Comeback America Initiative

Keeping America Great

Restoring Fiscal Sanity: The Tough Choices We Face and Two Possible Paths Forward

July 2011

The Comeback America Initiative (CAI) Restoring Fiscal Sanity Report was prepared at the suggestion of CAI's prestigious Board of Directors, which is comprised primarily of former CEOs, and CAI's prestigious Advisory Council, which is comprised of many prominent players, including two former Chairmen of the Federal Reserve. The report is fact-based and incorporates the considerable experience of Hon. David M. Walker, CAI's Founder and CEO, former U.S. Comptroller General, and former Public Trustee of Social Security and Medicare. This includes consideration of his direct interactions with a large number of key government and other leaders in Washington and many thousands of citizens in 48 states.

This report features two illustrative fiscal frameworks. These frameworks are not CAI's specific proposals; rather they represent illustrative reform proposals based on a range of options that have been suggested by a variety of parties, including various government agencies, commissions, task forces, think tanks and members of the public.

This report was prepared with the assistance of Barry Anderson, former Deputy Director of the Congressional Budget Office (CBO) and the former top career executive at the Office of Management and Budget (OMB). All of CAI's staff and a number of other individuals contributed to the report. The numbers used in the report are based on numbers from the CBO January 2011 baseline and other authoritative sources.

Table of Contents

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Introduction:

The American people are rightfully concerned about the need to generate more job growth and security for today and tomorrow. At the same time, they have also become increasingly concerned about increased federal spending, escalating deficits, mounting federal debt burdens and our nation's excessive reliance on foreign lenders. Both our jobs and fiscal challenges are real and must be addressed by Washington policymakers in a reasoned, responsible and timely manner.

This report is focused primarily on the need to put our nation's finances in order, to avoid a U.S. debt crisis and generate more job growth for both today and tomorrow. This is a very important and challenging endeavor. Continued weak economic growth, high unemployment and underemployment rates, several sovereign debt challenges in Europe, and the current federal debt ceiling debate have made it a matter of increased urgency. In order to successfully address these challenges, America must reexamine itself, learn from history, learn from others and act before the markets lose confidence and force action.

To accomplish the above we will need to cut short-term spending, make selected investments, and create more certainty regarding future government spending, tax policies and regulatory approaches. This will provide businesses with a much higher degree of certainty than exists today to make long-term investments in the U.S. After all, the private sector is the primary engine of economic growth, innovation and job creation.

Developing a Fiscal Framework:

Given the above, federal policymakers need to develop a fiscal framework to accomplish these objectives. In that regard, we have two basic choices. We can act in a preemptive and prudent manner, before markets lose confidence in our willingness or ability to do so. This will involve leadership, require political courage, and reasoned compromises. Or, as too frequently is the case, Washington policymakers can wait for a crisis to provide political cover for them to react. Any such FAILURE to act represents laggardship and is caused by a lack of political courage, excessive partisanship, and/or ideological rigidity.

The Comeback America Initiative (CAI) has assembled two possible fiscal frameworks for consideration by federal policymakers and the general public. The first framework, the illustrative Preemptive (Prudent) Framework, is positive and would set the U.S. on the right track, while helping to avoid a U.S. debt crisis. The second framework, the illustrative Reactive (Crisis Management) Framework, would be in response to a crisis. However, before we outline them, it's important to review how we got where we are and why we need to act.

The American Republic:

The U.S. is a great nation - arguably the greatest in the history of mankind. The concept of American exceptionalism is real. It is rooted in the way our nation was founded, the documents that are the foundation of our government, and, most importantly, the people who comprise America.

The U.S. federal government is a republic, and therefore, a representative-based democracy. In fact, the U.S. is the longest standing republic still in existence, but not of all time. The Roman Republic lasted for over 500 years; however, it ceased to exist over 2,000 years ago due, in part, to fiscal irresponsibility by the government.

Our republic was created through one of the greatest political documents in the history of mankind - the U.S. Constitution. That document is based on certain timeless principles, including limited but effective government, individual liberty and opportunity, equal justice under a rule of law, fiscal responsibility and sustainability, and inter-generational equity. Some of these principles can be found in the Constitution itself and others can be derived from the writings of our nation's Founders.

From a financial perspective, our nation's Founders believed in certain core values like prudence, thrift, limited debt, savings and stewardship. Unfortunately, the facts reveal that within the past several decades, our nation and many Americans have strayed from these principles and values, and as a result, our future is now at risk. We must return to these timeless principles and values if we want America to stay great, and for our collective future to be better than our past.

The truth is, if we don't put our nation's finances in order and address the huge structural deficits and mounting debt burdens that lie ahead, America's position in the world, the job security of American workers, and our overall standard of living at home will suffer over time. Ultimately, even our national security and domestic tranquility could be called into question. All this comes at a time when many Americans already face sizeable debt burdens, including many college graduates who have significant student loans.

The Fiscal Risks:

We must act to address our serious fiscal challenge before a debt crisis forces us to. If we do, our best years can be ahead of us. On the other hand, if we wait until a debt crisis is at our doorstep, we will be forced to take dramatic and possibly draconian actions. These actions could serve to seriously threaten our domestic tranquility and impose serious hardships on tens of millions of Americans, especially the poor and most vulnerable. Such a crisis would also seriously constrain our ability to improve our longer-term economic growth and competitive posture, and to generate job opportunities for our children and future generations of Americans. It could also serve to threaten the social safety net that protects those most in need. We must not allow this to happen in the U.S., and it doesn’t have to.

What might a debt crisis look like? A loss of confidence by investors in the ability of the federal government to put its finances in order would likely result in a significant increase in interest rates and a potential dramatic decline in the value of the dollar. This would likely cause a severe global recession or depression, significant declines in the global capital markets, increases in commodity prices, much higher unemployment levels and much greater job insecurity. Can we afford the risk of this happening given our current economic challenges and unemployment rates?

Federal elected officials have kicked the can of tough choices down the road for so long that the economic, security and social stakes are very high. Our situation is so serious, it is highly likely that the decisions that are made, or that fail to be made by federal elected officials within the next five years, will largely determine whether America's future and the future opportunities for Americans will be better in the years ahead.

Fortunately, there is a way forward. If we learn from history and others we can develop a plan of action that helps us face the facts and develop non-partisan reform options that can achieve bipartisan support. After all, given the significance of the transformational changes that will be required to put the U.S. Government on a more prudent and sustainable path, anything less than a plan that can achieve bipartisan support will not be successful or sustainable over time.

Key Fiscal Facts:

In order to achieve success, we must first recognize where we are, where we are headed, and how we compare to other major nations. The facts in this regard are clear and compelling. Our nation's financial condition is worse than advertised. While today's around $1.4 trillion annual deficit and $14.3 trillion debt burden are a matter of great public concern, they do not represent the true threat to our future. Most of today's deficits are caused by temporary factors. The true threat is represented by the huge structural deficits and debt burdens that lie ahead if we do not change course. Importantly, the same factors that caused the mortgage related sub-prime crisis exist for sovereign debt. However, no one will "bail out" America; we must solve our own problems.

Over time, and without action, Social Security, Medicare, Medicaid, and other related social insurance program challenges will grow. Based on reasonable and sustainable assumptions, Social Security and Medicare alone are underfunded by approximately $46 trillion, according to the 2011 Social Security and Medicare Trustees' Report. These obligations grow faster than inflation and our economy. In addition, due to our delay in acting, the power of compounding is now working against us rather than for us.

When you combine our known liabilities with our unfunded obligations and various commitments and contingencies, the federal government was in an over $61 trillion financial hole, as of September 30, 2010. This amounts to about $200,000 per person and over $500,000 per household, and these amounts are increasing rapidly. Believe it or not, median household income in America is only about $50,000.

From a comparative perspective, the U.S. now ranks 28 out of 34 major nations in fiscal responsibility and sustainability, according to the recent CAI and Stanford University Sovereign Fiscal Responsibility Index (SFRI) which essentially is a fiscal fitness index. That puts the U.S. below Spain and Italy, and well below Canada and Mexico. The U.S. is in the same neighborhood as Ireland and Portugal, and is not that far ahead of Greece, which ranks last at number 34. A number of major sovereign nations, not just the U.S., face serious fiscal challenges that must be addressed. These collective challenges will have an impact on global markets at varying times, and to different degrees.

It's time for the U.S. to develop and implement a plan that will allow it to move on up and into a better neighborhood for our collective future. Interestingly, if the Congress and the President were able to agree to a fiscal plan that had the same fiscal impact as the Simpson/Bowles Commission report, the U.S. ranking would move up to number eight, we would achieve fiscal sustainability for forty plus years, and we would move up to number three in the fiscal governance area.

Shockingly, the U.S. has gone from the world's largest creditor nation with no foreign debt at the end of World War II, to the world's largest debtor nation where almost half of our public debt is held by foreign lenders. As a result, we are subject to more external pressures and have less relative influence over those nations who lend to us. Bond holder concerns and external market pressures could result in increased interest rates at any time. There is also a serious question regarding the availability of capital to finance the needs of sovereign nations without crowding out private sector investment.

The truth is nobody knows if and when investors will lose confidence in the willingness and ability of the federal government to put its financial house in order. What is clear is that if they do, interest rates will rise quickly and with that, much pain will follow. For example, for each one percent (100 basis points) rise in interest rates, the federal government must pay almost $150 billion in additional interest annually. And what would we get for that interest? Nothing!

Interest costs represent the price that is paid for past excess consumption. Higher interest costs also serve to constrain the ability of the federal government to meet legitimate societal needs and to invest in the future.

While we do not know when and how much interest rates will increase if investors lose confidence, we do know that if it happens it will be sudden and dramatic. For example, prior to the debt crisis in Greece the interest rate on Greek 10-year bonds was around 5 percent, and as of June 30, 2011 the rate on such bonds stood at over 16 percent. Why would we want to risk a significant rise in interest rates?

Tough Choices Required:

Given our deteriorating financial condition, poor fiscal state and imprudent reliance on foreign lenders, it seems pretty clear that the greatest threat to our collective future may be in our own fiscal irresponsibility. Americans must be made aware that doing nothing to address our current fiscal path is simply not an option. While public opinion surveys and recent elections reveal Americans' increasing concern regarding federal spending, deficits, debt and dependency; there is less societal agreement on a preferred path forward to put our nation's finances in order. This can change with appropriate fact-based and non-partisan citizen education and engagement efforts, coupled with real leadership from the President and Congressional leaders from both major political parties.

Americans need to understand that the real question is not whether we must make tough choices to put our nation's finances in order - it is whether we will do so in a reasonable and responsible manner, before the markets force us to. The choice in large part is up to us - We the People. After all, We the People are ultimately responsible and accountable for what does or does not happen in Washington and across our great nation.

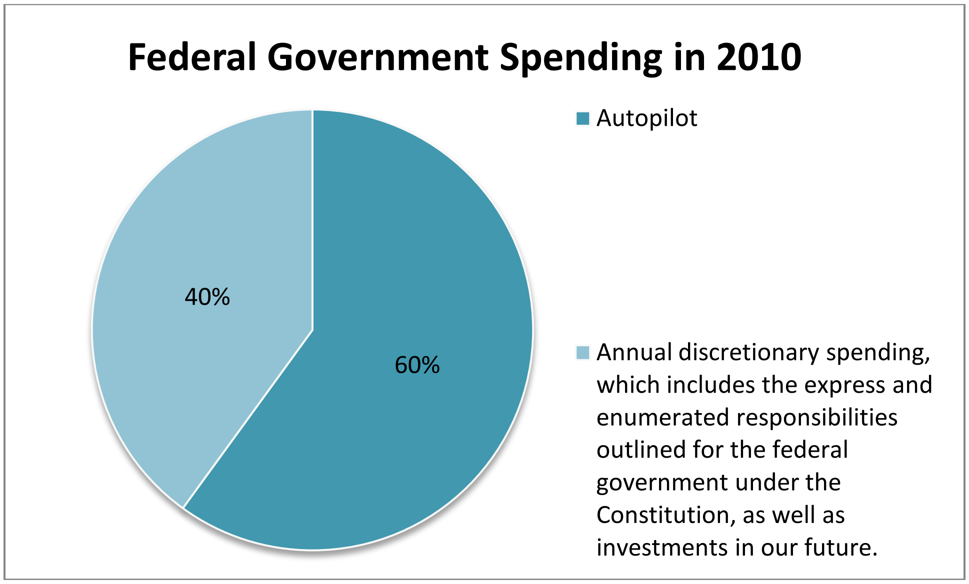
We must also keep in mind that our current position and path is not just fiscally irresponsible, it is also ethically and morally reprehensible. After all, it is easy to spend someone else's money - it is even easier to do so when the persons involved are too young to vote, or are not born yet. This is largely what is going on today and it must stop.

Also, we must be careful to address our fiscal challenges in ways that protect the poor and most vulnerable, not condemning these Americans to generations of poverty, while also eliminating wasteful or ineffective programs and policies. As has been said, the true test of any society is how it treats its most vulnerable.

As we seek a way forward, we must acknowledge that government has grown too big, promised too much and waited too long to restructure itself. Contrary to the assertions by some, the size of government is determined by the amount of spending, not by the aggregate tax burdens. Furthermore, large and growing deficits represent deferred taxes absent transformational reforms, to put the nation on a more prudent and sustainable path. Stated differently, they represent massive taxation without representation for future generations and persons too young to vote.

To illustrate how the federal government has grown, it now represents about 25 percent of the U.S. economy – up from 2 percent in 1800. It is set to grow to 39 percent of the economy by 2040, absent a change in course.

The portion of federal spending that is on autopilot is also growing. This growing imbalance serves to demonstrate the expansion of government far beyond what our Founders contemplated. Based on our current fiscal path, this trend will continue, which is both unacceptable and unsustainable.



Transforming Government:

The government must transform itself in such a way that its legitimate purposes can be met in an efficient, economical and effective manner. It needs to restructure and reposition itself to be more future focused, results oriented, affordable and sustainable. The time to chart a new course for America's future is now.

Transformational reforms are essential in order to avoid a super sub-prime crisis. Current fiscal and monetary policies in the U.S. will likely result in a further decline of America’s economic strength and the dollar’s market share and value as a global reserve currency. However, transformational reforms would help to reduce and eventually reverse this trend. We must also seek to reduce excess consumption, and increase selected investments in our future.

Any restructuring should be guided by a strategic framework, desired outcomes, available resources, and a set of timeless principles and values. As our nation's Founders intended, these should include such principles as limited but effective government, individual opportunity rather than entitlement, equal justice under the rule of law, fiscal responsibility and sustainability, and inter-generational equity. From a fiscal perspective, they should also include such values as thrift, savings, investment, limited debt, and stewardship.

While transformational reforms are needed, in order to be feasible they need to meet several key tests:

1) Do they make economic sense?
2) Are they socially equitable?
3) Are they culturally acceptable?
4) Do they pass a math test?
5) Are they politically feasible?
6) Can they achieve significant bipartisan support?

This means that any plan has to have economic merit, be ethically and morally grounded and be consistent with our nation’s cultural norms. The math for the proposed reforms must work. For example, if the primary objective is to achieve a stated fiscal objective (e.g., debt/GDP, balanced budget) then the numbers must work. To be politically feasible a plan must be able to pass the House, obtain 60 votes in the Senate and be signed by the President. Finally, any plan must be able to garner meaningful bipartisan support. This is a basic requirement for the plan to be viewed as "fair" by the American people. If a plan fails one or more of these tests, it will either not be adopted or sustained over time.

Preemptive (Prudent) Framework:

This illustrative framework outlines a number of major reforms that can be implemented in installments and in some cases, phased-in over time to help avoid a debt crisis and maintain the confidence of our foreign lenders. It includes a number of key areas: budget controls and process reform, Social Security, health care, defense, other spending, taxes/revenues, and interest.

This framework begins with the recognition that total discretionary spending grew dramatically between fiscal 2007 and fiscal 2010. Therefore, the illustrative Preemptive Framework proposes to start by cutting short-term discretionary spending back to fiscal 2008 levels, adjusted for inflation by the end of fiscal 2013. At the same time, the illustrative Preemptive Framework, recognizes the need to prevent a double dip recession, reduce unemployment and make selected critical short-term investments that can also help to stimulate additional economic and job growth. Therefore, the illustrative Preemptive Framework includes $500 billion in additional infrastructure, energy and other investments above the current law baseline level for fiscal 2012 and 2013. This framework also includes a transformation of surface transportation planning and financing to illustrate the type of approach that needs to be taken in other areas of the federal government.

This framework properly focuses on the true threat to America's future, which is the huge deficits and escalating debt burdens that lie ahead without a course correction. The key fiscal goal of this framework is to ensure that the nation's public debt/GDP ratio is brought down to a reasonable and sustainable level by 2035.

The sections below summarize an illustrative approach to addressing each of the above referenced major areas where "everything is on the table." This includes social insurance program reforms, defense cuts and comprehensive tax reform. The tax reforms proposed would generate more revenues than historical levels, but, importantly, would significantly reduce top marginal tax rates, improve America's competitive posture, and result in lower total tax levels, over time, than under the current law path.

Budget Controls and Process Reforms:

As we look to restore fiscal sanity we need to learn from history and from others. One prime example of this involves the need to impose statutory budget controls and enact various budget and appropriations process reforms.

We don't have to look that far back to see that statutory budget controls can make a difference. The federal government had certain pay-as-you-go (PAYGO) rules and spending caps in place during most of the 1990s and through the end of 2002. These controls were supported by Presidents George Herbert Walker Bush (41) and William Jefferson Clinton. They clearly made a difference and helped to restore fiscal sanity. However, once they expired at the end of 2002, things quickly spun out of control.

It's time to bring back statutory budget controls but the new ones will need to be a lot tougher because we are in much worse financial shape. These new budget controls could include:

- PAYGO rules on both the spending and tax sides of the federal ledger that do not include any significant exceptions.

- Tough but realistic spending caps by major budget category that do not exempt any major areas of the budget other than Social Security and interest on federal debt.

- Beginning the end of fiscal 2013, annual debt/GDP targets with automatic enforcement mechanisms if they are not achieved. Since our fiscal challenge is primarily the result of an expansion in the size and scope of government and the resulting surge in spending, the fail safe enforcement mechanism recommended under the illustrative Preemptive framework would be 3:1 spending cuts, to temporary revenue increases, excluding interest savings. The spending cuts should involve all areas, including possible freezes in Social Security cost of living increases, and elimination of statutory constraints on Medicare premium increases. Any revenue increases should be applied on a basis that will provide for a broad sharing of the burden among individuals. The additional interest savings that would result from any automatic spending cuts and temporary revenue increases would serve to further reduce any related deficits and debt burdens.

- In order to demonstrate serious fiscal resolve these new statutory budget controls should only be overridden by a formal Declaration of War or a 2/3 super-majority vote by both Houses of the Congress, along with the signature of the President.

These statutory budget controls should be a condition precedent to any effort by elected officials to ask the American people to provide more than the recent historical average of federal revenues/GDP (i.e., 18.2 percent). These budget controls should be coupled with or closely followed by round one of social insurance reforms, defense and other spending cuts, and comprehensive tax reform.

Beyond statutory budget controls, the time has come to adopt biennial budgeting and appropriations processes. After all, despite a related Constitutional requirement, the Congress has failed to adopt joint budget resolutions during the past two years. In addition, continuing resolutions and omnibus budget reconciliation and appropriations bills have become all too frequent an occurrence.

Moving to biennial processes will enable the Congress to spend more time on oversight, authorization and reauthorization activities. These activities should extend to all forms of spending programs, including direct discretionary, mandatory spending, commitments and guarantees and tax expenditures. Importantly, the $1.1-$1.2 trillion in annual tax expenditures represents “back door” spending and should be subject to the same level of transparency, oversight and reauthorization as direct discretionary spending programs.

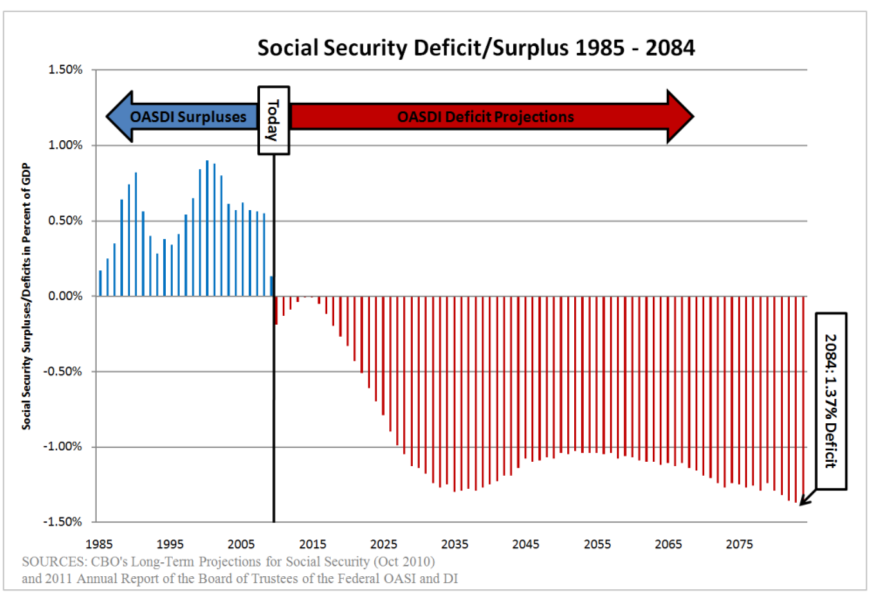
The number of so-called "mandatory spending" items should be reduced to just two – Social Security and interest on the federal debt. All other categories of federal spending, including Medicare and Medicaid, should be subject to annual budget limits/caps by no later than a date certain (e.g., fiscal 2015). In addition, “other mandatory spending” and “other discretionary spending” should be merged into one “other spending” category to provide more budget flexibility.

Finally, in addition to these statutory and procedural changes, the time has also come to consider certain Constitutional amendments to help ensure fiscal prudence in the future. These should include consideration of such items as a Presidential line-item veto, a requirement that all federal appropriations have a national purpose, a limit on the level of federal revenue as a percentage of the economy, a balanced budget requirement, and a debt/GDP limit. Any related amendments would be in addition to, rather than in lieu of the statutory reforms and controls noted above.

Social Security:

Social Security is the foundation of retirement income security for seniors and certain other portions of our population. It provides critically important income to retirees, survivors and the disabled.

The combined Social Security program is now paying out more in benefits and expenses than it receives in payroll and income related taxes. The resulting negative cash flow position means that beginning in 2010, Social Security began adding to federal deficits. These annual deficits are expected to escalate in the future. In addition, the Disability Insurance Trust Fund is expected to be fully depleted by 2018 - just seven years from now.



Based on the 2011 Social Security Trustees' Report, the combined Social Security program is underfunded by about $9 trillion today. Of this $9 trillion, about $2.6 trillion is backed by government bonds in the Social Security "Trust Funds," while the balance represents an unsecured, and according to the Supreme Court, amendable promise to pay benefits by the federal government.

While Social Security does not represent our biggest fiscal challenge and does not face an immediate crisis, it does represent our biggest opportunity to reform a major social insurance program that, if approached in an appropriate manner, can exceed the expectations of every generation of Americans. Reforming Social Security can also serve to demonstrate to the capital markets and the American people that policymakers have the willingness and ability to engage in major reforms of existing government programs and policies before a crisis is at our doorstep.

The illustrative reforms outlined below are designed to achieve these objectives.

- Do not change the current benefit formula or eligibility requirements for individuals over a stated age (e.g., 55).
- Require state and local government workers to participate in Social Security by 2015.
- Increase the minimum retirement benefit for those who work at least 35 years. This will especially help the 22 plus percent of Americans who rely on Social Security as their sole source of retirement income.
- Provide an enhanced benefit level for people 85-years of age and over.
- Provide a somewhat lower replacement rate benefit for higher income workers than under the current system (e.g., top 25 percent of workers).
- Modify the cost-of-living index formula to better reflect expenditures by seniors.
- Gradually raise the normal retirement age to 69 and the early retirement age to 64 over 30 years and 14 years, respectively, and index the eligibility ages thereafter to changes in life expectancy. Provide an exception for the higher early retirement age for individuals in occupations that involve significant manual labor. (e.g., mine workers, steel workers)
- Eliminate Social Security payroll tax payment requirements for individuals who continue to work past the normal retirement age.
- Take other actions to improve the equity of the Social Security system. (e.g., women, civil unions)

- If necessary, raise the current taxable wage base cap from $106,800 to no higher than $150,000 no earlier than 2018. Index the limit thereafter as under current law.

- Create an automatic supplemental savings account of three percent of wages up to the taxable wage base cap beginning in 2015-2020, depending on the amount of advance lead time necessary to ensure administrative efficiency and security. These savings would provide a pre-retirement survivor benefit, a supplemental retirement benefit and potential benefit to pass to one's heirs. Consideration should also be given to moving towards a larger and more universal retirement savings system over time.

- Merge the OASI and DI trust funds, and reform the disability program to address current abuses, including a growing number of able bodied young persons seeking to draw disability benefits for decades.

- Require that any future Social Security surplus be used to reduce outstanding public debt rather than to finance the ongoing operations of government.

The above reforms would result in a combined Social Security program that is solvent, sustainable and secure indefinitely. In fact, all of the above reforms will not be necessary to restore the financial integrity of Social Security for 75 years and beyond. These reforms would also serve to increase our nation's savings rate, which is of critical importance for future economic growth. Importantly, it would also demonstrate that the federal government can successfully reform an existing social insurance program. This should serve to enhance credibility both with investors and the public, while enhancing the confidence and ability of elected officials to take on tougher reform efforts such as health care and tax reform.

Health Care:

The largest single program threat related to our fiscal future is health care. The truth is if there is one thing that could bankrupt the federal government, it is out of control health care costs. It seems clear that the federal government has promised far more than it can afford to deliver in health care benefits.

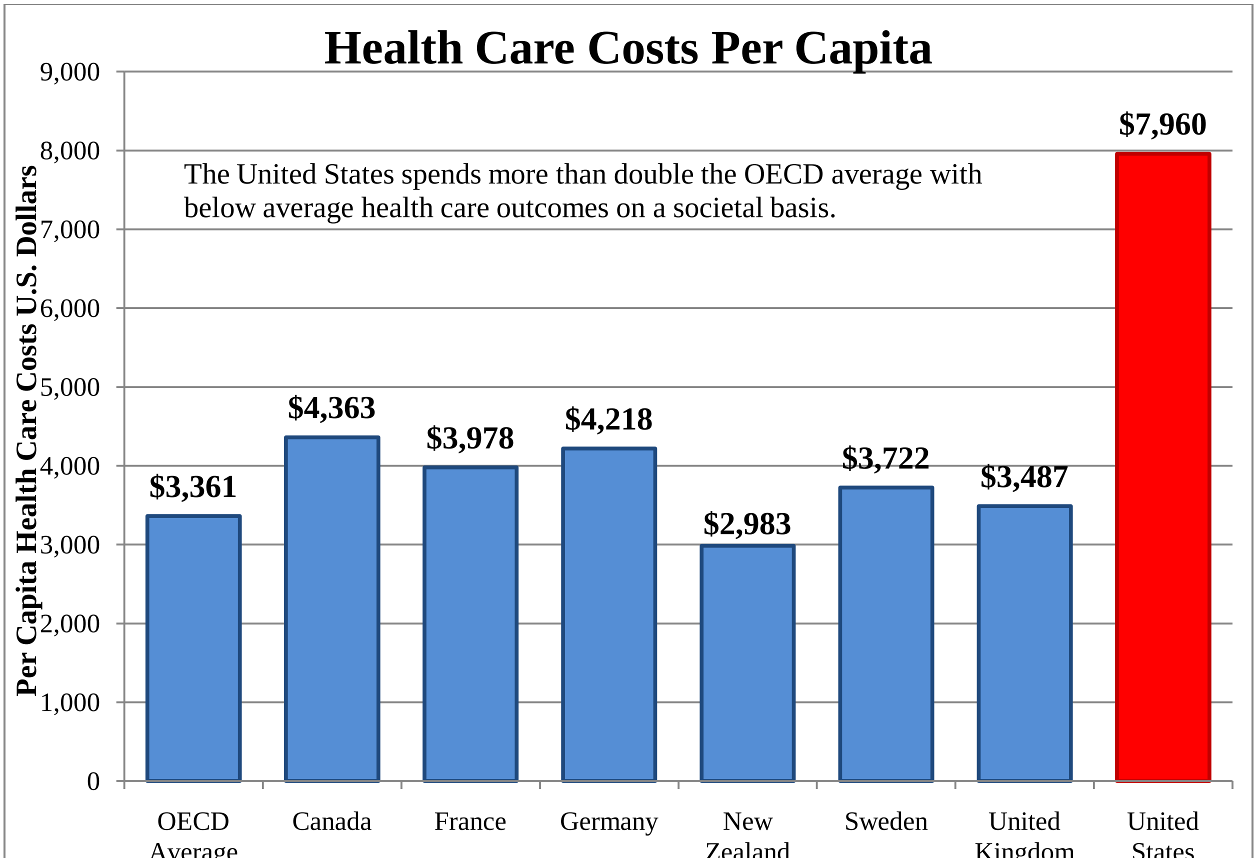
According to the latest Medicare Trustees' Annual Report, depending on which assumptions you use, the combined Medicare programs are underfunded somewhere between over $24 trillion and about $37 trillion as of January 1, 2011. Of these amounts, only about $340 billion is backed by government bonds in the Medicare Trust Funds, and the balance represents an unsecured and amendable promise to pay.

In addition to Medicare, the Medicaid program represents a major challenge to both the federal and state governments. Medicaid provides health and long-term care benefits that are growing rapidly and are projected to grow even faster with the retirement and aging of the "baby boom" generation.

The recent Affordable Care Act (ACA) of 2010 expanded health care coverage to an additional 32 million Americans. There is broad-based agreement that ACA will serve to increase total federal health care spending. Furthermore, despite assertions by some elected officials and other policymakers, based on reasonable and sustainable assumptions, this legislation is likely to seriously exacerbate our nation's deficit and debt challenges rather than ease them. This position is supported by Medicare's Office of the Chief Actuary's alternative Medicare cost projections.

ACA was largely a health care coverage expansion rather than a comprehensive health care reform bill. While there are some positive cost related provisions in ACA, it did not do nearly enough to address the drivers of health care costs that serve to threaten our fiscal future. ACA also included a new long-term care entitlement benefit as part of the CLASS Act that is not actuarially sound and is unsustainable in its present form.

Despite spending about double per person as other industrialized nations on health care, our country has below average societal outcomes in the health care area (e.g., infant mortality, life expectancy). We are also way above average in obesity, which serves as an early indicator of future health care and other costs.



Source: Organization for Economic Cooperation and Development, OECD Health Data 2011. Compiled by CAI.

Simply stated, our health care system is seriously ill and is in need of dramatic reconstructive surgery to put it on a more equitable and sustainable path. This is critical in order to achieve fiscal sustainability in the future.

While costs must be addressed as a top priority, as a great nation, the U.S. needs to move to a universal health care system that guarantees basic and essential health care coverage in an affordable and sustainable manner. This means that we need to rationalize our health care promises and focus much greater attention on reducing health care costs and improving health care outcomes. The illustrative health care reforms below are intended to achieve these objectives.

- Repeal the CLASS Act provisions of the ACA. Amend ACA so that taxpayer premium subsidies are reduced by one-third. Sunset the ACA by no later than 2020 and move to replace it with an alternative universal health care system that focuses on preventative, wellness and catastrophic protection. This replacement system would begin to be instituted no earlier than 2015 and would be fully implemented by 2020. The poor and disabled would be eligible for additional health care benefits as part of the nation’s social safety net program.

- Subject federal health care expenditures to an annual budget by 2015 with a health care expenditures cap of not more than 35 percent of total annual federal spending. Use appropriate expert bodies and/or premium support approaches or other mechanisms to ensure compliance.

- Make Medicare's voluntary Part B and Part D premium subsidies more means-tested and decrease the average taxpayer premium subsidy from 75 percent to 50 percent by 2020.

- Require competitive bidding of prescription drugs for all major federal health care programs, including Medicare's Part D program.

- Transform federal payment systems to an evidence-based and outcome-oriented approach over time, with physicians making related treatment decisions. Alternatively, consider a premium support approach for some federal health care programs using a FEHBP model.

- Facilitate a transformation of existing health care medical training, delivery systems and integrated practice approaches. Additionally, accelerate movement to electronic medical records and billing/payment systems by requiring federal providers to meet certain requirements by certain dates, in order to continue to be eligible for federal reimbursement.

- Transform the medical malpractice system by moving to bench trials for such claims and providing a "safe harbor" for providers who practice in accordance with the approved evidence-based standards.

- Reduce Medicare and Medicaid fraud and overpayments.

- Increase other Medicare cost sharing.

- Eliminate inappropriate Medicaid practices designed to maximize federal funding.

- Convert Medicaid to a block grant approach with a reasonable level of minimum standards.

- Provide reasonable alternative care and financing arrangements for long-term care.

- Take any other actions needed to comply with annual spending limits.

These reforms would significantly reduce the threat health care poses to our fiscal future. Furthermore, due to the unrealistic and unsustainable amounts used for health care costs in the current law baseline figures, the actual reductions in health care spending are likely to be significantly greater. This view is consistent with the views of the Office of the Chief Actuary of Medicare, which gave an adverse opinion on the Medicare Trustees' cost projections in both 2010 and 2011. Those Trustee projections were based on assumptions that were generally consistent with those used by CBO in preparing the current law baseline.

Defense:

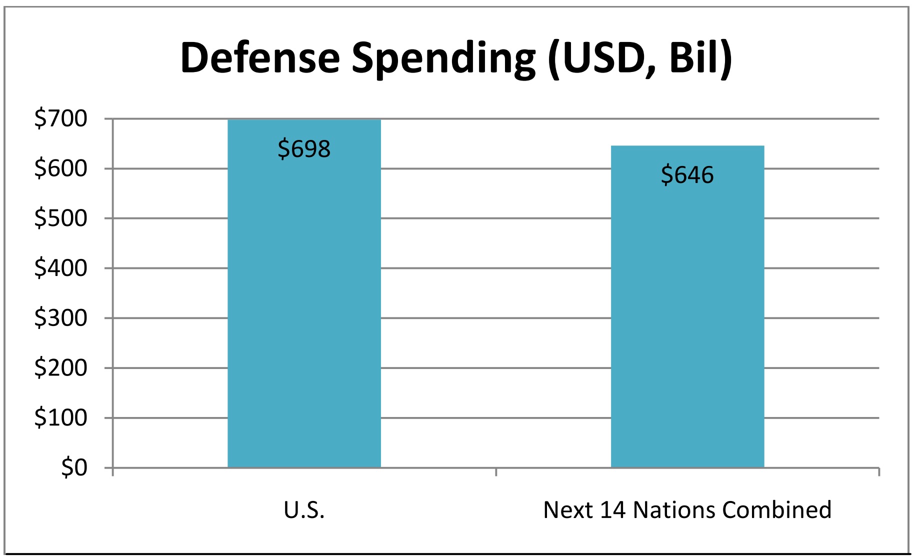
Unlike today's entitlement programs, national defense is one of the key express and enumerated responsibilities provided for the federal government under the U.S. Constitution. Defense, State, Homeland Security, the intelligence agencies and other entities that support the nation's security missions represent critical factors in the self-preservation foundation of Maslow's hierarchy of needs.

The United States is currently the world's sole superpower with unparalleled military capabilities. These capabilities have been used as a deterrent to any possible attack on the U.S. and as a means to help ensure global security. U.S. forces have been used in a range of offensive actions against global terrorist networks and regimes that harbor them (e.g., Afghanistan, Somalia), a range of humanitarian interventions (e.g., Bosnia, Libya), and even pre-emptive actions (e.g., Iraq).

Despite significant reductions in total U.S. forces since the end of the Cold War, the U.S. still has significant force deployments around the world. In fact, U.S. troops were based in more than 25 countries around the world in 2010. This extensive overseas basing is both unaffordable and unsustainable in the future.

The U.S. needs to engage in a new Solarium type exercise, similar to what Eisenhower did during his Administration. In doing so, the U.S. needs to consider the nature of current and likely future threats, and engage in a related reassessment and realignment of our strategies, structures, and capabilities. Among other things, this could mean less standing ground forces, and more emphasis on unmanned aerial vehicles, cruise missiles and Special Forces. It may also mean additional emphasis on cyber and electronic threats and capabilities.

Believe it or not the U.S. spends as much on defense as the next 14 nations combined.



Defense costs in the U.S. are driven by a range of factors including: a bloated defense bureaucracy, inadequate defense planning and budgeting processes, an excessive number of bases, over-reliance on contractors, systemic problems with existing acquisition and contracting practices, too many “want” versus “need” based acquisitions, the cost of the "all volunteer force," and the cost of a range of overseas contingency operations (e.g., Afghanistan, Iraq, Libya).

Given the above, the illustrative steps below represent actions that could be taken to reduce defense spending without compromising the nation's national security. Importantly, these actions are focused on addressing inefficient processes, questionable weapons systems acquisitions and existing troop levels, while preserving our commitment to take care of our Active Duty soldiers, their families and our veterans.

General:

- Adopt President Obama's proposed defense spending reductions.
- Repeal the current legal requirement, which states that the Defense Department should not consider “cost” in determining its “requirements.” This has led to the instigation and perpetuation of a number of programs and initiatives that were based on wants rather than true future risk-based needs.
- Reform the Planning, Programming and Budgeting System to make the service branches’ requirements more integrated and to consider the budget caps applicable to recurring defense expenditures.
- Reduce the size of the Defense Department bureaucracy and other “tail costs” (e.g., administrative/overhead) by at least 25 percent.
- Impose a budget on defense spending consistent with annual budget caps, and use appropriate transformation task forces and other mechanisms to identify appropriate reductions. At the same time, provide for a minimum defense allocation of at least 3 percent of GDP.

Personnel Cost Reductions:

- Reduce and restructure Total Force strength based on a forward looking threat and risk analysis, considering available resource levels.
- Convert more Active Duty members into the Guard and Reserves to maintain total force strength requirements for contingency purposes (e.g., Iraq, Afghanistan, Libya)
- Restructure benefit programs for non-active duty National Guard and Reserve members. For example, increase health care premiums in line with civilian employers to encourage the use of civilian job benefits over Tricare.
- Fully reassess the contractor, civilian and military strength to make sure the most cost effective approaches are being used to address key functional needs. Outsource nonessential military functions being performed by military (e.g. mail) and convert expensive contractors into more cost effective civilian positions.

Acquisitions and Procurement Cost Reductions:

- Require the Defense Department to implement the systemic acquisition and contracting reforms recommended by the Government Accountability Office (GAO).

- Rationalize existing weapons systems and proposed acquisitions based on future creditable threats and risks in a manner consistent with available resource levels. (e.g., F-35 Joint Strike Fighter, Expeditionary Fighting Vehicle, Attack Submarines, Ballistic Missile Defense)

Footprint:

- Reduce the number of overseas and domestic bases to be consistent with future threats and risks in a manner consistent with available resource levels.

War Time Operations:

- Reduce U.S. forces in the Afghanistan and Iraq areas of operations to no more than 45,000 by December 31, 2014.

- Require that any future use of U.S. forces for conflict operations should be authorized by the Congress in an appropriate manner. The incremental cost relating thereto should be paid for with a surtax that is clearly noted on individual tax returns.

Other:

- Reduce the number of carrier strike groups.

- Take any other actions needed to comply with annual spending limits.

Other Spending:

The category of other spending includes both mandatory and discretionary spending. This includes numerous programs, which should be reviewed to ensure that they are appropriate, properly targeted, effectively implemented, affordable and sustainable based on current and expected overall federal resource levels and related budget allocations. All programs should have a national purpose and generate appropriate value-for-money.

This category includes many programs, activities and organizations, including the Congress, the Judicial Branch, the Executive Office of the President, the Justice Department and the State Department. The basic functions performed by those organizations were designated by our nation's founders as express and enumerated responsibilities for the federal government. The relatively new Department of Homeland Security is arguably a combination of express and non-express functions and activities. There are many other federal entities and functions also included in this budget category, including such areas as Departments of Health and Human Services, Transportation, Education, Commerce, Interior, Labor, the EPA, Veteran's Affairs, NASA, and other agencies.

Listed below are illustrative reforms that are designed to achieve overall fiscal goals and objectives by eliminating, consolidating and/or better targeting existing federal programs. Given the expansion of government over the years, this category of federal spending has and should be under particular pressure.

- Adopt President Obama's "The First Step" proposed reductions.
- Switch all relevant federal benefit programs to chain-linked CPI.
- Increase civilian and military pension contributions.
- Reform civilian and military retiree health care eligibility requirements and increase cost sharing.
- Modernize and reform farm programs, including eliminating subsidies for entities above a stated size (e.g., $250,000 in annual income) and close loopholes whereby rural property owners receive subsidies in situations where they have no real intent of engaging in significant farming activities.
- Eliminate in-school interest subsidies on student loans.
- Reform the Pension Benefit Guaranty Corporation (PBGC) insurance program.
- Transform the current federal government approach to planning, executing and funding transportation programs. This would start with repealing the equity bonus program, repealing the Projects of National Significance Program, (an authorization for earmarks program) repealing the Appalachian Development Highway Program) and replacing the current system with a new approach consistent with the recommendations of the recent Carnegie Endowment “Transportation’s Road to Recovery” report (July 2011).
- Move towards a National Infrastructure Bank concept, focusing on a public and private partnership to address infrastructure investments. Government investments would be supplemented with private investment, but in the future more infrastructure projects would be privately financed through user fees and/or tolls.
- Rationalize the State Department's overseas presence given the past experiences and current presence of other countries.
- Review and reduce the federal government's role in the education area.
- Reform Veteran’s affairs programs to ensure full protection of wounded and disabled veterans, while reforming the definition of disability and modifying the eligibility and subsidy requirements for other veterans, especially short-service veterans.

- Increase fees for aviation security.

- Actuarially adjust flood insurance premiums for risk.

- Review, eliminate, consolidate and reform the many redundant and ineffective federal programs in a range of areas (e.g., financial literacy, training/development) as identified by the GAO, Inspectors General and others.

- Maintain a sound and secure safety net for those in true need, with appropriate safeguards to prevent abuse.

- Ensure a reasonable allocation of federal funding for health and other important basic research programs.

- Implement full or partial privatization as a one-time revenue source and longer-term expense reduction. Possible examples include, Amtrak, National Rural Electric Cooperative, Tennessee Valley Authority and the Postal Service.

- Encourage future investments in research agencies, using both private and public funding, and public/private partnerships, as appropriate. Examples of innovation agencies include DARPA, NIH and NASA.

- Take any other actions needed to comply with annual spending limits.

Taxes and Revenues:

There are three major systems in the United States that are in need of dramatic and fundamental reform based on international and outcome-based comparisons. These are our health care, K-12 education, and tax systems.

With regard to our tax system, despite some political rhetoric to the contrary, there are essentially two types of taxes – current and deferred. Large deficits and growing debt burdens will result in increased future taxes if a nation intends to honor all of its debt obligations. Clearly, the United States plans to do so.

There are also two basic forms of current spending. Direct spending programs and various tax expenditures (e.g., deductions, exemptions, credits and exclusions). Tax expenditures essentially represent “back door” spending. They should be subject to the same level of transparency and accountability as direct spending programs.

The truth is most people do not like to pay taxes. At the same time, taxes are the price of having a government and generational equity dictates that, with the exception of certain unexpected and national crises (e.g., World War), the government should normally achieve adequate revenues to finance its ongoing operations. Furthermore, passing on huge debt obligations to those who are too young to vote and not born yet is irresponsible, unethical and immoral. It also represents a violation of the key American principle of "no taxation without representation."

Ideally, a properly designed tax system should make economic sense, be simple, equitable, competitive and enforceable. It should also generate adequate revenues to pay for current operations, and to enable the government to deliver on its promises in a manner that does not transfer undue burdens onto future generations.

Our current federal tax system in the U.S. fails all of these tests. For example, the numerous special tax preferences (expenditures) in the tax code today cost the federal government $1.1 to $1.2 trillion a year in revenue. They also cause too many decisions to be made based on tax considerations rather than basic economic merit. Our current system is extremely complex; many CPAs can't prepare their own return, and most federal elected officials refuse to do so. This complexity results in huge expenditures for tax planning and compliance, but these expenditures could be put to a much more productive use in our economy. Shockingly, about 51 percent of current federal tax filers do not pay income taxes. On the other end of the spectrum, the median effective income tax rate for the top one percent of taxpayers was only 18.8 percent despite the fact that the top marginal tax rate is 35 percent. On the business side, the U.S. has the second highest statutory corporate tax rate and the second highest average effective corporate tax rate in the world. Furthermore, current estimates are that close to $400 billion in taxes that should be paid are not. Finally, our current tax system has proven to be inadequate to prevent the undue burdening of future generations and to stabilize debt/GDP at reasonable and sustainable levels over time. Simply stated, our current tax system is unacceptable and unsustainable.

In addition to dramatically reforming our individual and corporate income tax system, one new element of comprehensive tax reform that should be considered is a consumption tax (e.g., VAT). It would provide individuals with an incentive to save. It would also serve as a means to tax some of the legal and illegal underground economy, which cannot be achieved as easily through an income tax. We must keep in mind that the very wealthy consume more in the aggregate than others, and the majority of Americans don’t pay income taxes. A consumption tax would reach these individuals. However, a consumption tax should only be considered after statutory budget controls are in place and an initial round of social insurance reforms and other spending cuts have been agreed to.

Given the above, the current federal tax system is in need of dramatic and transformational reforms rather than modest and incremental reforms. Stated differently, we need to scrap the current system and go to a new one, ideally by the end of calendar 2013. The illustrative reforms below are intended to do just that.

- Do not allow total federal revenues to exceed current law base-line projected levels, but cap them at 21.5 percent of GDP, which is significantly less than projected levels over time (e.g., 23.3 percent of GDP and rising in 2035). Any additional revenues would be dedicated to debt reduction or tax dividends to individuals, and could not be used for additional spending.

- Do not extend the Bush/Obama tax cuts beyond their stated expiration date of December 31, 2012.

- Provide a temporary fix to the Alternative Minimum Tax (AMT) through December 31, 2013 and then repeal it as part of comprehensive tax reform.

- Make the Research and Development (R+D) tax credit permanent with an emphasis on basic versus applied research.

- Index all tax parameters with chained CPI.

- Limit application of the new individual income tax system to individuals and families who make over a stated percentage (e.g., 150) of the poverty level in their applicable area.

- Move to enact comprehensive income tax reform that will eliminate, consolidate and better target existing individual and corporate tax preferences (expenditures) in exchange for fewer tax brackets (e.g., two) and significantly lower top marginal tax rates that do not exceed 25 percent. Three clear exceptions would be charitable contributions, primary mortgage interest payments up to a new limit, and pension and savings contributions up to an annual limit. For example, this should include continuing to allow for full deduction of charitable contributions at the applicable tax rate. Allow a deduction of interest on one primary residence for a mortgage amount not to exceed the maximum conforming loan in the applicable geographic area. In addition, existing retirement income tax preferences should be consolidated to a single maximum limit for each individual while allowing for additional catch-up contributions beyond age 50.

- Phase-out the special income and payroll tax exclusion for employer provided and paid health care benefits by 2028. These represent a form of compensation that has served to disconnect individuals from the true costs of health care, while also fueling overall health care costs. Individuals who are fortunate enough to have such coverage should be subject to tax just as in any other form of compensation.

- Tax all capital gains at the same rate as ordinary income after comprehensive tax reform with much lower top marginal tax rates has been implemented.

- Retain an estate and gift tax with $5/$10 million exemption levels and a tax rate of 25 percent.

- Provide for a progressive consumption tax not to exceed 5 percent, either as a means to reduce marginal tax rates, and/or to generate the targeted levels of annual revenues as a percentage of GDP.

- Implement an integrated ad-valorem oil import fee and gas tax in order to fund surface transportation programs, and eliminate all general revenue funding of surface transportation programs.

- Eliminate ethanol and related energy subsidies from the tax code.

- Consider imposing a modest securities transaction tax to discourage excessive trading, provided that it will not materially undercut the competitiveness of U.S.-based exchanges.

- Provide for the ability of corporations to deduct dividends that are distributed to shareholders. All distributed dividends would be taxed as ordinary income to the applicable individuals.

- Consider a modified and competitive alternative minimum effective tax rate for corporations consistent with desired public policy goals.

- Consider a properly designed and temporary offshore profits repatriation incentive.

- Provide for a minimum 1 percent annual assessment against the value of a non-profit's total assets each year. Non-profits would be able to deduct any other applicable federal taxes in calculating any applicable minimum tax.

- Sell excess federal property.

- Auction spectrum licenses.

- Review and modify existing approaches to mining, mineral and energy rights on federal lands to eliminate related taxpayers abuses (e.g., unreasonable cap assumptions on prevailing commodity prices)

- Take any other actions needed to comply with annual revenue targets.

Interest:

Interest is the price that one pays for past excess consumption and borrowing. It represents a mandatory expense that must be met, irrespective of its level and impact on other federal spending programs and deficit levels. Interest payments on debt levels that are authorized by the Congress are arguably protected by the 14th Amendment to the U.S. Constitution. Therefore, the real question is how much interest the U.S. will have to pay given overall debt burdens, the confidence that investors have in U.S. debt, and overall supply and demand considerations in the global capital markets. This includes consideration of the financing needs of other sovereign nations and the potential ripple effect of debt crises experienced by other countries.

History has shown that interest rates can increase both suddenly and dramatically once a country passes a "tipping point" and investors lose confidence in the ability or willingness of a nation to put its finances in order. Recent examples include Greece, Portugal and Ireland.

In addition to high debt levels, the U.S. has the lowest average maturity for its debt of any major sovereign nation. This combined with very low current interest rates means that the U.S. has significant exposure to interest rate risk. For example, for every one percent (100 basis points) increase in interest rates, total federal interest costs would increase almost $150 billion based on current total debt levels.

Since interest costs are a function of total debt levels and prevailing interest rates, the only thing that can be done to reduce this cost from projected levels is to reduce expected deficit levels and debt burdens. Such is the case in connection with illustrative Preemptive Framework. Importantly, having and implementing a credible fiscal plan can also serve to keep interest rates lower than would otherwise be the case. This could result in additional potential savings that are not included in this analysis.

Other:

- Issue a Presidential Executive Order that requires all federal agencies to cease all program activities that are not consistent with statutory authorization language by the end of fiscal 2014.

- Form a Transparency and Transformation Task Force to review and recommend changes to current government organizational, operational and other prevailing business practices to improve the government's economy, efficiency, effectiveness and productivity, with allowance for expedited consideration by the Congress, as appropriate.

- Require the Office of Management and Budget (OMB) to prepare a strategic, future-focused, outcome-based and resource constrained government-wide framework periodically, (e.g., every 2-4 years) to guide executive branch decision making and enhance accountability.

- Require the OMB to prepare and submit a long-range fiscal sustainability and intergenerational equity report to the Congress and the American people, every four years.

- Consider certain Constitutional Amendments. (e.g., line item veto, national purpose, balanced budget, revenue/GDP, debt/GDP)

Reactive (Crisis Management) Framework:

Let us hope that we never have to implement this framework or one like it due to the FAILURE of Washington policymakers to act before a debt crisis is upon us. If we wait until we pass a "tipping point" and have a crisis of confidence, we will likely experience rising interest rates and a further decline in the value of the dollar, with resulting adverse implications for the budget, the price of commodities and imports, the economy in general, and jobs in particular. These factors will require immediate and expedited attention in order to prevent conditions that could lead to a global depression. After all, if the largest economy on earth experiences a debt crisis, it is likely there won't be anywhere to hide given increased global interconnectivity and interdependency.

Therefore, it is both prudent and appropriate to have some idea what an illustrative Reactive (Crisis Management) Framework might look like in order to avoid a "crisis management" atmosphere like the one that occurred during the financial institutions' crisis in 2008. After all, the same factors that contributed to that crisis exist for the federal government's own finances. We've also seen what can happen when investors lose confidence in the ability of a government to put a country's finances in order. It's not a pretty sight!

Having such an illustrative framework may also provide additional incentive for elected officials and other policymakers to pursue a more Preemptive (Prudent) Framework for the benefit of our country, children and the future generations of Americans. After all, unlike Greece, there won't be anyone to bail out the U.S. if a debt crisis does come to our shores.

As noted above, if a framework such as this must be implemented it will be because our political process has FAILED to avoid a crisis. Therefore, investors and the general public will have little confidence in the politicians who failed to act to avert what was a clear, compelling and foreseeable crisis in the making. As a result, the actions that will be necessary to regain confidence and stabilize the markets will have to be much more dramatic and potentially draconian in nature. Stated differently, 'trust me' will not be adequate; it will be 'show me' time.

While accelerating certain planned actions from the Preemptive (Prudent) Framework will clearly be appropriate, additional timely actions will be necessary. These actions will need to be both symbolic and substantive in nature. They will also have to be implemented immediately or in very short order to be credible. These would need to have an immediate and dramatic impact on the federal government's fiscal results. Such an effort could be designed to achieve a balanced budget very quickly. This dramatic reduction could be achieved through a combination of immediate actions in key areas such as budget controls and process reforms, Social Security, health care, defense, interest expense, comprehensive tax reform, including temporary deficit reduction revenues, and other spending. In summary, this framework includes steps that would be implemented primarily from 2011-2020, and then the U.S. could begin to transition to an approach more similar to the illustrative Preemptive (Prudent) Framework. Unless otherwise noted, the illustrative reforms would be effective in 2012.

Budget Controls and Process Reforms:

All of the illustrative reforms under the Preemptive (Prudent) Framework would be retained, many would be accelerated, and the spending caps and debt/GDP targets would be lowered. Furthermore, while various statutory actions will be required, action in connection with selected Constitutional reforms may be needed in order to provide additional assurance that Washington policymakers will not revert to their old ways once the immediate crisis has passed. The items listed below are possible actions that could be taken.

- Adopt a Presidential line item veto.
- Impose a requirement that any federal direct or indirect spending have a national purpose.
- Require a balanced budget except in times of a declared war or other significant events where two-thirds of the House and Senate and the President agree to a temporary and annual waiver.
- Impose a cap on the amount of revenue as a percent of GDP (e.g., 21.5 percent) subject to the above exception.
- Impose a cap in the amount of debt as a percent of the economy (e.g. 100 percent.) This higher Constitutional limit would be in addition to and not in lieu of the tough statutory budget controls that would be put in place.

Social Security:

Most of the illustrative reforms under the Preemptive (Prudent) Framework would be retained with the following significant differences:

- Would only leave persons age 60 and over largely unaffected by any changes.
- The higher retirement eligibility ages for Social Security would be increased to 70 for normal retirement and 65 for early retirement, and fully implemented by 2030 and 2020, respectively.
- Any new increase in the taxable wage base cap for Social Security would be effective in 2014.

Health Care:

Most of the proposed reforms under the Preemptive (Prudent) Framework would be retained with the following significant differences:

- Repeal the Affordable Care Act of 2010.
- Repeal the Medicare Modernization Act of 2003.
- The move to universal preventative/wellness and catastrophic health care coverage would be delayed by five years.
- The planned phase-ins of the higher Medicare eligibility age and increased premiums for Medicare's voluntary Part B and Part D programs would be accelerated and fully implemented by 2020.
- Take any other actions needed to comply with lower annual spending limits.

Defense:

Most of the illustrative reforms under the Preemptive (Prudent) Framework would be retained with the following significant differences:

- Accelerate the planned draw down of U.S. troops from Southwest Asia from the end of 2014 to the end of 2012.
- Accelerate the reduction of U.S. overseas military and civilian presence.
- Accelerate the rationalization of military and civilian infrastructure domestically.
- Accelerate other actions under the Preemptive Framework.
- Take any other actions needed to comply with lower annual spending limits.

Other Spending:

Most of the illustrative reforms under the Preemptive (Prudent) Framework would be retained with the following significant difference:

- Accelerate actions under the Preemptive Framework and comprise lower annual budget targets.

- Take any other actions needed to comply with lower annual spending limits.

Taxes and Revenues:

Most of the illustrative reforms under the Preemptive (Prudent) Framework would be retained with the following significant differences:

- Repeal the Tax Relief, Unemployment, Insurance Reauthorization and Job Creation Act of 2010.

- Impose temporary deficit reduction revenue increases in fiscal 2013-2014 to accelerate deficit reduction and debt/GDP stabilization efforts.

- Phase-in the special income and payroll tax exclusion on employer provided and paid health care by 2018.

- Take any other actions needed to comply with annual revenue targets.

Interest:

- No specific actions are required. We will have to pay what the market dictates. Let's hope that we don't get penalized too much.

Other:

- Issue a Presidential Executive Order that requires all federal agencies to cease all program activities that are not consistent with statutory authorization language within six months.

- Immediately, create a Government Transparency and Transformation Task Force to restructure the federal government and perform a regulatory review. The Task Force's recommendations should receive expedited consideration by the Congress.

- Announce that the U.S. is committed to developing a comprehensive energy plan within two years that, among other things, will reduce dependency on "high risk" oil sources by at least 50 percent no later than 2025.

- Announce that the U.S. is committed to achieving comprehensive immigration reform within one year that, among other things, will ensure that all master's and doctorate graduates from U.S. colleges and universities with stated degrees (e.g. science and engineering) will be given a green card and guaranteed a pathway to citizenship.

- Pursue certain Constitutional Amendments (e.g., line item veto, national purpose, balanced budget, revenue/GDP, debt/GDP).

Summary:

The illustrative Preemptive (Prudent) Framework can help us avoid a U.S. debt crisis, put our nation on a more prudent and sustainable fiscal path and ensure that our collective future is better than our past. It involves reforming social insurance programs while maintaining a sound social safety net, cutting and constraining federal spending, putting all major categories of the federal spending on an annual budget, except Social Security and interest on the federal debt, and implementing comprehensive tax reform.

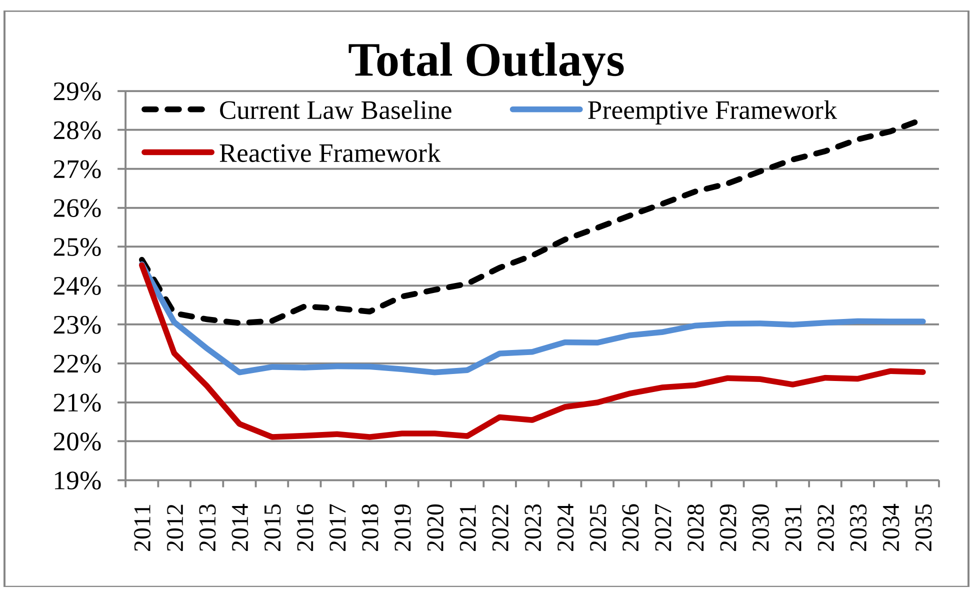
The result is a balancing of the primary budget (federal spending excluding interest) by 2014, and reduction of debt/GDP to about 63 percent of GDP in 2021 and declining, versus about 76 percent of GDP and increasing rapidly under CBO's current law baseline, and to about 52 percent and declining in 2035, versus about 91 percent and rising under the baseline. This framework includes cutting federal spending from 21.8 percent of GDP in 2021, from 23.9 percent under CBO's current law baseline and to 23.2 percent of GDP and stable in 2035, from 28.3 percent and rising under the baseline. This plan also does not raise taxes above levels expected under current law, while capping total federal revenue at 21.5 percent of GDP versus 23.3 percent of GDP in 2035 and rising under the current law baseline. The illustrative Preemptive (Prudent) Framework should be politically feasible if all key players and both major political parties are prepared to work together in good faith and put the nation's longer-term interests over short-term partisan political interests.

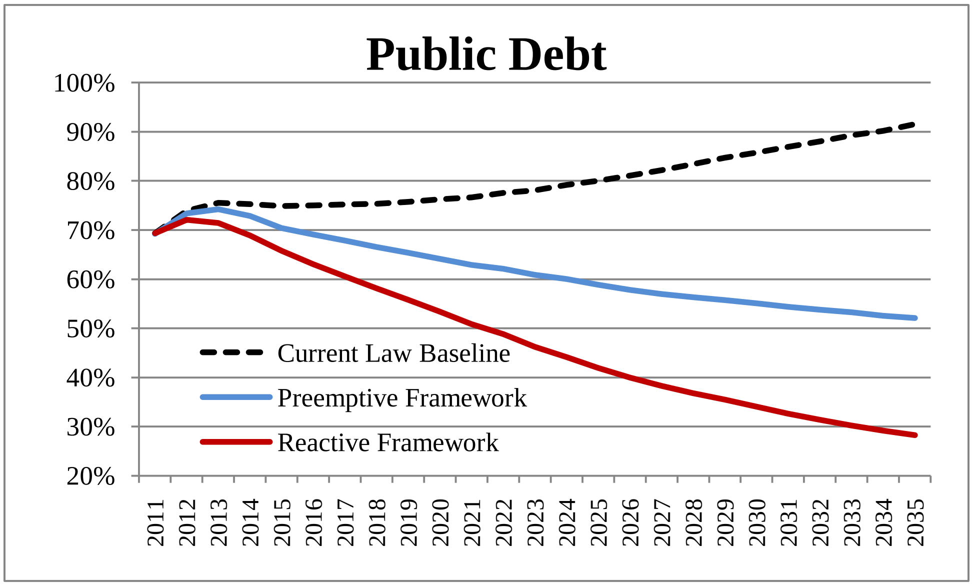
The illustrative Reactive (Crisis Management) Framework involves more dramatic reforms that are intended to restore confidence, stem an increase in interest rates, stabilize capital markets and help avoid a global depression. The result is a balancing of the total budget by 2015, and reduction of debt/GDP to about 51 percent of GDP in 2021 and declining rapidly, versus about 76 percent of GDP and increasing rapidly under CBO's current law baseline, and to about 28 percent and declining in 2035 versus about 91 percent and rising under the baseline. The Reactive (Crisis Management) Framework involves less spending in all major categories, with the most significant reductions being in the health care area. This means that, among other things, the timing of moving to universal health care coverage would be delayed and the level of health care coverage and public subsidies for health care will likely have to be less than otherwise is possible. This serves to reinforce the fact that rising health care and interest costs represent the biggest drivers of our nation's projected structural deficits on the spending side. Overall spending under the framework would be reduced to 20.1 percent of GDP in 2021, from 23.9 percent under the current law baseline, and to 21.8 percent of GDP and leveling in 2035 from 28.3 percent and rising under the baseline. Nominal public debt would be less in 2023 than 2015 and essentially stable.

The Reactive (Crisis Management) Framework also involves having to impose a temporary deficit reduction revenue increases to accelerate deficit reduction and debt/GDP stabilization, while maintaining an overall cap on federal revenues at 21.5 percent of GDP. In addition, this framework provides the opportunity for even lower tax levels as a percent of GDP through annual tax dividends/reductions or otherwise, and/or additional investments to help future economic growth and U.S. competitiveness, once the level of debt/GDP reaches a stated level (e.g. 30 percent). This feature could cause some to prefer this framework over the Preemptive (Prudent) Framework. However, this feature could also be incorporated as an aspect of that framework. Any such decisions will have to be made as part of the normal political process and would likely prove to be very difficult given the political feasibility factors noted in the introduction.

While the fiscal and financial results under the Reactive (Crisis Management) Framework are impressive, they would come at the price of considerably more controversy, pain, hardship and domestic unrest than is necessary. As has been the case throughout history, the poor and most vulnerable are likely to suffer the most during the relative period of austerity. This would be truly unfortunate since, as has been said, the true test of a society is how it treats the less fortunate. The type of dramatic and draconian actions outlined under the illustrative Reactive (Crisis Management) Framework are not necessary and can be avoided if Washington policymakers wake up and begin to promote progress over partisanship and results over rhetoric. In order to do so, they will have to make tough choices today in order to help create a better tomorrow for all of us, especially our children, grandchildren and generations yet unborn.

The graphs below illustrate the results of the two illustrative frameworks as compared to the common law baseline.




Public Debt
100%
90%
80%
70%
60%
50%
40%
30%
20%
Current Law Baseline
Preemptive Framework
Reactive Framework
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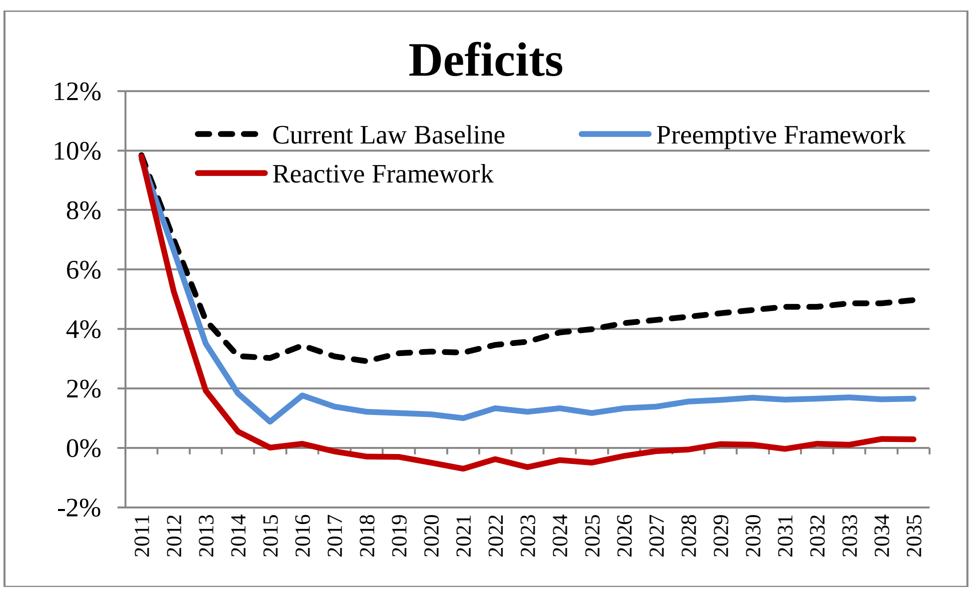
Deficits
12%
10%
8%
6%
4%
2%
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-2%
Current Law Baseline
Preemptive Framework
Reactive Framework
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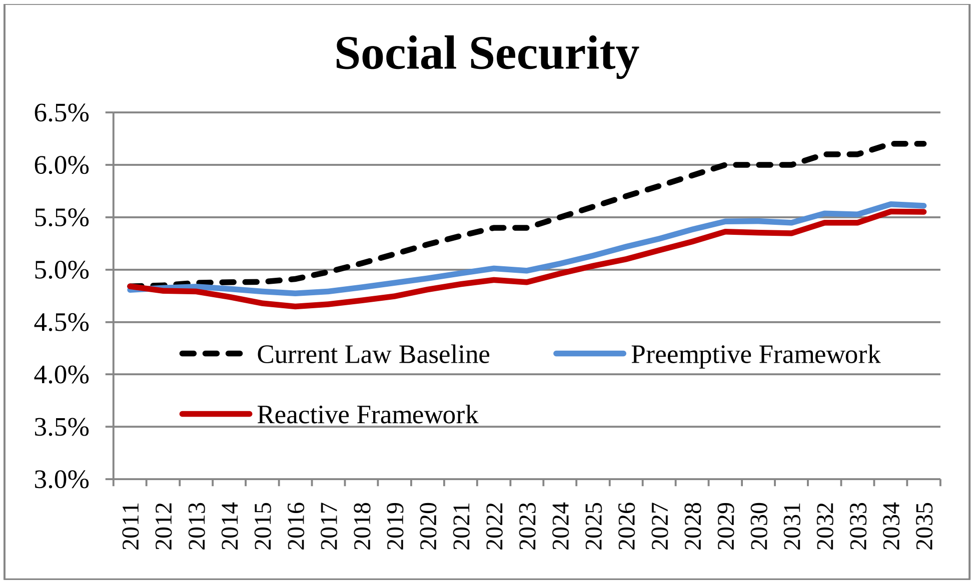
Social Security
6.5%
6.0%
5.5%
5.0%
4.5%
4.0%
3.5%
3.0%
Current Law Baseline
Preemptive Framework
Reactive Framework
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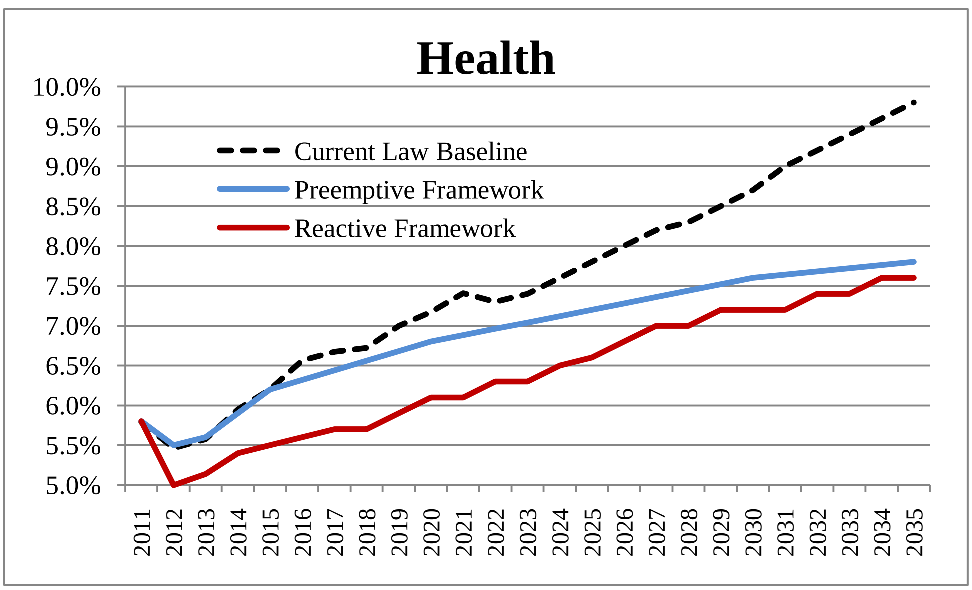
Health
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9.5%
9.0%
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8.0%
7.5%
7.0%
6.5%
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5.5%
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Current Law Baseline
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Reactive Framework
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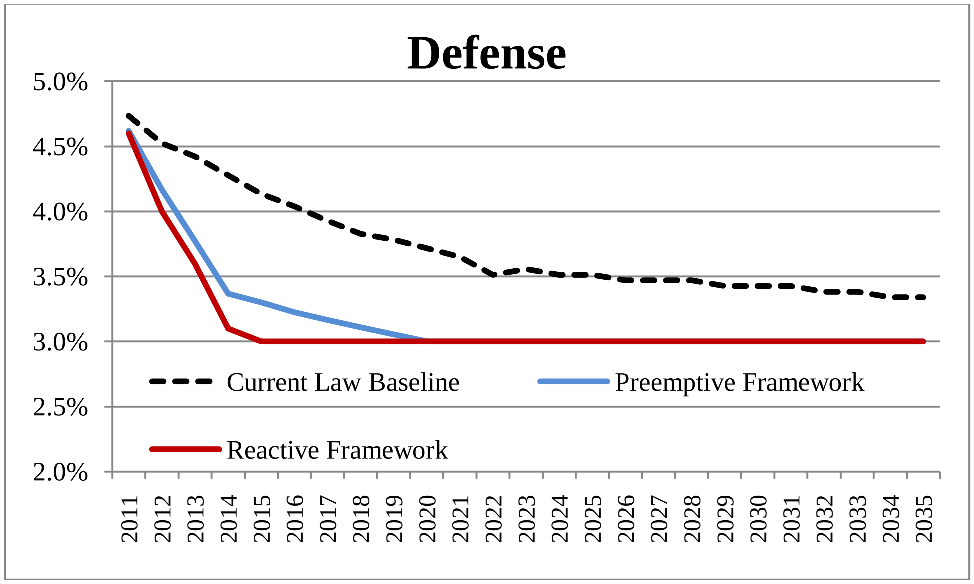
Defense
5.0%
4.5%
4.0%
3.5%
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2.5%
2.0%
Current Law Baseline
Preemptive Framework
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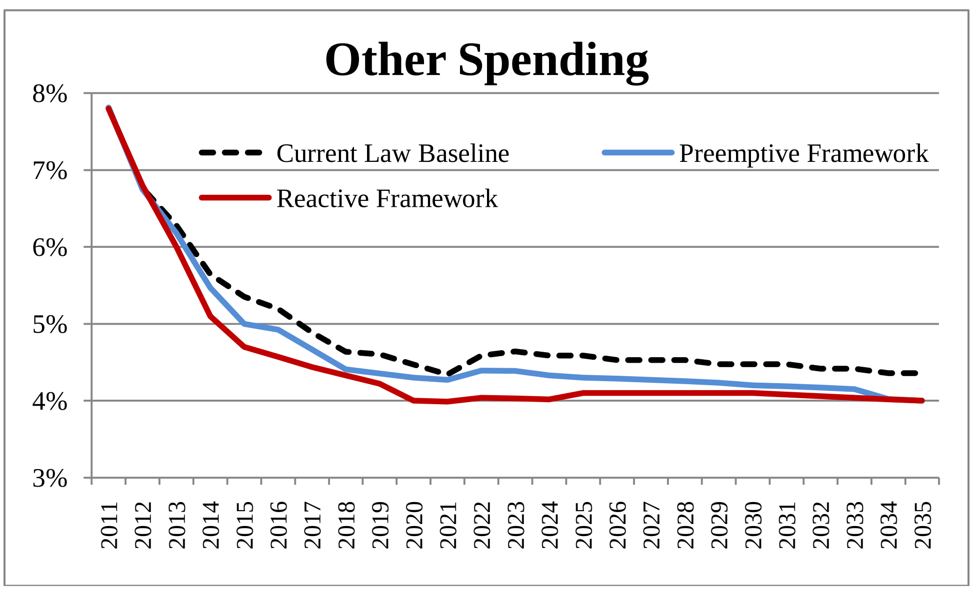
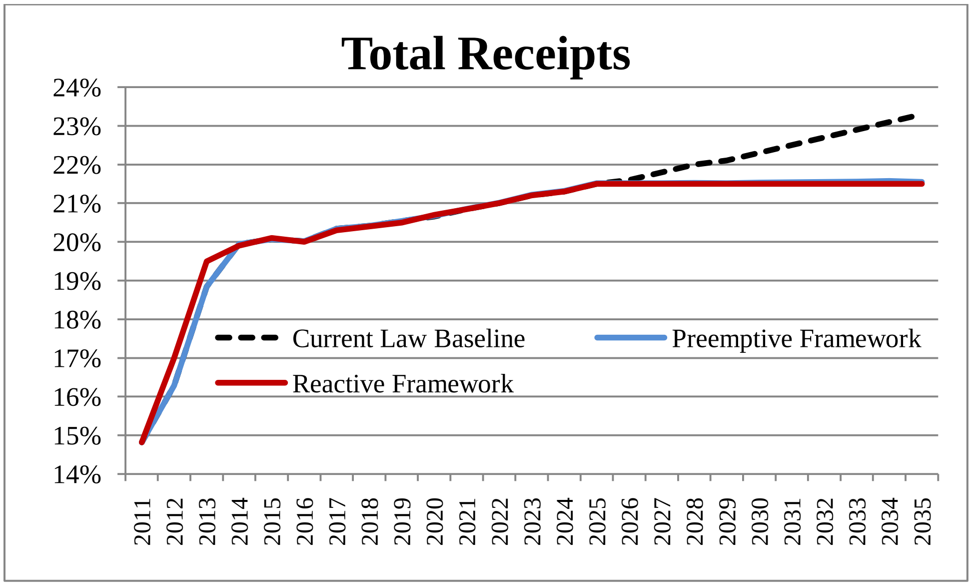
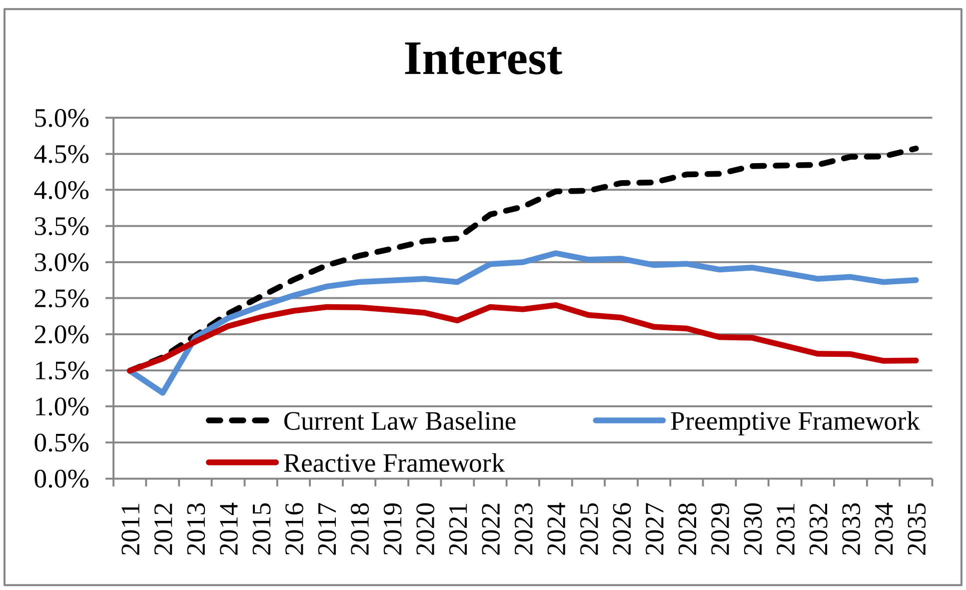

Other Spending
8%
7%
6%
5%
4%
3%
Current Law Baseline
Preemptive Framework
Reactive Framework
2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 2030 2031 2032 2033 2034 2035





The results of both the illustrative Preemptive (Prudent) Framework and the illustrative Reactive (Crisis Management) Framework have also been compared to results based on recent fiscal plans from the Heritage Foundation, the Economic Policy Institute, the Simpson/Bowles Commission and the Bipartisan Policy Center. This information can be found in Appendix A.

Final Remarks:

America is at a critical crossroads and the choices that our elected officials make, or fail to make, over the next five years will largely determine whether our future is brighter than our past. We must return to the time tested principles and values that made us a great nation.

Yes, we can return to those principles and values while making the tough choices necessary to put our finances in order in a reasoned and reasonable manner to keep America great and the American Dream alive. However, to be successful, the first three words in the Constitution must come alive -"We the People". We the People are ultimately responsible and accountable for what does or does not happen in Washington, as well as in our state capitals and city halls.

Hopefully, this report will help inform the American people, as well as our elected representatives. And remember these are illustrative reforms. They are intended to help inform policymakers and the general public. Hopefully, they will serve to help stimulate more fact-based, civil and constructive public discussion and debate. I can assure you that all of us at CAI will do our part to help fight for America's, our families' and our individual futures. All that we ask is that you do your part.

Appendix A

	Baseline		EPI		BPC		Fiscal Commission		Preemptive Framework		Reactive Framework		Heritage	
	2021	2035	2021	2035	2021	2035	2021	2035	2021	2035	2021	2035	2021	2035
Receipts	20.8%	23.3%	21.6%	24.1%	21.5%	23.1%	20.3%	21.0%	20.8%	21.5%	20.8%	21.5%	18.3%	18.5%
Outlays	24.0%	28.3%	24.5%	27.8%	21.6%	23.7%	21.8%	21.0%	21.8%	23.1%	20.1%	21.8%	18.1%	17.7%
Social Security	5.3%	6.2%	5.3%	6.2%	5.2%	5.9%	NPR*	NPR*	5.0%	5.6%	4.9%	5.6%	3.9%	3.4%
Medical	7.4%	9.8%	7.3%	9.7%	7.6%	9.5%	NPR*	NPR*	6.9%	7.8%	6.1%	7.6%	4.2%	5.8%
Other Spending	4.3%	4.4%	6.2%	5.8%	3.5%	3.8%	NPR*	NPR*	4.3%	4.0%	4.0%	4.0%	3.4%	2.8%
Defense	3.6%	3.3%	2.3%	1.9%	2.7%	2.4%	NPR*	NPR*	3.0%	3.0%	3.0%	3.0%	4.0%	4.0%
Deficit	3.2%	5.0%	2.9%	3.7%	0.1%	0.7%	1.6%	0.0%	1.0%	1.5%	-0.7%	0.3%	-0.2%	-0.8%
Debt	76.7%	91.5%	76.5%	81.7%	59.9%	38.2%	68.5%	40.0%	62.9%	51.4%	50.9%	28.2%	58.2%	30.0%

*NPR: Not Publicly Reported

The Comeback America Initiative (CAI) is a Bridgeport, CT based non-profit organization that promotes fiscal responsibility and sustainability by engaging the public and assisting key policymakers on a non-partisan basis in order to achieve solutions to America's fiscal imbalances. CAI seeks to foster a national discussion around the themes in the book "Comeback America," with an emphasis on various specific policy, operational and political reforms to put government on a more prudent, sustainable and accountable fiscal path. The organization's primary focus is federal fiscal issues; however, it will also highlight the larger national fiscal challenge and engage in certain reform initiatives in selected states (e.g., Connecticut) and cities (e.g., Bridgeport, CT).

To learn more about CAI and how you can make a difference, please go to our web site at www.tcaii.org.

You can also find us on Facebook at https://www.facebook.com/#!/pages/Comeback-America-Initiative/172592599444529

Follow our Founder and CEO Dave Walker on Facebook at https://www.facebook.com/#!/davidmwalker or on Twitter @DaveWalkerCAI.

Working together we can and will make a difference.