Beyond Paper Cuts

Eight smart ways to make real in-roads to deficit reduction—and make smart investments

by Charles Peters

In December 1992, two of Bill Clinton's top economic advisors, Roger Altman and Lawrence Summers, wrote the president-elect a private memorandum wargaming the first Clinton budget's economic goals. The two men—they are now top deputies to Lloyd Bentsen at the Treasury—argued that a deficit-reduction target which stabilized the growth of debt to the growth of the economy (a figure that turned out to be $500 billion) was, "the least ambitious deficit target that is defensible." Guess what target the President settled on? Not surprisingly, $500 billion.

When Congress finally passed the plan by the landslide margins of two votes in the House and one vote in the Senate this summer, the president hit the hustings: "Now we can truly say change has come to America," Clinton announced at one rally at the State Capitol in my old hometown of Charleston, West Virginia.

Or has it? Even by the president's men's own admission, what Clinton got this year was the bare minimum. The Congressional Budget Office's own figures, too, indicate that the public debt will actually grow from 52.5 percent of the gross domestic product in 1993 to 54.6 percent by 1998 and still higher thereafter—meaning that the $500 billion wasn't enough to begin with. So despite the President's cheerful words, true change won't come until Washington clears out the kudzu of stubborn subsidies, untouched benefits for the well-off, and tax loopholes that escaped pruning this year.

In that spirit, the *Monthly* would like to suggest how Clinton and Congress can free up money to cut the deficit and help pay for programs that are really needed. They were on the right track when they expanded the Earned Income Tax Credit and raised the top income tax rates—steps which put money in the pockets

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of the working poor while making the rich pay their fair share: Only 4,442 West Virginia families will pay higher income taxes while 105,000 families will get tax breaks—a small economic stimulus package on its own!

This is only the first step. While Clinton has tried to push a few of our cost-cutting ideas through Congress—freezing federal pay and ending ludicrous subsidies—Capitol Hill has resisted. We hope the President presses on, adopts the ideas he hasn't already, and that Congress will see the wisdom in taking money from bureaucrats, well-off entitlement junkies, and speculators to pay for rebuilding our roads and bridges, providing universal health care, and investing in education to create a better workforce.

Take just one example: Each year, the United States admits 800,000 new legal immigrants without investing in rudimentary training in English. These people, once in the workforce, could jumpstart the economy for everybody. But there is no federal money to teach them English, and churches in New York are holding lotteries for limited spaces in volunteer classes. As Bilga Abramova, a 35-year-old Russian refugee, told *The New York Times* at her third time through such a lottery, "My future is on hold. Without English, I cannot begin a new life. I do not want to depend on welfare. That is shameful."

So for the deficit chickens on both sides of the aisle, and for Clinton, here are cuts that would give people like Ms. Abramova a chance:

➤ ***Freeze federal salaries. Savings: $29 billion by 1998.***

One of Clinton's most courageous stands this year, sadly lost in the fallout from Cristophe's tarmac coiffing and the succession of Nannygates, was targeting the 2 million-strong federal civilian workforce (total payroll=$107 billion) for a pay freeze. Too tough on the feds? Consider this: Civil servants make an average of $36,279 in the U.S. and $45,000 in Washington; pay can go as high as six figures-plus for top bureaucrats. Meanwhile, the average private sector worker makes $26,758, and only 10 percent of private workers make as high a salary as a third of civil servants do.

Nevertheless, the well-connected federal employee unions wanted a 2.2 percent pay raise worth $3.1 billion in 1994. A big problem with all federal salaries (which Clinton has not acknowledged) is that they are based on job descriptions written by the feds themselves, not on the job they really do. That means the responsibilities of a file clerk, with minimal literary flair, can begin to sound a lot like Julius Caesar's. The government then takes these embroidered descriptions to companies, who read them and say what a comparable job in the private sector would pay. But because the descriptions are inflated, so are the private salaries on which comparability is based. The feds also wanted an additional $1.8 billion in "locality pay" to pay workers who live in costly cities more than those who live in cheaper ones. While it makes sense to pay workers who live in Los Angeles or New York City more to get by, there ought to be corresponding locality pay *cuts* for civil servants who live in places like Arkansas or Tennessee where federal salaries (set by Washington standards) make the local federal administrator better paid than the local bank president. Moreover, in a classic bureaucratic con, the feds are leaving their generous benefits out of the locality calculation in order to drive up the locality raise, the justification for which would often disappear entirely if the benefit package were taken into account.

Clinton rightly proposed killing the 2.2 percent raise, and though he should have tried to focus locality raises in the expensive cities where they are really needed, he did try to delay the scheme. This would have saved $28.7 billion over five years—66 percent of Clinton's discretionary savings in his original budget. But he got rolled, with employees' unions railroading lawmakers into authorizing the spending. Yet there's still hope: The money to pay for the double-barreled raises has to be specifically appropriated by Congress by January. The President ought to press for a rollback and go again for the jugular in 1994. This is big money, going to people who are better paid and have considerably better benefits than what corporate America offers its employees.

And while Al Gore's recommendation to eliminate 252,000 jobs is promising, that's just 12 percent of the workforce. When Conrail was on the verge of disaster in the eighties, it cut 61 percent and gained market share. Union Carbide has cut 22 percent and is planning more; in 1992, it was the best performer in Dow Jones industrials, rising 92 percent. Losing 20 percent of federal employees saves an additional $9 billion a year. To encourage new investments to put victims of downsizing back to work, see our plan for capital gains on page 34. [See "Myth Information," Jon Meacham, July/August 1993; "Building America To Last," Matthew Miller, January/February 1992, and "How to Cut the Bureaucracy in Half," Scott Shuger, June 1990.]

➤ ***Raise the civil service retirement age to 62. Savings: $5 billion by 1998. Defer cost of living adjustments (COLAs) for federal and military pensioners until age 62 and means test them thereafter. Savings: at least $6.5 billion by 1998.***

Another bureaucratic scam is the sweet deal retired federal government employees and military retirees enjoy from government pensions, which the President avoided this year. That's amazing, considering the $60 billion a year Washington spends on federal retirement is more than the government spends a year on higher education, consumer safety, Aid to Families with Dependent Children, food stamps, AIDS research, and low-income housing *combined*. And the big trouble is ahead. The government's "unfunded pension liability"—the amount by which planned pension benefits outstrip workers' contributions—in the federal civil service alone is $600 billion. Add in military expectations and the total exceeds $1 trillion. That's just at the federal level—states, cities, and towns are facing an aggregate liability of $160 billion to $450 billion.

A major cause of this federal shortfall is that civil servants can retire with full benefits at age 55 after 30 years of service. That's why 362,892 federal civil pensioners—or one in four—are still in their fifties. Servicemen and -women can retire after 20 years, while they are still in their early forties, and as a result 90 percent of military retirees are nondisabled and under age 62. Both military and civilian retirees can therefore become double or even triple dippers, bringing in a government pension, Social Security, and possibly a third pension from a mid-life job. There's nothing wrong with that, of course, so long as the rest of us aren't footing the bill for overly generous pensions and cost-of-living adjustments that grow faster than inflation. Just raising the civilian retirement age to 62 would raise $5 billion over five years.

COLAs in government pensions were uncommon until the years after 1969, when the country was at last paying the bills for Vietnam and was suffering the shocks of two giant oil price hikes. That period of inflation ended about 1982, but the government retiree programs continued to fund generous COLAs—now a $2 billion a year tab—and federal employee and military retirees came to look on the COLAs not as a temporary helping hand in inflationary times but as an entitlement.

Instead of adjusting COLAs downward when inflation fell or giving them only to people whose overall income is low, COLAs became permanent features for the public sector. The difference between the government and the private sector on this is vast: In 1991, all federal employees and 50 percent of state and local employees had this benefit. How many private sector workers had it? Just 5 percent.

COLAs have gone wrong for two reasons. First, they are compounded every year, piling COLA on top of COLA. Second, they are applied indiscriminately to all retirees instead of protecting the marginal pensioner from inflation. Deferring COLAs until age 62—hardly onerous—would save $6.5 billion over five years. Means testing the COLAs for well off pensioners would save even more money while protecting those on the margin. [See "A Pension for Trouble," Matthew Cooper, July/August 1989.]

➤ ***Means-test Social Security COLAs. Savings: $8.25 billion by 1998.***

We are delighted that Clinton and Congress agreed to tax 85 percent of Social Security benefits, but this is just the first step toward a sane Social Security system. Because of increases in the Social Security tax in the eighties, poor workers saw their tax burdens rise by about 28 percent while the system funded the retirements of the Rockefellers and silver-haired Rotarians at two to 10 times the amount they paid in. Though we would prefer that the working poor and lower middle class receive breaks and that the affluent pay taxes on 100 percent of benefits (and would *really* prefer a means test to strip the rich of Social Security benefits altogether if their income is more than $100,000 a year), there are signs of support for means testing COLAs for Social Security.

On the night the Senate passed the Clinton package, Senator Alan Simpson went on ABC's "Nightline" to discuss the vote. There, guest host Barbara Walters pressed Simpson on issues where the Republicans might join ranks with Democrats in the coming year. "You're going to help on entitlements?" Walters asked Simpson, who answered: "Sure. But Al Gore talked to me just after the election and he was talking about something we all ought to talk about. We have to do something with cost-of-living allowances for people; we have to start means testing, we have to do these things and we have to do it together. This is where you join hands and go over a cliff."

It's a leap worth taking, and we hope Simpson is serious about federal retiree pensions and about Social Security. According to the CBO, freezing Social Security COLAs across the board for just one year would save a whopping $46 billion by 1998. However, we believe in protecting the person who's living on the edge and genuinely needs a COLA to keep up with the cost of living. Why not pay the full COLA for people making less than, say, $20,000 a year, and take it away from those with more than $50,000 of household income? According to data analyzed by Phillip Longman and Neil Howe for *The Atlantic* in 1992, 20 percent of Social Security's outlays—or $55 billion—go to households making more than $50,000. Take the COLA away from them and you save roughly $8.25 billion by 1998, assuming 3 percent inflation.

Done with care, this rectifies divisions resulting from the fact that in the eighties, Social Security, Medicare, and federal pension benefits paid to households making over $200,000 doubled. Meanwhile, households with incomes less than $10,000 lost 7 percent of their federal benefits. The vote to tax 85 percent of benefits—and Simpson's remarks—shows that there is a realistic possibility we can stop wasting money on people who are already affluent. [See "The W-2 Step," James Bennet, June 1991.]

➤ ***Limit the home mortgage deduction to a set percentage. Savings: $21 billion by 1998.***

Home ownership is so much a part of the postwar American world that you'd think only an Eddie Haskell affecting a Socialist pose would suggest the great picket-fenced middle class is ripping the country off. But homeowners can deduct mortgage interest expenses from their taxable income—even though homes do not produce any taxable income. The case for such deductions is based on the not unreasonable assumption that they encourage home ownership and improvement. That's true, of course, but the size of the current deduction is generous by any standard. In fact, although no other kind of consumer interest has been deductible since 1991, home mortgages amount to a *$50 billion* yearly subsidy from all taxpayers to homeowners.

Capping the deduction at just $12,000 for single filers and $20,000 per joint return would quickly raise $21 billion, and these limits are higher than what 95 percent of homeowners claim. If these caps were adopted, the CBO says, only mortgages of $250,000 or more would lose *any* of the deduction, and only 4 percent of new mortgages in 1992 were in that high priced range. This way, only those people well-off enough to consider luxury homes or vacation houses would be affected at all.

➤ ***Cancel the space station and the Supercollider. Savings: $16.5 billion by 1998.***

There's more nibbling going on around these two behemoth projects than at a lobbyist-sponsored cocktail buffet, but the clear answer is to be done with them both. The space station has already soaked up $9 billion with no objective or end in sight. If NASA can't talk to its own satellites, how can they host a permanent slumber party in space? The same goes for the Supercollider, the darling of Don't-Tax-But-Spend-in-Texas Senators Phil Gramm and Kay Bailey Hutchison. While Clinton reduced the size of the projects cloaked in rhetoric about "smaller, more focused missions," there are too many problems back here on Earth to justify shooting billions into space and into research about radioactive decay.

➤ ***Freeze Medicare payments to hospitals for one year; lower subsidies to high income recipients; strip surgeons of their raises for Medicare-funded patients. Savings: $22 billion by 1998.***

We are wary of proposing too much on Medicare because we hope the Clinton health plan, which will surely involve a restructuring of Medicare, will give the rich and poor equal access to the same level of care. Still, there are a few money-saving steps that could immediately be taken.

First, for all the squawking about the $56 billion in Medicare "cuts" this year, only the program's automatic *growth* was somewhat limited. Freezing payments to hospitals produces $15 billion in savings over five years and would force hospitals to be more efficient. House Republicans sensibly proposed means testing the Medicare deductible for beneficiaries making over $100,000 to make them pay the first $2,000 of hospital costs instead of the current $697. Also, cutting subsidies on Medicare's supplemental insurance for couples making $125,000 and phasing the subsidy out for those making over $200,000 would bring in $6 billion.

One glaring mistake ought to be corrected right away. In the budget deal, Clinton and Congress raised the government subsidy to one of the richest sections of society: surgeons. By including surgeons in the 8.9 percent raise in the fee schedule—mean U.S. surgical income is now $223,800, compared to $111,500 for family doctors—the Democrats caved to a major special interest. How's that for shared sacrifice?

➤ ***Raise the estate tax and close the angel-of-death loophole. Savings: about $80 billion by 2000.***

As we have pointed out in recent issues of the magazine, the new way to get rich quick in this country is to inherit. There's a $200 billion annual transfer of wealth going on between baby boomers and their parents, who are dying off. And 97 percent of estates now go untaxed. Changing that and closing the angel-of-death-loophole which exempts capital gains tax on stock sold after it's inherited would raise, by some estimates, $80 billion by the year 2000. [See "Brother, Can You Spare My BMW?" David Segal, April 1993, and "The Secret Solution to the Deficit," Paul Glastris, January/February 1991.]

➤ ***Give capital gains tax breaks to investments in new jobs. Savings: billions.***

The more businesses and governments downsize to make themselves efficient, the more people will be out of work. This could have the terrible result of cutting the number of customers these new, lean corporations will have—and the number of taxpayers for the government—unless new plants and businesses are opening to take up the slack.

While Congress passed a break for small business capital gains held for over five years, it's imperative that Clinton keep his campaign promise to reward people who invest in job-producing stocks and startups across the board. Now, the tax code makes no distinction between the investor who takes a risk by investing in a new company and who sells, say, five years and so many new jobs later and the speculator who buys 10,000 shares of AT&T on Monday and sells them on Tuesday. The first man deserves a tax break; the speculator, whose in-and-out trading encourages company managers to maximize short term profits at the expense of the long-term good of the company (and, in the big picture, of the economy), shouldn't get a break. Now, investors pay 28 percent capital gains regardless of whether it's a job-producer or a speculation; making short termers pay the same higher rate on their stock deals that they pay on ordinary income will save billions. And a targeted cut will encourage investors to put their money where it counts: Investments that mean new jobs. [See "No Dollars, Common Sense," Charles Peters, December 1992.]

Our suggestions, added to what Clinton and Congress did this year, come to about $610 billion by 1998. They ask something of the middle as well as the rich; without both, nothing can be seriously accomplished. That said, we would not put *all* of these savings toward deficit reduction. A third of it, about $200 billion, should go to making good public investments in roads, education, and health care. Now *that's* real change. ◻

THE WHITE HOUSE

WASHINGTON

August 6, 1993

MEMORANDUM FOR GENE SPERLING

FROM: PAUL DIMOND

SUBJECT: FOUR IDEAS

1. **ADDITIONAL SPENDING CUTS.** The cursory review of Domestic Agency programs provided by OMB to me several months ago demonstrated that there was substantial room for more cuts -- **if we have a clear policy focus.** I believe that the Administration can get very serious about submitting substantial additional spending cuts to Congress this fall -- if the current FY95 Budget and Performance Reviews have a **much** sharper policy focus. Stated another way, Budget Review and Performance Reviews without policy direction may be able to cut fat, but they won't be able to cut entire programs that are wrong-headed and inconsistent with where the President wants to lead the country. The FY95 Budget and Performance Reviews therefore provide the only chance for the new Administration to get rid of what prior Congresses and previous Administrations have piled on the budget. Now that the House has asked us to submit more spending cuts, the Administration has an open invitation to do what it otherwise might not have been able to do: put Congressional pork and entire programs that are inconsistent with the President's vision right on the table, all alone, before the full glare of the nation. That certainly provides our best opportunity to get rid of programs and cut spending that are counterproductive, don't work, or the country doesn't have the luxury have to afford.

2. **ADDITIONAL INVESTMENTS.** The spending cut feeding frenzy also means that we will have to become more creative in how to fund new investments to put people first: my suggestion is to create, **forthwith,** an elite working group to look at the potential for using the capital budget corner of the Credit Reform Act to finance new investments in education, training, lifelong learning, worker transition assistance, and infrastructure. As with the direct student loan program, all such investments will be scored for budget purposes based on the current value of any subsidy and the default rate on repayment of the loans -- not on the amount of the loan. Imagine if we financed some substantial portion of the DOL, DoEd, HHS, and infrastructure programs on the basis of a stream of future repayments of current federal investment: we could reduce current spending substantially, while increasing current investments! Gene, this is a bargain that we cannot afford to ignore. That, of course, is also the ultimate

charm of the direct student aid portion of the National Service: we just need to see how far we can extend the principle. Remember, also, the current CBO Director is the primary proponent of this approach to budgeting and to real investment in our future; and there are other experts within CBO and OMB who could help us take a very close look at the full potential of this approach.

3. A HORSETRADE: FINANCING HEALTH CARE AND WELFARE REFORM WITH A CUT IN CAPITAL GAINS TAX FOR INCREASE IN CIGARETTE TAX AND, AS APPROPRIATE, THE ESTABLISHMENT OF A BTU TAX. Move basic health care plan costs entirely off of company payrolls (with a co-payment requirement) and increase our international cost competitiveness; give a shot to current tax collections from sales of investments and provide greater incentives for new investment; and move to a tax on consumption that promotes health and the environment. Enough said? Worth a shot? A different, bi-partisan coalition? Change the whole political dynamic?

4. TENNIS AND POLITICS. As you know, I played tennis with Senators Breaux and Mitchell last week. Although I hardly brought my best game to the court, I didn't embarrass myself despite the heat. Both Senators are sufficiently talented that we could get some good exercise -- and build a close relationship -- if you joined me in taking them on for a regular home and home series on the White House court and the Senate court. Similarly, I am informed by reliable sources that there are Republican Senators who might like to join us for a game of tennis: this could provide an opening to establish some beachheads for bipartisan action off the court, too. In your role as political head of the NEC, I think this offers an opportunity to get your game in shape that you can't refuse. You will have to negotiate use of the Court so that we won't be subject to bumping: that would be a political embarrassment of the first order.

I'll be in Ann Arbor through Monday. Give a holler if you need me.

cc Bob Rubin, Bruce Reed