prohibits appointees from collecting bonuses during presidential election periods. Top-level presidential appointees who are confirmed by the Senate can never receive such awards.[32]

While the savings from banning bonuses to political appointees would be small, the principle it would re-establish—no cash rewards in a time of deficit spending—is important if we are to restore budget accountability to Washington.

❒ Eliminate with the Historic Whaling and Trading Partners Program

10-year savings: $9 million[33]

The Historic Whaling and Trading Partners program funds cultural and educational organizations with experience in developing or operating programs that illustrate and interpret the contributions of the whaling industry. It also provides earmark grants to a variety of museums dedicated to the history of the whaling industry, such as the New Bedford Whaling Museum and the New Bedford Oceanarium in New Bedford, Mass.

While respecting our history and culture is important, funding programs such as these is inappropriate during a fiscal crisis and should instead be supported by foundations and the private sector. The House Appropriations Committee recommended terminating this program during the FY2007 budget process.

Part Two: Government Reinvention

❒ Reduce the number of non-competitive contracts

10-year savings: $53.5 billion[34]

To protect taxpayers and guarantee fair pricing, federal contracts are supposed to be awarded with full and open competition. The government is supposed to provide public notice of contract opportunities, ask for bids from all qualified bidders, and determine which bids provide the best value. There are times when full and open competition is impossible or unnecessary—such as when the contract serves vital national security interests that would be compromised by the bidding process. Federal law makes exemptions for these situations.[35]

The use of these exemptions has exploded the number of noncompetitive contracts over the past five years, at taxpayer expense. In FY2003, the federal government spent the $107 billion on more than 43,000 noncompetitive contracts—a $40 billion increase from the spending on no-bid contracts during the Clinton administration.[36] The Department of Homeland Security (DHS), partly because of a critical shortage of trained government contract managers, has engaged in the most noncompetitive contracting. Within DHS alone, the cost of contracts awarded without full competition increased 739 percent between 2003 and 2005. Furthermore, many of these contracts have experienced overcharges, wasteful spending, and mismanagement.[37]

By tightening the exemptions for noncompetitive contracting, the federal government could save 5 percent, or $53.5 billion over the next 10 years. Michigan has seen promising results from eliminating the number of no-bid state contracts.[38] In just three years of requiring competitive contracting, Michigan has achieved $343 million in savings and cost avoidance. While it is not appropriate to directly compare Michigan's experiences with potential federal savings, the state's reductions do point to potential savings from reforming the wastes in noncompetitive contracting.

❐ Switch to direct student loans

10-year savings: $22 billion

Taxpayers spend billions of dollars every year subsidizing private banks so they can offer low-interest student loans and be protected against default. The federal government should instead lend directly to students. With direct lending, the government would eliminate the middleman, save billions of dollars in administrative costs, and earn revenue that could be used to expand educational loans.

Government figures show that direct loans typically bring in 22 cents for every $100 borrowed, after administrative expenses. Meanwhile, the Federal Family Education Loan (FFEL), which subsidizes private banks, costs the Treasury $12.80 for every $100 borrowed. Unfortunately, as *U.S. News and World Report* notes, "dozens of colleges and universities are abandoning the Department of Education's direct-loan plan, lured by the promise of a quick buck from banks and state lending agencies. … In all, 62 colleges and universities have dropped out of the Education Department's direct-loan program since 2000, and the list is growing."[39]

All federal student loans for higher education (otherwise known as Stafford loans), should become "direct" loans instead of "guaranteed" loans. The Office of Management and Budget estimates that lending directly to students, rather than guaranteeing loans made by a third party, will save the taxpayers nearly $1,300 per $10,000 Stafford loan.[40]

❐ Reduce erroneous payments

10-year savings: $19 billion

A GAO audit found that 18 agencies made a total of $38 billion in improper payments to states, localities, and individuals in FY2005 alone. This number probably understates how much was actually misspent. The Federal Emergency Management Agency (FEMA) has been one of the most glaring offenders of erroneous spending. After Hurricane Katrina, it improperly paid many individuals twice for their lodging. Also, millions of dollars of assistance was sent to people who provided the names and Social Security numbers of incarcerated individuals.[41] While it is unreasonable to think the federal government can completely eradicate mistaken payments, tough fiscal times require tough medicine.

In 2002, Congress enacted the Improper Payments Information Act in an attempt to address this issue. Now it should take the advice of the GAO auditors and OMB: It should clarify how agencies identify programs susceptible to significant improper payments, and it should develop more explicit guidance for agencies' improper payment reporting. Together, these efforts could cut mistaken payments by 5 percent annually.

❒ Consolidate military personnel costs into a single appropriation

10-year savings: $15 billion

According to the CBO, more than 20 percent of the federal government's costs to recruit and retain military personnel fall outside the DOD's military personnel appropriation. The DOD pays for many personnel benefits—for example, commissaries, some medical care, DOD schools, and on-base family housing—from other appropriations. The U.S. Department of Veterans Affairs (VA) pays some additional benefits, such as Montgomery GI Bill awards and veterans' disability payments.

Personnel-support costs funded by DOD should all be rolled together in the same military personnel appropriation. Some VA programs might also be funded in the defense budget as well. That realignment of funding would achieve two related goals: It would more accurately provide information about how much money is being allocated to support military personnel, and it would give DOD managers a greater incentive to use resources wisely. The potential savings from better management are substantial. Savings of just 1 percent, for example, would equal about $1 billion annually.[42]

❒ Finance the Food Safety and Inspection Service with user fees

10-year savings: $8.8 billion[43]

Sometimes government regulation can actually benefit business. For example, without the stamp of approval of the U.S. Department of Agriculture (USDA), consumers would be more reluctant to purchase fresh meats or poultry. Federal inspections benefit both producers and consumers of meat and poultry products because they prevent diseased animals from being sold as food. But the meat and poultry industries benefit in other ways as well: For example, they can advertise their products as having been inspected by the USDA, which may enhance the quality of those products in the eyes of consumers. Even so, the meat and poultry industry only pays for inspections by the USDA's Food Safety and Inspection Service (FSIS) when its plants are operating on holiday or overtime hours.

The FSIS employs about 7,000 inspectors, at least one of whom must be present at all times when a meat or poultry slaughtering plant is operating. Inspectors monitor processing plants daily for adherence to federal standards (for sanitary conditions, ingredient levels, and packaging), and sample and test processed meat and poultry products. Recently, the FSIS has also been charged with protecting the nation's meat and poultry products from bioterrorism. The agency gets most of its funding through annual appropriations, which totaled $817 million in 2005.

Given the benefits of these important services to the industry, the government should begin financing all federal meat and poultry inspection activities through user fees paid by meat and poultry slaughtering and processing firms.[44]

❒ Adjust capital payments to hospitals under Medicare

10-year savings: $6.9 billion[45]

This proposal would make a long overdue change to the formula used to account for capital expenditures in Medicare payments to hospitals. When first established in 1992, the hospital payment system was based on estimates of capital expenditures that subsequently turned out to be too high. This mistake was partly corrected by Congress in 1997, but the portion that was unchanged remains substantial.

❒ Permanently extend the FCC's authority to auction radio spectrum licenses

10-year savings: $6.9 billion[46]

In 1993, the Federal Communications Commission (FCC) was granted limited authority to use competitive bidding to assign licenses for use of the radio spectrum. The Balanced Budget Act of 1997 went further—not just permitting but requiring the FCC to auction licenses in all circumstances in which more than one private applicant seeks a license. From 1994 through 2003, those auctions generated a total of $20 billion in federal receipts. The FCC's authority to auction spectrum licenses is set to expire at the end of fiscal year 2007. Congress should permanently extend it. That would produce $7 billion in additional federal receipts over the next 10 years.

Besides increasing federal revenues, the other argument for this policy change is that competitive bidding directly places licenses in the hands of the parties that value them most—a more efficient outcome than the one produced by lotteries or comparative hearings, the methods previously used to assign licenses.

❒ Reform graduate medical education

10-year savings: $5.08 billion

Medicare pays a significant percentage of the salaries and related expenses of U.S. medical school graduates while they are training in residency at the country's 400 teaching hospitals. America certainly has an interest in ensuring an adequate supply of well-trained doctors, but the government should not allow medical training to be isolated from the day-to-day problem of delivering better value to consumers for their health-care dollars. Currently, medical training is designed to teach doctors how to perform specific medical procedures successfully, instead of how to achieve the best health outcomes for patients. For example, the emphasis is on performing heart bypass surgeries, not preventing and managing heart disease. When doctors finish their training, they often have to be retrained to think that way. Those retraining costs are typically borne by large group practices like the Mayo Clinic or HMOs such as Kaiser Permanente.

This proposal would spur teaching hospitals to transform themselves into leaders in value-based health-care delivery by contracting with those private entities to underwrite medical training, instead of relying on the government. Teaching hospitals would have five years to find new ways to pay for training that the federal government currently funds. After that, Medicare's graduate medical training payments would be limited to only salaries and benefits. In addition, Congress should allow teaching hospitals to enter into performance-based contracts with Medicare instead of billing for procedures.[47]

❒ Use technology to reduce the cost of operating military equipment

10-year savings: $4.6 billion

Congress should authorize an additional $600 million a year to invest in technologies that can help reduce the operation and maintenance (O&M) costs of weapon systems. The funds would go into "technology insertion accounts" that would be applied to equipment already used by military units in the field—for example, to support the research, development, procurement, and installation of reliable digital compasses in place of antiquated analog versions, or to replace universal joints on truck axles with constant-velocity joints, which reduce a fleet's tire wear by one-third. Such investments can lessen the need to repair or replace failed components, freeing up maintenance workers and ultimately reducing the costs of operating equipment. Similar opportunities to save on O&M costs without sacrificing performance exist for all of the aging weapon systems. The CBO has estimated that over 10 years, $6 billion worth of technology investments could produce $10.6 billion in savings—for net savings of $4.6 billion.[48]

The Armed Services currently spend relatively little on technology insertion. Of the $38 billion spent each year on maintaining weapon systems, only about $600 million is devoted to technology insertion to reduce costs. As an extreme example, the program manager for the M1A1 Abrams tank—the Army's second largest weapon system—received only $1.2 million for research and development on ways to reduce the system's $2.9 billion annual operating costs. Studies conducted for the DOD by the Logistics Management Institute and others have concluded that funding for technology insertion is inadequate.[49]

❒ Use purchase cards to streamline federal procurement

10-year savings: $3 billion [50]

The U.S. government has increased its use of purchase cards to avoid the procurement process and save money. Purchase cards are internationally accepted credit cards issued by individual contractors that are available to personnel under a GSA contract.[51] Agencies use the cards to procure mission-related goods and services for purchases under $2,500. For example, agencies previously had to follow a series of time consuming steps to order office supplies. First someone would fill out a request form and other appropriate paper work. The forms would then go through an approval and signature collection process before office supplies could be ordered. Purchase cards allow federal agencies to bypass this cumbersome process.[52] Under proper management, these cards streamline the acquisition process and provide greater flexibility to federal agencies. Purchase cards create efficiencies in processing procurement transactions, billing, making payments, and post-procurement audit activities. They reduce the amount of paperwork, allow for easy third-party verification, and offer agencies extra income through purchase card rebates. However, a GAO audit found that few agencies utilize their full negotiation power to gain better prices through major purchase card vendors. The auditors recommended that in addition to training on proper use of purchase cards, agencies should provide cardholders with information to help them find the lowest prices using GSA Schedule contracts or agency discount agreements. Some agencies have already begun leveraging their buying power. The Department of Agriculture saved 10 percent on office supplies, for example, and the Department of Interior saved between 20 percent and 35 percent on laptop computers. Adopting the GAO recommendations for price negotiations through purchase card vendors can save $3 billion over the next 10 years.

❒ Consolidate and encourage efficiencies in military exchanges

10-year savings: $1.79 billion

The DOD operates three chains of military exchanges that provide a wide array of retail goods and consumer services at military bases (though commissaries), and have combined annual sales of about $10 billion. To promote efficiency and savings, the three chains should be consolidated into a single organization. To increase incentives to operate more efficiently, the combined chain should pay all of its operating costs out of its own sales revenue, rather than relying on the DOD to provide some services free of charge. Those changes would save approximately $200 million annually after a three-year phase-in period.[53]

❒ Create centers of excellence for Medicare patients

10-year savings: $1.5 bllion[54]

Medicare currently pays doctors and hospitals separately when patients are hospitalized. This payment system discourages doctors and hospitals from joining forces to deliver higher-quality, lower-cost care. Numerous studies have proven that doctors and hospitals together can become centers of excellence in medical care for specific procedures—such as heart bypass surgeries, cataract surgeries, or heart valve replacements—by doing high volumes of those procedures and continually improving their processes. Congress should create a Center of Excellence payment within Medicare for designated procedures. The payment would be lower than the cost of paying for the services separately, but would allow the doctors and hospitals to keep the financial benefit of becoming more efficient. The Centers of Excellence would be required to disclose their performance in order to establish benchmarks for quality of care and to prevent cherry picking of patients who are healthier, and therefore less expensive to treat.

❒ Change the pricing structure for military depot repairs

10-year savings: $1.3 billion

Unit commanders can repair many components of weapon systems—such as transmissions and radars—in their own local repair facilities, or pay to have the components repaired in centralized maintenance depots. Under current policies, however, the prices that the central depots charge units for repairing such components (known as depot-level reparables) exceed the actual cost of making the repairs. Those pricing policies raise total costs to the DOD because they discourage commanders from relying on the depots even when doing so would be less costly for DOD as a whole. For example, one avionics sensor used by the Army costs $16,000 to repair at a local facility and $12,000 to repair at a depot. Nevertheless, because of bureaucratic red tape, under the current pricing structure, the depot charges $71,000 to repair the sensor—creating an incentive for unit commanders to use their local facilities even though the actual cost of the repair is less at the depot. Depots should instead charge only the actual cost of repairs. By encouraging unit commanders to choose the most cost-effective source of repair, the new pricing policy could lower the annual cost of repairs by a total of more than $1.2 billion over the next 10 years.[55]

❒ End corporate giveaways to commodities traders

10-year savings: $620 million

The purpose of the Commodities Futures Trading Commission (CFTC) is to allow markets to operate more efficiently by ensuring the integrity of futures markets and protecting investors from abusive and fraudulent trade practices. A fee on transactions overseen by the CFTC could cover the agency's operating costs. Such a fee would be similar to one now imposed on securities exchanges to cover the operating costs of the Securities and Exchange Commission and the Office of the Comptroller of the Currency. A per-contract transaction fee could be imposed and remitted quarterly. It could be adjusted periodically so that the money collected equals the CFTC's cost of operation.[56]

❒ Create a workers' compensation insurance pool for DOD contractors deployed overseas

10-year savings: $551 million

The Defense Base Act (DBA) requires that DOD contractors purchase workers' compensation insurance for employees working overseas. Traditionally, firms purchase their own DBA insurance coverage on the competitive market for each DOD contract. There is evidence that insurance premiums are presently higher than predicted by historical rates. DOD should instead negotiate a large-scale DBA insurance pool with a single broker for all contractors. That blanket coverage would provide a worldwide DBA rate for an agreed period of time. Creating a larger DBA insurance pool would reduce risk premiums and strengthen the buyer's negotiating position. The Department of State and the U.S. Agency for International Development use the blanket-coverage approach, and their contractors currently pay lower DBA insurance premiums than do DOD contractors. A similarly modeled pilot program is under way for contractors associated with the Army Corps of Engineers.[57]

❒ Shift responsibilities of foreign agricultural service attachés to the State Department

10-year savings: $364 million

The U.S. agricultural attachés, located at 97 offices worldwide, provide U.S. agricultural producers and traders with information on foreign government policies, supply and demand conditions, commercial trade relationships, and market opportunities. That information is an integral part of the market forecasting and analysis system of the USDA. The attachés, employed by the Foreign Agricultural Service of the USDA, also represent that department in disputes and negotiations with foreign governments on agricultural issues. The attaché positions were developed to promote U.S. commodities and to help farmers, processors, distributors, and exporters adjust their operations and practices to meet world conditions. The responsibilities of the foreign agricultural attachés should be shifted to existing U.S. State Department personnel, and the attaché positions should be eliminated.[58]

❒ Merge the National Endowment for the Arts and the National Endowment for the Humanities and encourage efficiencies

10-year savings: $132 million[59]

The National Endowment for the Arts and the National Endowment for the Humanities were founded in 1965 to support and provide recognition to the arts and humanities. Both entities have supported important projects, such as the Ken Burns documentary on the Civil War and broadcasting of classical music on public television. Often, the projects the two agencies support overlap. For example, funding of the museum tour of the "Treasures of Tutankhamen"—the blockbuster exhibition seen by more than 1.5 million people—could have been funded by either organization under their respective congressional mandates. And the creation of both organizations by the same piece of congressional legislation—the National Foundation on the Arts and Humanities Act of 1965—underscores their shared and mutually supporting missions. In order to take advantage of the symmetries of both agencies and to raise the profile of the arts and humanities in America, Congress should merge the entities into a single "National Endowment for the Arts and Humanities" and use the administrative savings to provide additional grants and reduce the deficit.

❒ Merge the Office of Thrift Supervision and Comptroller of the Currency

10-year savings: $120 million[60]

The Office of Thrift Supervision (OTS) is the primary regulator of federally chartered and state-chartered savings associations, their subsidiaries, and their registered savings and loan holding companies. The Office of the Comptroller of the Currency (OCC) charters, regulates, and supervises all national banks. Because of their similar functions, there would be substantial cost savings to taxpayers from eliminating duplication and consolidating operations. The OTS's five regional offices in Jersey City, Atlanta, Chicago, Dallas, and San Francisco are virtually identical to the OCC's six regional offices in New York City, Atlanta, Chicago, Dallas, San Francisco, and Kansas City. Thus, there would be considerable opportunity for office consolidation without the attendant employee relocation costs and family disruptions.

❒ Combine the Overseas Private Investment Corporation and Export-Import Bank and encourage efficiencies

10-year savings: $72 million[61]

Throughout the 1990s, there was significant consolidation in the financial services industry. Insurance firms and banks merged in order to promote economic efficiencies and improve the bottom line. The best-known example was the merger between CitiCorp and Travelers. In a similar fashion, the Export-Import Bank (Ex-Im Bank) and the Overseas Private Investment Corporation (OPIC) should be combined into a single government corporation.

The Ex-Im Bank and OPIC both promote U.S. exports and overseas investment by providing a range of services to U.S. companies wishing to do business abroad. The Ex-Im Bank offers subsidized direct loans, guarantees of private loans, and export credit insurance; OPIC provides investment financing and insurance against political risks. Appropriations in 2005 for Ex-Im Bank and OPIC were $77 million and $66 million respectively.

Both these programs would benefit by merging their functions, eliminating duplication, and promoting greater efficiencies.

❒ Consolidate statistical agencies

10-year savings: $50 million[62]

Today, at least 70 different federal agencies engage in statistical activities, and the division of labor between them often makes little sense. Experts have concluded that consolidation of the major economic statistical agencies would produce better data at a lower cost. The goal is not to decrease the collection and analysis of data, but to instead consolidate the principal statistical agencies—including the Bureau of the Census and the Bureau of Labor Statistics (BLS)—into a single agency and eliminate redundancy.

Part Three: Budget Reform

❒ Create a corporate subsidy reform commission

10-year savings: $250 billion

Depending on to whom one listens, federal subsidies to private businesses cost taxpayers anywhere from $60 billion to $87 billion per year.[63] And of course, one person's corporate welfare is another's strategic program or tax incentive. Yet, most budget experts believe that corporate welfare is a growing presence in the budget. According to the Cato Institute, corporate welfare grew 30 percent from 1997 to 2001, and this year's omnibus spending bill is riddled with 7,000 earmarks for special interests.[64]

Senator John McCain (R-Ariz.) and former Rep. Dick Gephardt (D-Mo.) have suggested creating a corporate welfare commission modeled on the military base closing commission legislation in the 1990s. The proposal described here is based on an idea for a corporate subsidy reform commission originally developed by the Progressive Policy Institute.[65] Under the proposal, a bipartisan commission would recommend a list of corporate subsidies—both on the programmatic and tax side of the budget—to eliminate, which Congress would have to vote on within a specific timeframe, with limited ability to debate and amend. Such an approach would force Congress to vote on the whole package of cuts rather than on individual items. This would increase the likelihood of enactment.

The commission idea is based on the recognition that there are legitimate differences of opinion as to what constitutes a "corporate subsidy" in the budget or tax code—not to mention powerful pressures on members of Congress to defend subsidies with a special impact on their states or districts. Like the highly successful Defense Base Closing Commission, the Corporate Subsidy Reform Commission would be an independent body nominated jointly by the president and key members of both parties of Congress.

In essence, the commission approach would provide political cover, and an opportunity for involvement for the many members of Congress who oppose all subsidies in principle but support some subsidies in practice.

How much would a corporate welfare commission save the American taxpayer? That is a difficult number to estimate. However, a reasonable amount of savings that could be achieved if a commission were fully empowered would be around $250 billion over 10 years.

❒ Switch to the superlative Consumer Price Index

10-year savings: $55 billion[66]

Many of the federal entitlement program benefits, including Social Security, are adjusted annually to keep pace with inflation according the Consumer Price Index (CPI). However, virtually all economists agree that the CPI slightly overstates the rate of inflation, causing unnecessary spending. The Bureau of Labor Statistics has created a "superlative CPI" to account for the discrepancies between actual inflation and the estimated inflation in the traditional CPI. The BLS expects this new index to rise about two-tenths of one percentage point less than the traditional CPI each year. While a fraction of a percentage point difference may seem inconsequential, it can actually save the federal government $153 billion over the next 10 years. According to economists Alice Rivlin and Isabell Sawhill, switching to the superlative CPI would reduce Social Security benefit costs by $70 billion and raise personal income tax collections by $83 billion over the next decade.[67]

❒ Impose discretionary budget caps

10-year savings: $90 billion[68]

The Budget Enforcement Act of 1990 (BEA) established caps on discretionary spending, helping to constrain fiscal policy. That made a direct contribution to the more favorable budget outlook that developed by the end of the 1990s.

According to CBO data, total discretionary spending was $45 billion less in 1995 than in 1991.[69] Further exemplifying the role of budget caps (and PAYGO rules), total outlays fell from of 21.2 percent of GDP in 1989 fell to 18.7 percent of GDP in 1999—a level not seen since 1974.[70] Although these savings disappeared in later years, this was primarily due to a spending spree unleashed by the growing budget surpluses and the expiration of the budget rules during the Bush administration.

The lesson to be learned from the overall success of the BEA is that the budget process can be an important tool in achieving long-term strategic goals. Discretionary budget caps and PAYGO helped Congress manage the political pressures inherent in our competitive political system, in which the rewards for reducing taxes and delivering helpful benefits are more immediate and direct than the distant, diffuse, and indirect rewards for prudent financial stewardship.

The statutory enforcement mechanism of the 1990 BEA has now expired. Congress needs a set of new rules to help enforce any plan it may adopt to rebalance the budget. Under this proposal, a new set of caps would be set in place to hold discretionary spending to the rate of inflation. The caps would be similar to the ones set by the BEA, but would be strengthened to include emergency spending unless waived by a super majority, as suggested by Charles Schultze of the Brookings Institution.[71]

❒ Enact a constitutionally viable line-item veto

10-year savings: $5 billion

Under current law, the president can request that Congress rescind or eliminate unnecessary spending. However, Congress can simply ignore the president's request by choosing not to vote. Proposals for a constitutionally viable line-item veto (otherwise known as super rescission) would require that Congress vote up or down on a president's request to eliminate wasteful spending and to consider the proposals more quickly. Some proposals would require the president to submit rescission requests within a specified number of days after signing an appropriations act into law. The House passed expedited rescission proposals in the 102nd and 103rd Congresses.

Unlike the line-item veto, super rescission would not require a constitutional amendment, because it would not create a new veto authority, but only require Congress to vote on rescissions from the president that can now be ignored. Budgetary savings would be achieved because once members of Congress are forced to vote on a particular piece of pork spending, they would be more likely to approve cost-saving requests than risk being portrayed as champions of pork and wasteful spending.

Based on the experience with the line-item veto in the 1990s, super rescission savings might provide an additional $5 billion in savings over 10 years.

Part Four: Tax Reform

❒ Proposal: Institute third-party reporting of capital gains

10-year savings: $250 billion[72]

Every year, there is a difference of approximately $345 billion between what taxpayers owe and what they actually pay. The Internal Revenue Service calls it the "tax gap." Most of it—about $285 billion—comes from taxpayers underreporting their income, mostly by accident but sometimes through chicanery. Yet with one type of income—wages and salaries—there is virtually no underreporting problem. Why? Because wage and salary income is subject to third-party reporting: Employers have to report wage and salary payments to the IRS on W-3 and 1099 forms—and much of the time they also withhold taxes up front. By contrast, income from sole proprietorships, which is subject to little third-party reporting or withholding, is badly underreported. Only 57 percent of earnings that should be taxed are actually declared.

Capital gains income is another area that is not subject to third-party reporting. There, the IRS has found a 12 percent noncompliance rate and an $11 billion tax gap. Others have estimated that the tax gap on capital gains might be as high as $25 billion, because of inflated reporting of the cost basis of stocks and other securities. Meanwhile, the tax gap for income from interest and dividends, which is subject to third-party reporting by financial institutions, is just $3 billion.

Clearly, requiring financial institutions to track and report the cost basis of shareholders' securities to the IRS would help close the tax gap. Senator Evan Bayh (D-Ind.) has introduced such a proposal, and Sen. Hillary Clinton (D-N.Y.) recently put forward her own plan as part of the Democratic Leadership Council-sponsored *American Dream Initiative*.

Many taxpayers are likely to welcome third-party reporting of the value of securities because of all the headaches it will help them avoid. As Jason Furman of New York University has argued, calculating cost bases often requires detailed recordkeeping and potentially complicated calculations when stocks split or when mutual fund distributions are reinvested.

❒ Freeze the estate tax at its 2009 level

***10-year savings: $175 billion*[73]**

Under the tax law enacted in 2001, exemptions for assets subject to the estate tax are scheduled to rise until 2010—thus decreasing the number of estates that are taxed—and then revert to pre-2001 levels. At that point, it will be tempting for Congress to either extend the law or let it expire. But extending it would permanently exempt too many wealthy estates from taxation, and letting it expire would subject too many relatively small family businesses to taxation. Instead, Congress should freeze the Estate Tax rate at its 2009 level. That would preserve about 60 percent of the revenue that would be lost by permanent repeal, according to the Joint Committee on Taxation, while totally exempting 997 of every 1,000 families from the tax. The remaining estates that are taxable would pay only about 17 percent of their value in taxes.[74]

This proposal would reduce the total number of people paying the tax—while still taxing the very wealthiest estates, and thus avoiding an extreme concentration of wealth in the hands of a very few families. It would also help smaller family-owned businesses, while avoiding the complications and inequities associated with preferential treatment for business assets.

❒ Clarify the definition of offshore tax shelters

10-year savings: $130 billion

Currently there is no single definition of "tax shelter," which forces the Treasury Department and the IRS to disallow them on a case-by-case basis. Clarifying the definition of tax shelters would reduce waste, make it harder for new variants of shelters to be developed, and raise about $13 billion a year in revenue, according to the Joint Committee on Taxation.[75]

❒ Restore capital gains and dividends tax rates to their pre-2003 levels

***10-year savings: $125 billion*[76]**

The Jobs and Growth Tax Relief Reconciliation Act of 2003 reduced the special tax rates that apply to most capital gains. For gains that had been taxed at 20 percent, the law lowered the rate to 15 percent; for gains that had been taxed at either 8 percent or 10 percent, the law reduced the rate to 5 percent. The 15 percent rate on gains is used by people whose income puts them in the top four tax brackets for ordinary income (25 percent, 28 percent, 33 percent, or 35 percent). The 5 percent rate applies to people whose income puts them in the two lowest tax brackets (10 percent or 15 percent). In addition, the law extended the 5 percent and 15 percent rates to dividends from domestic and qualifying foreign corporations, thus reducing the tax rates on such dividends from the rates on ordinary income to those on capital gains. Under the law, the rates are effective from 2003 through 2008. In 2008, the 5 percent tax rate is scheduled to drop to zero.[77] Congress should restore the rates on capital and dividends to their 2003 levels in an effort to make the tax code treat income from work and income from capital more equitably.[78]

❐ Eliminate Bush rate cuts for families making more than $200,000

10-year savings: $118 billion[79]

Americans deserve a tax system that ensures they are not paying more than they should and makes certain that no one games the system. Unfortunately, the Bush tax cuts have made the U.S. tax code less fair and more complicated—all in an effort to put more money in the hands of those who need it the least. For example, the 2003 Bush tax cut gave an average tax break of $20,000 to the wealthiest 1 percent of Americans—29 percent of the total benefits—while the bottom 60 percent got an average relief of only $85 per year.[80] Furthermore, to date, 8 million low-income and middle-class families have gotten no tax cut whatsoever.

Congress should restore progressivity and fairness by recapturing the revenue from the provisions of the 2001 and 2003 Bush tax cuts that go to the wealthiest 2 percent of families. Those top two tax rates on income should be restored to their pre-2001 levels.[81]

❐ Close the tax gap through greater enforcement

10-year savings: $30 billion

It is highly unlikely that the IRS will ever be able to collect 100 percent of the taxes that are due, because the tax system is so complex. But there are smart policy steps that lawmakers can take that would help close the tax gap. One simple change would be to increase resources devoted to enforcement. The number of IRS enforcement personnel declined from 22,000 in 1996 to only 14,000 in 2005. In 2002, IRS Commissioner Charles Rossotti testified that $2.2 billion in additional enforcement funding would enable the IRS to collect $30 billion from non-compliant taxpayers the agency had identified but had not been able to collect from with its existing resources.[82]

❐ Close the Bermuda loophole

10-year savings: $26 billion[83]

There are many steps that could be taken to curb our current array of wasteful, if not perverse, tax subsidies for multinational corporations. As Robert McIntyre of the Citizens for Tax Justice has stated, “we don’t have to let a mail drop in Bermuda turn an American company into a foreign corporation.”[84] Rather, we could follow the example of countries such as Germany, Japan, and the United Kingdom, and treat any ostensibly “foreign” corporation whose shares are mostly owned by Americans as American. Another way to crack down on these “unpatriotic” firms would be to prohibit companies that repatriate overseas to avoid U.S. taxes from receiving federal government contracts. According to the Center for American

Progress, closing this loophole, known as corporate inversion or the "Bermuda loophole," would raise about $2.6 billion a year in revenue.[85]

❐ Reinstate the Superfund Tax

10-year savings: $17.7 billion[86]

The Environmental Protection Agency's (EPA) Superfund program has cleaned up the nation's most hazardous waste sites since 1981. Funding for these cleanups and other programs come from an annual appropriation. Traditionally, Congress has designated two sources of funds in the appropriation: the general fund and balances in the Superfund trust fund (formally, the Hazardous Substance Superfund). Revenues credited to the trust fund have come primarily from taxes on petroleum and various industrial chemicals, as well as from a corporate environmental income tax. However, authorization for the taxes expired in December 1995, and the fund's balance has declined every year since 1997.[87]

Reauthorizing the Superfund tax is consistent with the "polluter-pays" principle. For example, petroleum products and various chemical feed-stocks and derivatives are common sources of contamination at Superfund sites, and therefore producers and users of such substances, as well as corporations more broadly, should foot much of the bill for the cleanup program.[88]

❐ Close the CEO pay loophole

10-year savings: $15 billion

Under section 162(m) of the federal tax code, created in 1993, corporations can deduct up to $1 million in executive compensation from their tax returns. However, the IRS currently allows corporations to deduct more than $1 million from corporate income taxes if the compensation is "performance based" and is decided by a compensation committee made up solely of independent directors.

Unfortunately, the IRS definitions of performance-based compensation and director independence have been abused, and the American taxpayer is subsidizing the multi-million-dollar salaries of corporate CEOs. According to Harvard Law School Professor Lucien Bebchuk, abuse of section 162(m) has cost the Treasury at least $20 billion.[89]

The marketplace should determine what CEOs make, not taxpayer monies. Therefore, it is time to close the loophole.

❐ Modify the effective date of leasing provisions of the American Jobs Creation Act of 2004

10-year savings: $4.09 billion

The American Jobs Creation Act of 2004 outlawed foreign sales-in/lease-out (SILO) arrangements. Typically, in foreign SILO transactions, a foreign government or other foreign tax exempt entity sells property, such as highways, subways, or bridges to U.S. taxable investors who then lease the property back for use. This allows a transfer of depreciation deductions from non-taxed entities, who do not benefit from the deductions, to taxable investors, who benefit with little economic risk.

The 2004 American Jobs Creation Act only targets SILO arrangements entered into after March 12, 2004. Congress should amend the law to disallow all future losses on foreign tax exemptions for property agreements. This modification will save the federal government more than $4 billion throughout the next 10 years.[90]

❐ Reform nonqualified deferred compensation plans

10-year savings: $806 Million

Nonqualified compensation plans allow employees to be paid in the future for their services. Typically, employees enter nonqualified deferred compensation plans because they believe that will put them in a lower tax bracket in the future, and therefore will pay less in taxes when their compensation is received. This proposal would require the annual amount that can be deferred to be limited to the lesser of $1 million or the average taxable compensation for the previous five years. Those who do not comply with the new regulation will face ordinary income tax and penalties applicable to other deferral rules. This new limit will create $806 million savings over a 10 year period.[91]

❒ Expand whistleblower reforms

10-year savings: $402 million

The current tax code authorizes the IRS to pay rewards to whistleblowers who provide information on underpayments of taxes. The reward amount depends on the type of information and the amount of taxes collected. This proposal would expand the whistleblower reforms enacted in the Tax Relief and Health Care Act of 2006, creating greater certainty and independent review for those who are seeking a reward for providing assistance to the IRS.

Under the expansion, the IRS should establish a Whistleblower Office that would monitor all information received from informants and determine award amounts. The reward program would apply to actions in which the deficiencies exceed $20,000 and in the case of individuals, incomes that exceed $200,000. It is estimated that these changes to the whistleblower rewards will create $402 million in savings over the next 10 years.[92]

❒ Deny deductions for punitive damages

10-year savings: $299 million

Currently, business owners are allowed to deduct any ordinary and necessary expenses that are paid or incurred during the tax year. But for obvious reasons, expenses related to bad corporate behavior are supposed to be excluded. For example, the law does not allow companies to deduct payments to government agencies that constitute illegal bribes or kickbacks, and it does not allow companies to deduct fines paid for violation of laws. Additionally, no deduction is allowed for two-thirds of any damage payments made by a taxpayer who is convicted of a violation of any antitrust law. Furthermore, one's gross income does not include monies received from personal physical injuries and physical sickness. These exclusions, however, do not apply to any punitive damages.

Congress should fix that quirk in the law. It is estimated that denying deductions for punitive damages could create $299 million savings over the next decade.[93]

❒ Expand signature requirements and penalty provisions for tax preparers[94]

10-year savings: $30 million

Under present law, the definition of an income tax return preparer (any person who is compensated for the preparation of a tax return) does not include a person preparing non-income tax returns, such as estate and gift, excise, or employment tax returns. Currently, income tax return preparers are required to sign and include their taxpayer identification numbers on income tax returns and income return-related documents prepared for compensation. These same rules do not apply to non-income tax returns.

Congress should expand preparer identification and penalty provisions to all non-income tax returns and non-income tax return-related documents prepared for compensation. To increase accountability and reduce errors further, paid preparers should face penalties for preparing non-income tax return-related documents that contain false, incomplete, or misleading information or contain frivolous positions that delay collection.

Appendix

Table 2: Proposals to Cut the Federal Deficit
(Figures In Millions of Dollars)

SPENDING CUTS	10-YEAR SAVINGS
Reduce the number of federal contractors by 750,000.	284,874
Repeal add-on subsidies in Medicare drug bill.	19,900
Reduce the federal travel budget.	18,500
End payments to wealthy farmers.	5,700
Cut the Economic Development Administration's budget by 50 percent and require a state/local match.	2,600
Cut congressional staff by 10 percent.	1,700
Trim the federal vehicle budget by 5 percent.	1,500
Eliminate the Oil Technology Program.	780
Cut the number of political appointees.	707
Freeze funding For the Market Access Program.	531
Eliminate subsidies for special agricultural products.	458
Suspend the acquisition of new federal office space.	351
Reduce federal media contracts by 10 percent.	88
Ban bonuses for political appointees.	15
Eliminate the Historic Whaling and Trading Partners Program.	9
SUBTOTAL	**337,713**

(Author calculations)

Table 2: Proposals to Cut the Federal Deficit (continued)

(Figures In Millions of Dollars)

GOVERNMENT REINVENTION	10-YEAR SAVINGS
Reduce the number of non-competitive contracts.	53,500
Switch to direct student loans.	22,000
Reduce erroneous payments.	19,000
Consolidate military personnel costs into a single appropriation.	15,000
Finance the Food Safety and Inspection Service with user fees.	8,800
Adjust capital payments to hospitals under Medicare.	6,900
Permanently extend the FCC's authority to auction radio spectrum licenses.	6,900
Reform graduate medical education.	5,080
Apply technology to reduce the cost of operating military equipment.	4,600
Use purchase cards to streamline federal procurement.	3,000
Consolidate and encourage efficiencies in military exchanges.	1,790
Create centers of excellence for Medicare patients.	1,500
Change the pricing structure for military depot repairs.	1,300
End corporate giveaways to commodities traders.	620
Create a workers' compensation insurance pool for DOD contractors deployed overseas.	551
Shift responsibilities of foreign agricultural service attachés to State Department.	364
Merge the National Endowment for the Arts and the National Endowment for the Humanities and encourage efficiencies.	132
Merge the Office of Thrift Supervision and Comptroller of the Currency.	120
Combine the Overseas Private Investment Corporation and Export-Import Bank and encourage efficiencies.	72
Consolidate statistical agencies.	50
SUBTOTAL	**151,279**

(Author calculations)

Table 2: Proposals to Cut the Federal Deficit (continued)

(Figures In Millions of Dollars)

BUDGET REFORMS	**10-YEAR SAVINGS**
Create a corporate subsidy reform commission.	250,000
Switch to the superlative consumer price index.	155,000
Impose discretionary budget caps.	90,000
Enact a constitutionally viable line-item veto.	5,000
SUBTOTAL	**500,000**
TAX REFORMS	**10-YEAR SAVINGS**
Institute third-party reporting of capital gains.	250,000
Freeze the estate tax at its 2009 level.	175,000
Clarify the definition of offshore tax shelters.	130,000
Restore capital gains and dividends to their pre-2003 levels.	125,000
Eliminate Bush income tax rate cuts for families making more than $200,000.	118,000
Close the "tax gap" through greater enforcement.	30,000
Curb the Bermuda loophole.	26,000
Reinstate the Superfund Tax.	17,700
Close the CEO pay loophole.	15,000
Modify the effective date of leasing provisions of the American Jobs Creation Act of 2004.	4,090
Reform nonqualified deferred compensation plans.	806
Expand whistleblower reforms.	402
Deny deductions for punitive damages.	299
Expand signature requirements and penalty provisions to non-income tax returns.	30
SUBTOTAL	**892,327**
TOTAL SAVINGS	**1,881,319**

(Author calculations)

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