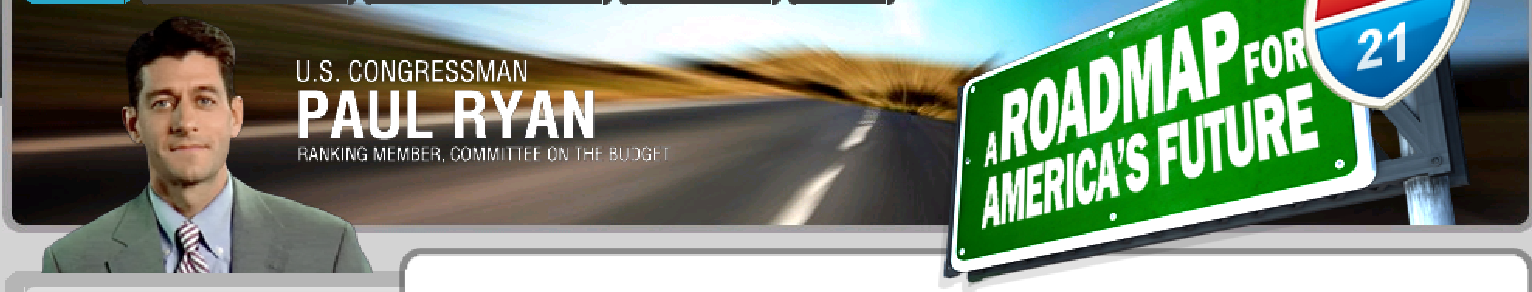

THE ROADMAP PLAN

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INTRODUCTION
A Choice of Two Futures

Rarely before have the alternatives facing America been so starkly defined.

For the past year, Washington's leaders have taken an already unsustainable budget outlook and made it far worse. They have exploited Americans' genuine economic anxieties to justify an unrelenting and wide-ranging expansion of government. Their agenda has included, among other things, a failed, debt-financed economic "stimulus"; an attempt to control the Nation's energy sector; increasing domination of housing and financial markets; the use of taxpayer dollars to seize part ownership of two nearly bankrupt auto makers; and, of course, the planned takeover of Americans' health care, already heavily burdened, manipulated, and distorted by government spending and regulation. This domineering government brings taxes, rules, and mandates; generates excessive levels of spending, deficits, and debt; leads to economic stagnation and declining standards of living; and fosters a culture in which self-reliance is a vice and dependency a virtue – and as a result, the entire country weakens from within.

Increasingly, Americans are rejecting this approach, and for good reason. But the status quo is not acceptable either. The Federal Government's current fiscal path is unsustainable: it leads to unprecedented levels of spending and debt that will overwhelm the budget, smother the economy, weaken America's competitiveness in the 21st century global economy, and threaten the survival of the government's major benefit programs. The President and congressional Majority are only hastening America's march toward this reckoning, adding to trillions of dollars worth of unfunded liabilities, and accelerating the erosion of Americans' health care and retirement security. Their "progressivism" ironically points backwards – to a future in which America's best century is the past century.

There is another choice, as reflected by the proposal described in this report: A Roadmap for America's Future. It is a comprehensive, alternative approach to the Nation's most pressing domestic priorities. Specifically, the plan addresses the following:

▫ **Health Care**. It provides universal access to affordable health coverage, not by expanding government, but by reinforcing the role of consumers – patients – in a truly competitive marketplace. In conjunction with this, the plan takes on the necessary task of restructuring the government's medical entitlements, making them sustainable for the long term.

▫ **Retirement Security**. It saves and strengthens Social Security, making the program sustainable for the long run, and helping expand investments needed for economic growth.

▫ **Tax Policy**. It offers an alternative to today's needlessly complex and inefficient tax code, providing the option of a simplified mechanism that better promotes and rewards work, saving, and investment.

▫ **Job Training**. It helps the Nation's workforce prepare for success in the global economy by transforming 49 job training programs, scattered across eight agencies, into a flexible, dynamic program focused on results, and accompanied by clear measures of transparency and accountability. The plan requires the development of performance measures, and gives each State the option to consolidate funding into one program, if such an approach can be shown to improve outcomes and achieve job training goals.

This plan is not simply a slimmer version of the "progressive" ideology. It is a true alternative, and a complete legislative proposal consisting of specific policies supported by Congressional Budget Office estimates of its fiscal and economic consequences. More important, it is based on a fundamentally different vision from the one now prevailing in Washington. It focuses government on its proper role; it restrains government spending, and thus limits the size of government itself; it rejuvenates the vibrant market economy that made America the envy of the world; and it restores an American character rooted in individual initiative, entrepreneurship, and opportunity – qualities that make each American's pursuit of personal destiny a net contribution to the Nation's common good as well. In short, it is built on the enduring truths from which America's Founders established this great and exceptional Nation.

This proposal does not attempt to abandon commitments Americans established over the past century, or to dismantle government. It recognizes that government has a necessary role in supporting the institutions through which Americans live their lives, and in providing a safety net for those who face financial or other hardships. But it rests on the conviction that government's principal role is to maintain the freedoms through which individuals can pursue their own destinies. As Jefferson put it: "A wise and frugal government, which shall restrain men from injuring one another, which shall leave them otherwise free to regulate their own pursuits of industry and improvement, shall not take from the mouth of labor the bread it has earned. This is the sum of good government."

The balance of this introduction describes these two futures in detail. The remainder of the report describes the principal domestic challenges through which this choice appears at present, and then presents a full description and explanation of the policies embraced in this legislation.

AN EXPANDING CULTURE OF DEPENDENCY

In 1930, just after the great stock market crash, Federal Government spending totaled just 3.4 percent of gross domestic product [GDP]. As late as 1935, the cumulative spending of State and local governments still exceeded total outlays from Washington. The New Deal created programs designed to aid an economically devastated country, and to try to put people back to work. Some were significant achievements. Some longer-term administrative measures have led to a growth of bureaucracies that over time weakened Americans' control of the Federal Government. They also planted the seeds for a gradual change in thinking about the government's limited powers and mission in its relationship with the people. The effect has been to increase, step by step, the extent to which Americans depend on their government – not only for assistance during temporary hardships, but for their livelihoods, housing, savings, and means of retirement.

These so-called "progressive" reforms had well-intentioned aims as they unfolded in the Great Society programs of the 1960s. But addressing the challenges of modern society with a steady expansion of government brought its own unintended burdens – and they are looming larger every day. One is that public programs have extended their reach into America's economy and Americans' lives. Further, the government's largest entitlement programs, now deeply entrenched, are driving an unsustainably rapid rate of spending growth – one that threatens to overwhelm the Federal budget and smother the economy.

Equally troubling has been the effect on national character. Until recently, Americans were known and admired everywhere for their hopeful determination to assume responsibility for the quality of their own lives; to rely on their own work and initiative; and to improve opportunities for their children to prosper in the future. But over time, Americans have been lured into viewing government – more than themselves, their families, their communities, their faith – as their main source of support; they have been drawn toward depending on the public sector for growing shares of their material and personal well-being. The trend drains individual initiative and personal responsibility. It creates an aversion to risk, sapping the entrepreneurial spirit necessary for growth, innovation, and prosperity. In turn, it subtly and gradually suffocates the creative potential for prosperity.

Now America is approaching a "tipping point" beyond which the Nation will be unable to change course – and this will lead to disastrous fiscal consequences, and an erosion of economic prosperity and the American character itself. The current administration and Congress are propelling the Nation to the brink of this precipice.

The consequences of this growing culture of dependency, and its implications for America's future, are described from four perspectives: 1) public policy; 2) fiscal policy; 3) economics; and 4) the American character.

Public Policy: A Larger and More Intrusive Government

Throughout 2009, the President and Congress pursued another great surge of "progressive" government expansion – one comparable in size and scope to the New Deal or the Great Society; and they exploited a genuine economic crisis to justify this ambitious program. Among its principal components have been the following:

▫ **Fiscal 'Status.'** With the slippery promise of "saving or creating" three-and-a-half million jobs, the Majority passed a $787-billion "stimulus" bill that failed to halt the rise in unemployment, but did include numerous policy changes consistent with the big-government agenda. By expanding Medicaid – a program in desperate need of reform – and launching a new "comparative effectiveness" health program, the bill started the movement away from patient-centered medical care and toward the planned government takeover of the health care sector. The "stimulus" also heaped another $1 trillion in debt onto the taxpayers' already large burden.

The legislation rested on the Keynesian-inspired notion that government can somehow "manage" a free-market economy, commanding it to grow with heavy doses of borrowed money. All the measure really did was set off a weak and temporary spike in consumer spending, while unemployment continued to rise. Worse, the heavy borrowing used, unsuccessfully, to "prime" the economic pump drained resources the economy will need for sustained growth. Yet the House refused to accept reality, and in December 2009 poured another $150 billion into this failed economic doctrine.

▫ **TARP extension**. The Troubled Asset Relief Program [TARP] was intended to thaw credit markets that seized up during the financial crisis – and it succeeded in its short-term objective. But it has now morphed into a $700-billion fund for whatever interventions the administration desires. These have included buying shares of two U.S. auto companies, launching new housing programs, and bailing out large insurance companies – in other words, effecting further transformation of America's free-market economy.

In the latest version of the administration's exploitation of TARP for purposes other than stabilizing financial markets, the House – with the President's blessing – claimed to offset $75 billion in additional "stimulus" spending with a reduction in TARP authority. This move ignored carefully wrought statutory instructions to protect the taxpayer and not use authority to offset new spending. The package further enshrined TARP as Washington's latest slush fund.

▫ **Cap and Trade**. This proposal effectively establishes a government takeover of most of the energy market. The legislation requires companies responsible for more than 86 percent of U.S. energy resources to obtain new emissions permits from the Federal Government to stay in business, includes a series of new mandates on the production and use of energy, and expands bureaucracies – or creates new ones – to oversee this program. Yet it fails to boost two of the most reliable sources of clean energy: nuclear and hydro-power.

By sharply increasing the cost of energy, the bill imposes substantial tax increases that will be absorbed largely by middle-income earners – breaking the President's promise not to raise taxes for those making less than $250,000 per year. Although the measure contains a complex scheme of allowances, tax credits, and tax rebates that attempt to reduce the impact on households, the bottom line is inescapable: the higher energy costs will have to be absorbed by someone; and the "someone" will be the U.S. taxpayer. Meanwhile, in contrast to the President's pledge to "change the way Washington works," the legislation gives away 83 percent of its carbon allowances to energy- and climate-related special interests, at the expense of U.S. taxpayers.

Yet after all this, the benefits of cap-and-trade remain highly doubtful. Some studies show the scheme might move temperatures by no more than a fraction of a degree by the end of this century – which would make little difference on whatever climate effects result from greenhouse gas emissions. There are no effective limits on emissions by foreign countries, such as China and India, that are responsible for the fastest current growth in greenhouse gases.

▫ **Financial Market Legislation**. In a single stroke late last year, the House passed the most significant overhaul of the Nation's financial system since the creation of Depression-era banking and securities laws.

The new legislation expands the role of government in the financial arena on multiple levels for institutions and individuals. Instead of forcing insolvent banks to close down, and allowing market discipline to deter imprudent decisions, the bill further enshrines the notion of "too big to fail," and insulates certain firms from the fear of bankruptcy resulting from poor management. It gives a new government council the power to designate which large, interconnected institutions fall into this category. It also establishes a permanent bailout fund of up to $200 billion – in essence, a "TARP II" – which will exaggerate market distortions, artificially lowering the price of risks taken by large firms and by those who invest in them. Such protection given to big banks creates further disadvantages to the smaller banks – leaving them "too small to succeed."

The financial bill creates a new government agency designed to safeguard consumers from risk-taking for a broad array of products, from mortgages to credit cards. But ironically, the new bureaucracy will harm the very consumers it seeks to protect: by writing far-reaching rules and restricting risk, it will limit consumer choices, ration credit, and hamper individuals' ability to make investment decisions. Another provision in the bill would limit institutions' ability to issue debt to raise capital, and would disrupt bond markets by requiring senior, secured creditors to take a 10-percent "haircut" on the short-term bonds in the event of failure, disrupting a key tenet of debt financing, and making it more expensive and difficult for institutions to raise capital.

▫ **Housing Markets**. For years, the Federal National Mortgage Association [Fannie Mae] and the Federal Home Loan Mortgage Corporation [Freddie Mac] enjoyed the special status of "Government-Sponsored Enterprise" [GSE] – a title carrying the implicit guarantee that Washington stood behind every loan they securitized. When in 2008 they were taken into conservatorship – along with their $5.3-trillion portfolios – the taxpayer guarantee became explicit. Private sector participants in the market, most unable to compete after the housing bubble burst, were squeezed out.

Mortgage origination has now become a public oligopoly, with the government controlling 94 percent of the market. Fannie's and Freddie's market share has grown from 39 percent in 2006 to 72 percent in 2009, while that of the Federal Housing Administration's has leapt from 3 percent in 2006 to 22 percent in 2009. In addition, the Federal Reserve has been a major force in suppressing interest rates and providing liquidity in the housing market. In 2009, it agreed to purchase up to $1.25 trillion in agency mortgage-backed securities [MBS], or at least 80 percent of Fannie's and Freddie's new MBS issuance.

Instead of shrinking the housing giants and reducing the risk on the Federal Government's balance sheet, the administration, on 24 December 2009, increased Treasury's commitment to Fannie and Freddie to unlimited amounts for the next 3 years – and has allowed for expansion of the firms' trading portfolios. The administration also has placed Fannie and Freddie at the center of its loan modification and refinancing efforts, further deteriorating the GSEs' financial health at taxpayers' expense.

▫ **Health Care**. The most ideologically driven policy the President and Congress have pursued threatens to further encumber and distort America's health care sector, and intrude even more deeply into this most valued, most sensitive, and most personal of services. It is the clearest and most pervasive manipulation of Americans' individual lives; and its overbearing nature is reflected by its more than 2,000 pages of legislative text.

The legislation increases government's leverage in deciding which medical treatments are worth paying for and which are not. It imposes government control over physicians' medical decisions, and causes private-sector insurers to limit coverage in line with the government's choices. Whether directly or not, it will effectively bind all Americans to a "one-size-fits-all" national managed care program that disregards personal choice and compassionate care.

If enacted, the bill's rating restrictions, coverage mandates, and benefit requirements will halt innovation and drive individualized health products out of the market. It will disqualify Health Savings Accounts, which provide more than eight million people with access to low-cost health care. It will cause 64 percent of seniors in Medicare Advantage to lose their coverage over the next 5 years, and would subject plans to approval by a new health care bureaucracy, with the authority to audit, review, and penalize any health plan that does not comply with the rules set by this Washington-based office.

The health bill activates the "Comparative Effectiveness Research" program, giving the Federal Government even greater leverage in deciding which medical treatments are worth paying for and which are not. This will inevitably impose government control over physicians' medical decisions, and cause private-sector insurers to limit coverage in line with the government's choices. Further, while proponents assert that providers will be able to negotiate rates with the government, they will do so under a heavily regulated regime; and there is nothing to prevent this from becoming a take-it-or-leave-it, price-setting system. Put simply, prices will be dictated to health care providers at rates determined by a cost-wary Federal Government.

These are some of the major elements of the government expansion envisioned by Washington's current leaders. Put simply, they all contribute to an extensive and deliberate power grab in which government seizes ever more of the economy – and controls more of Americans' lives.

Fiscal Consequences: An Unsustainable Path

The fiscal impact of the President's policies – which he and the Congress are seeking to implement step by step – is a level of spending, deficits, and debt unprecedented outside of wars. According to the Congressional Budget Office [CBO], the President's policies will increase spending to $5.1 trillion by 2019, nearly a full quarter of the Nation's economic resources. His deficits never fall below $633 billion in the next 10 years, and exceed $1 trillion by the end of the decade.

Debt as a share of the economy is projected to exceed 60 percent this year (2010) – greater than the 2009 level, which was the highest in 50 years – and will reach 82 percent of GDP by the end of the next decade under the administration's policies. (In nominal dollars, debt held by the public will triple over the next 10 years.) The U.S. has not seen debt at these expected levels since the end of World War II. Even the countries of the European Union, hardly exemplars of fiscal rectitude, are required to keep their debt levels below 60 percent of GDP.

All this would be bad enough on its own. But it only adds to a fiscal crisis already well under way. The status quo is unsustainable and unacceptable.

For several decades, fiscal experts have warned of the untenable and overwhelming nature of the Federal Government's budgetary trends. The threat comes entirely from domestic entitlement programs, as clearly reflected in CBO's biennial report, The Long-Term Budget Outlook, the most recent of which was released in June 2009. The report, looking forward 75 years, shows that within the next several decades, the government's current fiscal path will lead to catastrophic levels of debt, even if Congress imposed substantial tax increases.

Extension of Current Fiscal Policies. In a scenario that essentially extends today's underlying fiscal policies, CBO assumes the 2001 and 2003 tax relief provisions and alternative minimum tax [AMT] "patches" are permanently extended. As a result, revenues grow slightly faster than the economy and equal 22 percent of GDP by 2080.

The projection also assumes Medicare physician reimbursement payments will track the historic growth of Medicare rather than the "sustained growth formula" [SGR], which has in recent years called for steep reductions in those payments. (Congress has repeatedly boosted physician payments, an action called the "doc fix.")

The scenario projects that Social Security, Medicare, and Medicaid will grow faster than the economy. But CBO also makes an artificial downward adjustment in the future growth rates of the two health entitlements. Without this adjustment – applying historical rates of health care spending growth – Medicare and Medicaid spending as a share of the economy (currently 4.9 percent of GDP) would double in 20 years, triple in 30 years, and equal the size of today's entire government in less than 50 years. Other spending is allowed to grow with GDP rather than inflation after 2011.

It is noteworthy that even without deliberate tax increases, tax revenue as a share of the economy is still projected to grow – rising from 15.5 percent of GDP in 2009, to 19.9 percent in 2050, and to 21.9 percent in 2080. For comparison, Federal revenues peaked at 20.9 percent of GDP in 2000. Yet even with revenues at historically high levels, spending still outpaces revenue by significant amounts, leading to more government borrowing and debt, and still higher interest payments.

CLICK HERE TO VIEW TABLE

To summarize:

▫ **Spending**. Even with no legislated expansion of government programs other than the "doc fix," primary (non-interest) Federal spending grows to levels unprecedented in peacetime, despite the assumed moderation in health care spending growth. For instance, in just 40 years, by 2050, this spending would exceed 28 percent of GDP.

▫ **Deficits**. Because spending outpaces revenue by increasing amounts, budget deficits rise to staggering levels – reaching 22.2 percent of GDP in 2050, more than the entire Federal budget in 2008.

▫ **Interest Payments**. The growing gap between spending and revenue leads to increased government borrowing. That will result in expanding government interest payments, causing total spending to exceed 42 percent of GDP by 2050.

▫ **Debt**. The path also will drive debt held by the public to catastrophic levels – more than three times the size of the economy by 2050, and more than seven times by 2080.

Also noteworthy is that substantial tax increases do not solve the problem. CBO has projected that even if all the 2001 and 2003 tax relief provisions expired in 2011 as scheduled, and the alternative minimum tax were not indexed for inflation in the future – meaning it would reach 45 percent of households by 2035 (compared with 3 percent now), and 70 percent by 2080 – spending would still outpace revenue by increasing amounts, leading to growing deficits, debt, and interest payments. One assessment of this kind of fiscal policy – which calls for tax increases of roughly $3 trillion over the next 10 years – comes from the Brookings-Heritage Fiscal Seminar, a group of policy experts spanning the ideological spectrum:

[R]estoring tax rates to pre-2001 levels will not close the gap between spending and revenues. . . . Even raising revenues as a percent of GDP to European levels – levels that are unprecedented in the United States – will not be sufficient. If the wedge between spending and revenues attributable to social insurance programs continues to grow, taxes would have to be raised continuously and would eventually cripple the economy.

The Fiscal Gap. CBO quantifies the degree of long-term budget shortfalls using a concept called the "fiscal gap." It is a present-value measure that reflects the excess of Federal spending over revenue during a given time period. It represents the extent to which the government would need to immediately and permanently raise tax revenues, cut spending, or use some mix of both to make the government's debt the same size – relative to the size of the economy – at the end of that period as it was at the beginning.

Table 2 below shows the results of CBO's fiscal gap analysis under current fiscal policies, with revenues holding at 19.9 percent of GDP. Once again the conclusion is clear: projected levels of spending are not only unsustainable, they also are the primary culprit behind expected future budget imbalances.

CLICK HERE TO VIEW TABLE

Under these estimates, the fiscal gap in 2033 is 5.4 percent of GDP. The figure essentially means that, on average, spending is expected to exceed revenue by the equivalent of 5.4 percent of GDP throughout the next 25 years. To close the fiscal gap – or to put it another way, to keep the debt from growing larger relative to GDP – Congress would need either to raise revenues or to cut spending by the equivalent of 5.4 percent of GDP immediately and permanently. This amount is more than the government now spends for all of national defense, or all of Social Security; and the gap worsens after that.

In fact, revenues actually are projected to rise higher than 19.9 percent of GDP, even if the 2001 and 2003 tax relief provisions are retained. Revenues are expected to exceed their peak of 20.9 percent of GDP, achieved in 2000, rising to 21.9 percent of GDP (or to 25.9 percent under the scenario in which taxes increase as scheduled under current law. But even these higher revenue levels will be far outstripped by spending increases. The growing debt that would result would be unsustainable for both the budget and the economy. As CBO put it:

The large amounts of debt that would accumulate . . . imply that the government would have to spend increasing amounts to pay interest on that debt. The growth of debt would lead to a vicious cycle in which the government had to issue ever-larger amounts of debt in order to pay ever-higher interest charges.

CBO has noted that if the fiscal gap were closed by raising marginal tax rates, "incentives to work and save would be reduced and economic growth would slow." When asked to evaluate the economic impact of closing the fiscal gap solely through increases in marginal tax rates, CBO concluded:

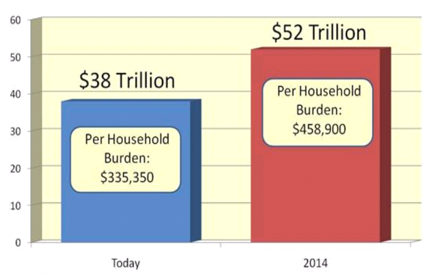
With no economic feedbacks taken into account and under an assumption that raising marginal tax rates was the only mechanism used to balance the budget, tax rates would have to more than double. The tax rate for the lowest bracket would have to be increased from 10 percent to 25 percent; the tax rate on incomes in the current 25-percent bracket would have to be increased to 63 percent; and the tax rate of the highest bracket would have to be raised from 35 percent to 88 percent. Such tax rates would significantly reduce economic activity and would create serious problems with tax avoidance and tax evasion. Revenues would probably fall significantly short of the amount needed to finance the growth of spending; therefore, tax rates at such levels would probably not be feasible.

Unfunded Liabilities. Another way of viewing the government's disastrous budgetary situation is by looking at its fiscal position the way a private company would. To do so, analysts focus on the "unfunded liabilities" of the Federal Government's major benefit programs. These liabilities reflect the excess of projected spending in these programs over the amount of revenue currently estimated to be available for them.

The problem is most acute in Medicare. Like Social Security, Medicare faces the daunting demographic challenge of supporting the baby boomers as they retire. But its much larger problem is that of medical costs, which are rising at roughly double the rate of growth in the economy. Today Medicare has an unfunded liability of $38 trillion over the next 75 years (see Figure 1). This means that the Federal Government would have to set aside $38 trillion today to cover future benefits for the three generations of Americans: retirees, workers, and children. This translates to a burden of about $335,350 per U.S. household. Moreover, the problem worsens rapidly: in just the next 5 years, by 2014, Medicare's unfunded liability is projected to grow to $52 trillion – or about $458,900 per household.

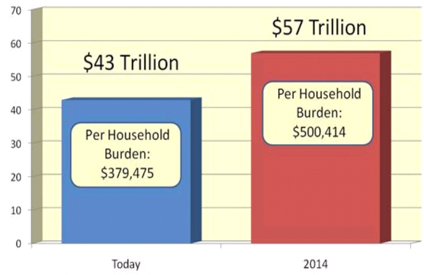
When Social Security and Medicare are taken together, the total unfunded liability is $43 trillion, or about $379,475 per household (see Figure 2). In the next 5 years, that total will grow to $57 trillion, or $500,414 per household.

Figure 1
Medicare's Unfunded Liability
(Over 75 Years)



Source: 2009 Medicare Trustees Report / Census

Figure 2
Social Security / Medicare Unfunded Liability
(Over 75 Years)



Source: 2009 Social Security Trustees Report / 2009 Medicare Trustees Report / Census

Without fundamental changes, the government would have to finance these obligations with higher taxes, higher debt, or a combination of the two. Either way, the results would be crippling for the U.S. economy: they would entail shifting unprecedented amounts of economic resources away from growth-generating activities of the private sector:

> [A]bsent a significant rise in revenue beyond the historical level of GDP, spending on Social Security, Medicare, and interest on the debt could squeeze out all other areas of the budget. Taxes could, in principle, be increased to cover these costs, but the unprecedented tax levels required would have an extremely negative impact on employment, wage growth, and our ability to compete internationally. Borrowing to pay for the programs, on the other hand, would lead to such high deficits that the debt would be unsustainable.

Debt. As noted, even if Congress and the President adopted huge tax increases – as much as $3 trillion over the next 10 years – government spending would still outpace this huge revenue increase. The result will be increasing government borrowing and debt. The accumulating debt will increasingly crowd out more productive private-sector investment, and thereby squeeze capital formation.

That in turn will lead to productivity declines and lower rates of real economic growth, materially affecting living standards. The U.S. already relies on foreign investors to finance about half of the Federal debt. As this debt rises, these investors will come to realize that the path of the deficit was unsustainable. As a result, foreign investors will likely reduce their purchases of U.S. securities, which could cause a reduction in the exchange rate of the dollar; interest rates could rise, and consumer prices would face upward pressure. With higher interest rates, sharp inflationary pressures, and a mix of fundamentals that will lower business profits, the stock market also would decline.

In short, the debt arising from government spending trends is sacrificing the prosperity of future generations. This trend is in place now, under current laws, and is inevitable without a fundamental transformation of America's domestic programs and spending. The current administration and Congress have not only ignored this crisis, but are hastening its approach with policies that vastly increase Federal Government spending.

Economic Consequences: Losing the American Legacy

The longstanding American economic tradition is simple: work to fulfill one's potential today, and make tomorrow better for the next generation. But the government's current fiscal path has put that legacy very much in doubt; and the added spending and debt sought by Washington's current leaders only make matters worse..

The debt impact described above reflects only the macro-economic consequences of the current fiscal trend. The effect on personal standards of living will be devastating, and it will be felt as those born today are completing college and beginning their careers. By 2050, workers and families will begin seeing the growth in their wages and incomes erode. Standards of living will begin to stagnate, and then decline in real terms. By 2058, the economy enters a free-fall, beyond which the catastrophe cannot be measured: CBO cannot model the impact because debt rises to levels the economy cannot support.

CBO also concluded that financing this unrestrained rate of Federal spending with higher marginal tax rates yielded results similar to those from financing it with debt: over the long run, the economy cannot sustain the tax rates needed to finance this spending. CBO focused on three points in time: 2030, 2050, and 2080. Analysts found that by 2080, income tax rates (individual and corporate rates) would have to more than double to fund the projected spending path. Specifically, the current 10-percent income tax bracket would rise to 25 percent, and the current middle bracket of 25 percent would have to increase to 63 percent. The current top rate of 35 percent would rise to 88 percent. These tax rates would end up sinking the economy, CBO concluded.

These rates also would more than double the income tax burden on the average family. Today, a family of four with a median income of roughly $66,000 pays slightly more than $3,100 in individual income taxes; applying the high-tax scenario to today's dollars, this family's income tax bill would jump to $7,750 – an increase of $4,650 (and this figure does not include payroll taxes).

This is the outlook under current fiscal policies; the expansions sought by Washington's current leaders will hasten the reckoning.

Erosion of American Character

During the 20th century, America created a safety net for those suffering hard times. Americans established the principle of retirement security through private savings, pensions, and the Social Security Program. In the 1960s, the government created health care programs for retirees, and those less well off.

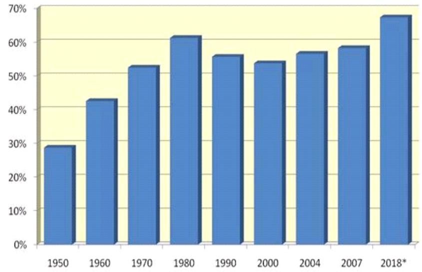
These missions are not in question. Reasonable minds differ about the extent to which government should be the main provider of these benefits. But the issue is becoming moot: the major entitlement programs have expanded beyond the government's ability to sustain them in the future. Trying to do so will bankrupt the country, and deprive the next generation of retirees the promised services for which they worked, and to which they contributed, all their lives.

More ruinous in the long run is the extent to which the "safety net" has come to enmesh more and more Americans – reaching into middle incomes and higher – so that growing numbers have come to rely on government, not themselves, for growing shares of their income and assets. By this means, government increasingly dictates how Americans live their lives; they are not only wards of the state, but also its subjects, increasingly directed in their behavior by the government's "compassion." But dependency drains individual character, which in turn weakens American society. The process suffocates individual initiative and transforms self-reliance into a vice and government dependency into a virtue. The Nation becomes a sort of vast Potemkin Village in which the most important elements – its people – are depleted by a government that increasingly "takes care" of them, and makes ever more of their decisions for them. They take more from society than they provide for themselves, which corrodes society itself, from the inside out. The environment also becomes ripe for exploitation and control by the few who remain "ambitious."

If the government continues following the "progressive" ideology now prevailing in Washington, America will increasingly resemble a European welfare-state – a society in which the majority of the people pay little or no taxes but grow dependent on government benefits; where tax reduction is impossible because more people have a stake in the welfare state than in free enterprise; where permanent high unemployment is a way of life; and where the spirit of risk-taking is smothered by a thick web of regulations and mandates from an all-providing centralized government.

The U.S. already has drawn perilously close to this "tipping point." The Tax Foundation estimates that today 60 percent of Americans receive more in benefits and services from the government than they pay in taxes. The President's fiscal agenda exacerbates this problem, raising the net reliance on government from 60 percent to 70 percent. Another analysis shows that from 1950 through 2007, the share of the population reliant on the government rose from 28.7 percent to 58.2 percent (see Figure 3). The study predicted that even without enactment of legislation such as cap-and-trade and health care, the share of the population dependent on the government will rise to 67.3 percent by 2018.

Figure 3
The 'Tipping Point'
(Percentage of Population Relying on Government)



Source: Gary Shilling's INSIGHT September 2009 * - Estimate

In the past, Democrats and Republicans, progressives and conservatives, understood the threat to the American character from uncontrolled government and redistribution programs. Even while developing his New Deal measures in the Great Depression, President Roosevelt – in words later repeated by President Reagan – warned:

> The lessons of history, confirmed by the evidence immediately before me, show conclusively that continued dependence upon relief induces a spiritual and moral disintegration fundamentally destructive to the national fiber. To dole out relief in this way is to administer a narcotic, a subtle destroyer of the human spirit. . . . It is in violation of the traditions of America.

Now America is drawing toward a "tipping point" for this culture of dependency. It is a line that, once crossed, precludes any likelihood of turning back.

Conclusion

This is the path on which America is now embarked. It creates a government that grows in size, scope, and influence to a magnitude unprecedented in peacetime. It generates unsustainable levels of spending and deficits, leading to a vicious cycle of unmanageable and ever-growing debt. This drags down the economy, causing standards of living to fall, leaving the next generation – for the first time in American history – worse off.

At the heart of all this is a growth of dependency on government, which erodes self-reliance and individual responsibility – and thus weakens America from the inside out.

BACK FROM THE BRINK: A ROADMAP FOR AMERICA'S FUTURE

But there is a choice. To pull back from the culture of dependency and its hazards requires a bold change of course. This proposal, A Roadmap for America's Future, is steered by the same compass that guided America's Founders – a restoration of the self-evident truths enshrined in America's most fundamental principles:

▫ As declared by America's Founders, the "laws of Nature and of Nature's God" are the surest touchstone for a just and free Nation.

▫ That all human beings are created with equal natural rights – to live, to be free, to acquire property and other means of seeking happiness, fulfilling human potential and satisfaction in one's achievements. The very idea of "equal rights" implies that individuals' results should differ from one another, because "justice" or "fairness" requires that each individual obtains what each has earned and merited.

▫ That the great purpose of government is to secure these natural rights: protecting each person's life, liberty, and freedom to pursue happiness is its high mission, true to America's founding. When government strays and expands beyond this limited mission, it does so at the expense of the people and the other institutions of American culture through which they live.

But as noted earlier, this is not a call to dismantle government. Rather, the vision of this plan reflects a view expressed by President Reagan more than a quarter century ago: "It is not my intention to do away with government. It is, rather, to make it work – work with us, not over us; to stand by our side, not ride on our back. Government can and must provide opportunity, not smother it; foster productivity, not stifle it."

The Founders enshrined in the U.S. Constitution the principles of a government drawing its legitimacy from the consent of the governed, of freedom, and of leaving future generations better off – the second and third of which are best captured by the phrase to "secure the Blessings of Liberty to ourselves and our Posterity."
The Founders also understood the importance and value of free enterprise. In addition to the Declaration of Independence, the year 1776 saw the publication of Adam Smith's treatise The Wealth of Nations, which argued in part that the "system of natural liberty," or free markets in commerce, would vastly increase national wealth. The Founders saw Smith not only as an economic thinker, but as a moral philosopher whose other great work was The Theory of Moral Sentiments. They were just as committed to an American economics of freedom as they were to American moral greatness. In Federalist 12, Hamilton wrote: "The prosperity of commerce is now perceived and acknowledged by all enlightened statesmen to be the most useful as well as the most productive source of national wealth, and has accordingly become a primary object of their political cares."

Economic arrangements – systems of commerce, however large or small – are as important to the organization of societies as are governments. That is why some of the greatest political and economic thinkers – Weber, Durkheim, Hayek, Friedman, and others – examined economic and social systems as a starting point for evaluating their politics. History has shown that politically free societies demand free markets, and vice versa: each validates and reinforces the other. It is this combination of political liberty and free enterprise that made America the world's economic leader in the 20th century.

The attack on economic freedom has always revolved around its moral standing: the system is blamed for promoting greed, dishonesty, materialism, social Darwinism, and indifference to society's most vulnerable. Such critics express their wish for the supposed higher morality of collectivist forms of government. With the demise of the Soviet Marxist experiment 20 years ago, the appeal has shifted to European-style socialism, with its redistribution of resources. But no collectivist approach has ever come close, over the long run, to matching free-market democracy's ability to produce and create widespread prosperity – and there is genuine, and often overlooked, moral virtue in this:

> It may have been John Locke (1632-1704) who first articulated the new possibility for economic organization. Locke observed that a field of, say, strawberries, highly favored by nature, left to itself, might produce what seemed to be an abundance of strawberries. Subject to cultivation and care by practical intelligence, however, such a field might be made to produce not simply twice but tenfold as many strawberries.

Human productivity, through the cultivation of resources, fulfills nature's promise: "There was born in Locke's vision a novel and invigorating sense of the human vocation. . . . The vocation of the human being came to seem ennobled. . . . to be inventive, prudent, farseeing, hardworking." Free markets and private property promote this vocation by rewarding individual initiative; and individuals' productivity benefits the entire society.

The prosperity that market freedom produces offers non-material benefits as well. First, it creates expanding opportunities so that no individual or family is bound to their circumstances: they can advance, they can improve their conditions, through their own efforts. Only a growing economy can create the opportunities in which personal advancement can become a reality.

Second, such growth helps maintain individuals' confidence and trust in the system of political freedom to which they belong: "[L]egitimacy flows from the belief of all individuals that they can better their condition. This belief can be realized only under conditions of economic growth. Liberty requires expanse and openness."

Nevertheless, government does have important roles. Government must secure property rights, enforce laws that protect individual freedoms and personal security, and provide for the society's defense. It can play a useful role in providing for needed public works. It must also ensure a safety net, maintained by government if necessary, for those facing financial or other hardships.

Less obvious is that it is up to government to ensure the maintenance of a competitive, free market system. The participants will always seek advantages over their competitors – even through anti-competitive means (monopolies, trade barriers, and so on) – and only the government can prevent this. While government should limit itself to maintaining the rules of the game – not choosing winners and losers – it should maintain those rules with conviction: it is government's responsibility to uphold the principles of free and competitive markets.

The discussion below describes the effect of these understandings, these First Principles, on public policy, fiscal policy, the economy, and the American character.

Public Policy: Limited Government

Often lost in the "size-of-government" debate is that limited government does not mean weak government. When government is limited to a smaller number of tasks, it can do them well. Limiting government leaves more room for the exercise of economic freedom, and greater vitality in the other key institutions through which Americans live, including family, community, vocation, and faith. When government expands, it encroaches on one or more of these institutions, as expressed, in economic terms, as follows:

Grover Cleveland once asked, "If the government supports the people, who will support the government?" His meaning was this: The government is wholly dependent upon tax receipts (or occasionally other types of payments) for its revenues. It is a nonsensical reversal of roles for the people to be dependent upon the government for their material well-being. To put it yet another way, the government produces no goods; rather, it consumes some portion of the goods taken from the people. It can only play a larger role by increasing the portion that it takes and thus reducing the amount available to the people generally.

The purpose of limiting government is to enhance and strengthen the role of these fundamental institutions, resulting in greater prosperity and happiness.

The strategy of A Roadmap for America's Future applies this vision to the major domestic challenges facing America. The policies are described in detail later in this report. To summarize:

▫ **Health Care**. Empowering consumers – patients – is the critical element in restraining the growth of health costs without government rationing, and removing the distortions in the health sector that have resulted from excessive government involvement. Also necessary is the restructuring of medical entitlements and tax preferences, which are pushing costs upward. Without concurrent reform of these programs, any attempt to slow medical cost growth and expand access to coverage will fail.

▫ **Retirement Security**. Social Security, too, must be reformed to be saved; but equally challenging is the question of whether the economy itself will be capable of generating sufficient resources to support the growing population of retirees. Restructuring Social Security will allow market forces to strengthen its financial underpinnings, making it sustainable for the long run, while helping expand investments needed for future economic growth.

▫ **Tax Policy**. The U.S. tax code is needlessly complex and non-competitive. Taxes must be levied to finance the government; but government should do so in a way that imposes the least burden on work, saving, and investment.

▫ **Job Training**. To help the Nation's workforce prepare for success in the global economy, the Roadmap transforms 49 job training programs, scattered across eight agencies, into a flexible, dynamic program focused on results, and accompanied by clear measures of transparency and accountability. The plan requires the development of performance measures, and gives each State the option to consolidate funding into one program, if such an approach can be shown to improve outcomes and achieve job training goals.

Fiscal Consequences: A Sustainable Path

As shown in the previous discussion, the government's current fiscal path threatens a national economic catastrophe. The Roadmap charts a path of fiscal sustainability first by gaining control of explosive spending growth. Next, it avoids a rapid increase in the tax burden by holding revenues to roughly their historical average. The result is that interest and debt accumulate at much slower rates than projected under current fiscal policy, and actually begin to decrease after peaking in mid-century.

Under this plan, Federal spending peaks in 2033 at 24.1 percent of GDP. With revenue projections never exceeding 19 percent of GDP, this means the largest deficit faced under this plan is 5.1 percent of GDP. Although this number is large (the 50-year historical average is just over 2 percent of GDP), recent history shows it is sustainable for a short period. (In 1983, the Federal Government ran a deficit of 6 percent of GDP, and last year the deficit surged to a post-World War II high of 11 percent of GDP.)

Figure S-2
Federal Government Spending
(As Percentage of GDP)

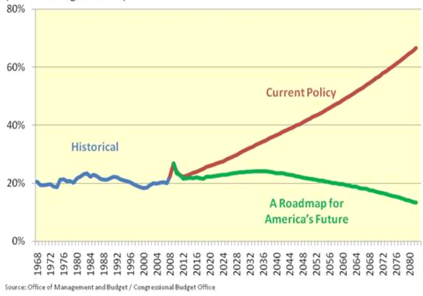
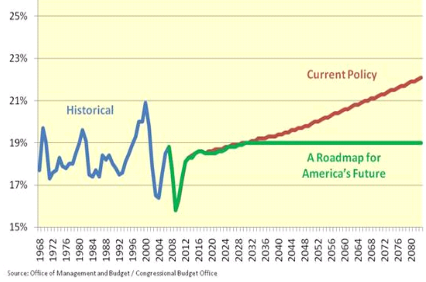


Figure S-3
Federal Government Tax Revenue
(As Percentage of GDP)



What is important about this plan, however, is not how it compares with the past, but how it compares with the trajectory under current policy. Absent policy reforms, the Federal Government will face a deficit of 6.2 percent of GDP in 2022, which will then swell to nearly 20 percent of GDP in 2041, and continue growing to more than 50 percent of GDP in 2083. In contrast, deficits in the Roadmap peak in 2041 and then begin a rapid decline until the budget reaches surplus. Although the plan continues projecting revenues at 19 percent of GDP, Congress should seriously consider reducing taxes when surpluses are achieved.

Similarly, the Roadmap keeps debt held by the public from spiraling to unsustainable levels. Under current policy, debt held by the public soars to the improbable level of more than 750 percent of GDP (though the economy would crash well before this level were reached). As CBO notes in The Long-Term Budget Outlook, countries that carry debt of more than 100 percent of GDP must change their fiscal policies because those levels are not sustainable over the long run. The Roadmap also slows the accumulation of debt held by the public, and eventually reduces debt year-over-year beginning just before the middle of the century.

Figure S-4
Long-Term Deficits
(As Percentage of GDP)

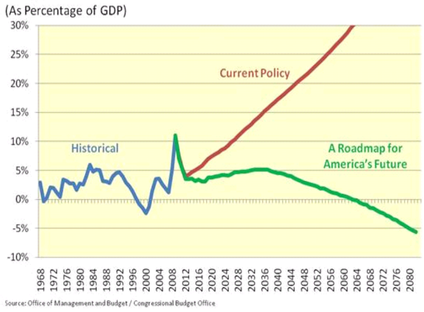
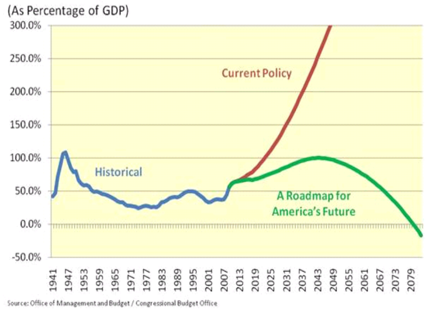


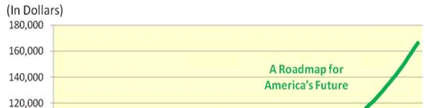
Figure S-5
Debt Held by Public
(As Percentage of GDP)

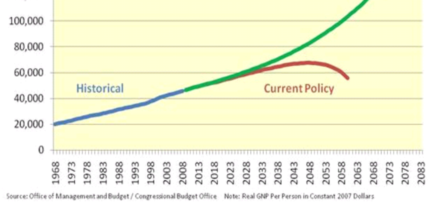


Economic Consequences: Maintaining the American Legacy

Although deficit and debt levels rise moderately in the Roadmap, CBO concluded the economy could sustain them, and would be "considerably stronger" than under current policy. Most important, real living standards continue to increase under this budget path. Data from CBO show that, under this scenario, the standard of living for a child born today would double (i.e. per-capita output would rise from $45,000 to more than $90,000) by the time he or she reached middle age, just after the middle of the century. In this way, the sustainable budget path continues the American legacy of providing the next generation with the opportunity for continued prosperity. This contrasts with current fiscal policy, which leads to stagnant, and declining, standards of living.

Figure S-1
Economic Growth Per Capita
(In Dollars)





In short, unlike the current fiscal path, the Roadmap supports the distinctly American legacy of leaving the next generation better off.

Moral Consequences: Restoring the American Character

In the Nation's first inaugural address, President Washington said:

> [T]he foundation of our national policy will be laid in the pure and immutable principles of private morality . . . [T]here is no truth more thoroughly established than that there exists in the economy and course of nature an indissoluble union between virtue and happiness . . . [T]he propitious smiles of Heaven can never be expected on a Nation that disregards the eternal rules of order and right which Heaven itself has ordained.

Consistent with this is the longstanding recognition among Americans that freedom and responsibility are two sides of the same coin. If one exercises liberty irresponsibly – ignoring consequences, and refusing to accept them – that freedom eventually will be lost. On the other hand, only by taking responsibility for oneself, to the greatest extent possible, can one ever be free; and only a free person can make responsible choices – between right and wrong, saving and spending, giving or taking. These moral characteristics inhere in individuals, growing from the coupling of freedom and responsibility; and this in turn is the root of the Nation's virtue.

Throughout history, Americans established world standing as a people of exceptional character. In the 1830s, Tocqueville wondered about the heedlessness of frail Yankee clippers that sailed the world for 2 years so they could sell Chinese tea in Boston for a penny a pound less than English merchants. "Americans put a sort of heroism into their manner of doing commerce," he said. A French observer around 1890 said Americans succeeded because of their "character, personal energy, energy in action, creative energy"; and another in 1908 praised "the greatness of the United States . . . ready for any kind of enterprise."

America's democratic character opposes militarism and prefer the pursuits of peace and prosperity. Still, since the American Revolution, America's national character has sustained U.S. citizens in long struggles to keep the Nation free, independent, and safe.

The late Nobel Laureate Alexandr Isayevich Solzhenitsyn, soon after being expelled from Russia by the Soviet government, assessed the American character this way:

> The United States has helped Europe to win the First and Second World Wars. It twice raised Europe from postwar destruction – twice – for 10, 20, 30 years it has stood as a shield protecting Europe while European countries counted their nickels to avoid paying for their armies (better yet, to have none at all), to avoid paying for armaments, thinking about how to leave NATO, knowing that in any case America will protect them . . . The United States has long shown itself to be the most magnanimous, the most generous country in the world. Wherever there is a flood, an earthquake, a fire, a natural disaster, an epidemic, who is the first to help? The United States. Who helps the most, and unselfishly? The United States.

This is the character on which the policies described in this report are built. Its approach draws from, and reinforces, the most real source of America's strength: its people, acting through family, community, vocation, and faith – with a limited government supporting the growth of these most important institutions. It promotes personal liberty and initiative, coupled with personal responsibility. It rewards work, saving, and investment, so individuals can experience the satisfaction of enjoying the fruits of their own labor, and providing a better life for their children and future generations.

THE NEED TO ACT NOW

America is not the servant of inexorable historical forces. Americans make history, by their choices and actions in a free society that rewards personal initiative, promotes individual responsibility, and provides expanding opportunities.

The two futures described here entail such a choice – one of historic dimensions. The challenge is long term, but the need to address it is urgent. The longer policymakers delay, the worse circumstances will become. Avoiding reforms of the government's major entitlement programs does not protect them. Indeed, a failure to reform puts those programs, and their benefits, in greater jeopardy; and the longer reform is delayed, the more wrenching the inevitable changes will be. CBO has described the accumulating hazards of the current path this way:

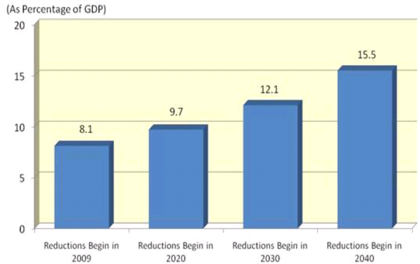
> The longer that policy action on the budget is put off, the more costly and difficult it will be to resolve the long-term budgetary imbalance. Delays in taking action would create three major problems:
>
> The amount of government debt would rise, which would displace private capital – reducing the total resources available to the economy – and increase borrowing from abroad.
>
> The share of Federal outlays devoted to paying interest on the Federal debt would grow, so lawmakers would have to make ever-larger policy changes to achieve balance. As interest costs rose, policymakers would be less able to pay for other national spending priorities and would have less flexibility to deal with unexpected developments (such as a war or recession). Moreover, rising interest costs would make the economy more vulnerable to a meltdown in financial markets.
>
> Uncertainty about the economy would increase. The longer that action was put off, the greater the chance that policy changes would ultimately occur suddenly, possibly creating difficulties for some individuals and families, especially those in or near retirement. [Italics added.]

CBO also has quantified the cost of delay, as reflected in Figure 9. It shows that waiting just 11 years to take action increases by nearly 20 percent the amount of spending reductions or tax increases (as a percentage of GDP) needed to close the fiscal gap. Waiting until 2030 increases the amount by about 50 percent; and waiting until 2040 nearly doubles the spending cuts or tax hikes needed to close the gap.

Figure 4

The Cost of Delay: Non-Interest Spending Reduction or Tax Increase to Close Fiscal Gap

(As Percentage of GDP)



Source: Congressional Budget Office

It may seem unlikely that the United States' standing in the world ever could be seriously threatened. America's exceptionally resilient economy and extraordinary industrial and technological might have overcome economic and military crises before, and surely can do so again. But history's greatest powers have fallen in very similar circumstances; and historian Niall Ferguson has warned that the Federal Government's current fiscal path, and the debt accumulating from it, could have the same corrosive effect on America:

If the United States doesn't come up soon with a credible plan to restore the Federal budget to balance over the next 5 to 10 years, the danger is very real that a debt crisis could lead to a major weakening of American power.

The precedents are certainly there. Habsburg Spain defaulted on all or part of its debt 14 times between 1557 and 1696 and also succumbed to inflation due to a surfeit of New World silver. Prerevolutionary France was spending 62 percent of royal revenue on debt service by 1788. The Ottoman Empire went the same way: interest payments and amortization rose from 15 percent of the budget in 1860 to 50 percent in 1875. And don't forget the last great English-speaking empire. By the interwar years, interest payments were consuming 44 percent of the British budget, making it intensely difficult to rearm in the face of a new German threat.

Call it the fatal arithmetic of imperial decline. Without radical fiscal reform, it could apply to America next.

Nor will small or incremental actions suffice. "The American people know – or sense – that there is something wrong," former Comptroller General David M. Walker has said. "[W]e cannot grow our way out of this problem; eliminating earmarks will not solve the problem; wiping out fraud, waste, and abuse will not solve the problem; ending the war or cutting way back on defense will not solve the problem; restraining discretionary spending will not solve the problem; and letting the recent tax cuts expire will not solve this problem."

But in fact, transformation need not be some radical departure from American tradition. It does not require abandoning the commitments Americans made throughout the 20th century, or the missions of the government's major benefits programs. Instead it should rely on the fundamental strengths that have always brought out the best in American society: a reliance on individual creativity in free markets and a free society, with government maintaining the economic rules, and a sturdy safety net for those who need it. It is the kind of restoration called for in this proposal and described in this report.

There is still time to change America's course – but that time is not unlimited. Guided by the idea of equal freedom of opportunity, A Roadmap for America's Future represents a plan to break away from the current path of national decline; to put America on a path to fiscal sustainability; and to reach new heights of prosperity, restrained by nothing but the limits of human imagination.

Today's Major Domestic Challenges

The principles described in the previous section could be applied to the challenges specific to any point in history. Today – and with respect to this proposal – they are aimed at health care (including the Federal Government's medical entitlements), retirement security, taxes, and job training.

To address these areas properly, the discussion below summarizes the particular nature of the problems in each. The text also examines the broader questions of government spending in general and America's challenges in the global marketplace of the 21st century, and concludes with a discussion of why it is necessary to take action now.

THE STATE OF HEALTH CARE TODAY

Overview

The rising cost of health care in the United States is the fastest-growing burden on families, businesses, governments, and the economy. In 2007, the U.S. spent an estimated $2.1 trillion to provide, administer, and finance health care – nearly twice the amount per capita spent by any other industrialized nation in the world. Moreover, the rapid growth of health care costs – about 7 percent per year – is eroding paychecks for millions of Americans; and skyrocketing insurance costs are overburdening businesses across the U.S., and in 2010, 50 million people – 19 percent of the non-elderly population – will lack access to health insurance at some time during the year.

Even with public health programs such as Medicare and Medicaid, families and individuals face increasingly limited access to care and coverage. State budgets are unable to keep pace with the financial resources these programs demand while the number of physicians and health care practitioners choosing to participate are steadily declining. Failed Federal policies and inadequate reimbursement levels are threatening the existence of these programs for future generations.

The personal realities of this crisis also have a distressing effect on U.S. economic stability. The Federal Government devotes 21.7 percent of its budget to the two major health entitlements, Medicare and Medicaid, which is more than national defense (17.8 percent, including war costs). Overall health care costs are absorbing 15.2 percent of national gross domestic product [GDP]. If the status quo continues, health care costs will consume 20 percent of GDP by 2016.

Rising health care spending also is the major contributor to the unsustainable projected increases in the Federal Government's two major health programs, Medicare and Medicaid, which are the main contributors to projected chronic Federal budget deficits. The effect of this spending growth is even greater than that of lengthening life-spans and the forthcoming retirement of the baby boomers. "Long-term deficits are driven not only by the aging of the population," says Dr. Isabel V. Sawhill, senior fellow at the Brookings Institution. "[T]hey are much more driven by increasing health care costs per capita . . . The demographics play a role. But if you look at the numbers carefully you will see that the problem has been health care spending per capita that has been growing 2 to 3 percent faster than per-capita incomes or per-capita GDP." During the period 1999 through 2008, the monthly premium for seniors who participate in Medicare has risen at nearly the same rate as those in private insurance, from $45.50 to $96.40.

Furthermore, the government health programs rely on the infrastructure of private health care. As noted by the Congressional Budget Office [CBO]: "[M]ost [public] services are furnished by private providers. For example, Medicare and Medicaid beneficiaries receive most of their care from physicians, hospitals, and other providers that deliver services to the general population." Therefore, inadequacies or inefficiencies in private health care services affect Medicare and Medicaid as well. It is another reason why correcting problems in the government health entitlements also requires addressing inefficiencies in the market.

But if rising private health costs drive the growth of Medicare and Medicaid spending, the converse also is true: Medicare and Medicaid themselves contribute in their own way to medical inflation. These two programs account for roughly 37 percent of all health care spending nationally (including the State share of Medicaid), according to the most recent figures from CBO. Another 10 percent comes from other public programs, including those of State and local health departments, the Department of Veterans Affairs, and workers' compensation. Such large infusions of government funds inevitably stoke rising medical costs.

CLICK HERE TO VIEW TABLE

Also noteworthy is that real per-capita growth in Medicare and Medicaid spending has outpaced that occurring in the market (see Table 4). This demonstrates that government spending tends to be less efficient than spending in the market. Hence, overall medical costs cannot be tamed without also addressing the structure of the Federal health entitlements.

Failings of Recent Health Care Proposals

The overhaul legislation considered in Congress during the past year failed to correct the fundamental problem in U.S. health care: the distortions of the health care market created by ever-deepening government intrusion. Instead, it sought to expand the government's role, impose further regulation, as well as job-killing taxes on small businesses. It failed to bend down the medical "cost curve," meaning more rapid cost increases, resulting in government rationing and price setting. As recently summarized about the legislation under consideration:

> [I]ts principles are a reprise of previous reforms – addressing access to health care by expanding government aid to those without adequate insurance, while attempting to control rising costs through centrally administered initiatives. Some of the ideas now on the table may well be sensible in the context of our current system. But fundamentally, the "comprehensive" reform being contemplated merely cements in place the current system – insurance-based, employment-centered, administratively complex. It addresses the underlying causes of our health-care crisis only obliquely, if at all; indeed, by extending the current system to more people, it will likely increase the ultimate cost of true reform.

It also sought to establish a huge new government entitlement, and aimed to drive private insurance out of the market. The proposals were rooted in an ideological view that always sees government as the necessary solution to any significant problem.

The Real Sources of America's Health Care Problem

The problems in American health care have been caused not by a failure of the health care market, but mainly by distortions imposed on the market from several directions; and the most significant of these are Federal tax subsidies and programs that have created a third-party payment system, which insulates consumers from prices and market forces. As one description puts it:

> All of the actors in health care – from doctors to insurers to pharmaceutical companies – work in a heavily regulated, massively subsidized industry full of structural distortions. They all want to serve patients well. But they also behave rationally in response to the economic incentives those distortions create. Accidentally, but relentlessly, America has built a health-care system with incentives that inexorably generate terrible and perverse results. Incentives that emphasize health care over any other aspect of health and well-being. That emphasize treatment over prevention. That disguise true costs. That favor complexity, and discourage transparent competition based on price or quality. That result in a generational pyramid scheme rather than sustainable financing. And that – most important – remove consumers from our irreplaceable role as the ultimate ensurer of value.

At the heart of the problem is the Federal tax exclusion for employer-provided health coverage. This policy undermines the health care market by hiding the true cost of insurance from those covered by it, and contributing to more expensive care and more costly insurance. As C. Eugene Steuerle of the Urban Institute describes it:

> The exclusion is open-ended. The more insurance we buy, the larger the amount of income we get to exclude from tax and the more the government subsidizes us. The exclusion favors most those of us who have the most generous health insurance policies. Moreover, because more insurance means that we face even less of the cost of what we buy – we and our doctors now bargain over what the plan, not us, will pay – we demand more care and more expensive care. . . . Additionally, the increased demand for health care tends to encourage growth in the health care sector in a less than optimal way. For instance, it tends to encourage suppliers of medical care to increase the quantity of what we get, with less incentive to increase quality.

One reflection of the problem is the dramatic decline in private and personal out-of-pocket spending for health care – even for routine procedures – while government spending has steadily grown:

From 1975 to 2007, the share of total health care spending that was financed privately shrank slightly, dropping from 59 percent to 54 percent, while the share that was financed publicly expanded correspondingly, increasing from 41 percent to 46 percent. During that period, consumers' out-of-pocket payments fell from 31 percent of total expenditures to 13 percent, and payments by private insurers rose from 25 percent to 37 percent.

The combination has encouraged overuse of health care services. "Because so many Americans rely on an insurance policy or a government program to pay their health care bills, the internal governors that temper the rest of their purchases are turned off," writes Investors Business Daily. "When a visit to the doctor's office or a diagnostic test costs them a mere $10 or $20 co-payment out of pocket – or there is no charge at all – cost has little impact on their decision to see a doctor."

The tax policy that contributed to all this came about not by plan, but as an accident of historical events. During the Second World War, when the Federal Government imposed wage and price controls, employers sought to attract workers from a tight labor pool by offering modest health coverage, and excluding the costs from wages. When these employers sought endorsement of the practice from the Internal Revenue Service [IRS], the IRS approved. After the war, when the IRS tried to rescind this decision, Congress wrote it into law. The exclusion, which this year totals an estimated $155 billion, has made employer-provided coverage the most common form of health insurance.

Although the employer-based tax benefit has been important to the provision of health care, it has evolved into an expensive, inflexible, and unfair subsidy. It also contributes to the insecurities felt by those who have employer-based health insurance, because they fear sacrificing coverage if they lose or change jobs.

The tax provision also has failed to encourage the expansion of health coverage. Since 2000, the percentage of businesses offering health benefits has fallen 69 percent – mainly due to the continued rise in insurance costs. Rising costs also make health coverage unaffordable to many small businesses, self-employed persons, and low-income persons. Indeed, the current tax policy actually increases the number of the uninsured:

> As the increased amount of money spent on the exclusion effectively increases the average cost of health care and of health care insurance, the greater the number of individuals in the economy who forego purchasing private health insurance. Not only are low-income people more likely to avoid purchasing health insurance, but many middle-class people and people between jobs decide to take a chance and save the amount of the health insurance premium. Employers, beset by demands from their workers for cash wages, are also more likely to drop health insurance. At times, this happens directly, but more often than not it works its way into the system indirectly. The company with expensive

health care insurance reduces the number of its employees, or, if growing, tries to outsource to groups for whom it does not have to pay for insurance. New companies without health insurance displace older ones that carry health insurance.

The third-party insurance arrangement also sharply reduces the options of health coverage packages available. Americans are limited in their choices of health insurance plans based on what their employers can afford – if a health plan is even offered at all. Consequently, Americans are deprived of a diverse health insurance market in which they can find affordable coverage options truly suited to their needs.

Adding to the problem is the lack of transparency in health care price and quality data, which further prevents patients from making the kinds of judgments they do in purchasing other services. For example, in the Milwaukee, WI area a heart bypass operation costs $100,000 at one hospital, while the same procedure costs $48,000 at another. Yet patients, and sometimes even doctors, are unaware of this difference.

Obviously, nearly all patients would rely on third-party coverage for such an event; it is the kind of episode for which consumers most need insurance. But because prices are opaque, patients have no incentive even to consider and compare them – let alone variations in the quality of services – in choosing where to undergo such procedures.

Medicaid

In fiscal year 2009, 67.8 million people were enrolled in Medicaid at some time during the year. Some 34 million of these beneficiaries were children, and 18 million were adults in families with dependent children. The program has provided Americans of limited means access to health care they could not have obtained otherwise.

But Medicaid spending, too, is spiraling out of control: it is growing at a rate of about
7.5 percent per year, and the combined Federal and State costs to run this program in fiscal year 2008 was $353 billion. As a share of total economic resources, Medicaid spending is projected to increase from 3 percent of GDP today to 5 percent by 2035, and 15 percent by 2080. State budgets are overwhelmed with these costs and Federal officials are struggling to meet the growing fiscal needs required to keep this program running. States are trying to shift their Medicaid costs to the Federal Government.

At the same time, Medicaid has fostered a two-tiered hierarchy within the health care marketplace that stigmatizes Medicaid enrollees. Providers are paid based on bureaucratically determined formulas that do not reflect the market. As a result, fewer and fewer providers are willing to participate in the program, meaning longer lines for beneficiaries, fewer operational clinics, and insufficient care.

Patients suffer as a result. With administrators looking to control costs and providers refusing to participate in a system that severely under-reimburses their services, Medicaid beneficiaries ultimately are left navigating an increasingly complex system for even the most basic of procedures.

Medicare

When President Johnson signed Medicare into law more than 40 years ago, he cited a principal goal of the program that cannot be achieved under its current spending path: “No longer will young families see their own incomes, and their own hopes, eaten away simply because they are carrying out deep moral obligations to their parents, and to their uncles, and their aunts.” Absent reform, the program will end up delivering exactly what it was created to avoid: it will consume the prosperity of today’s younger generation to finance an unsustainable path of spending.

Medicare was created with the worthy mission of providing health coverage for America’s retirees, and for many it has done so. But the program suffers from unsustainably rapid spending increases that continue to drain economic and fiscal resources on its way to insolvency. In short, the program, as currently structured, cannot keep its promises to future generations.

The cost of Medicare has always been higher than expected. For example, in 1965 it was estimated that benefit payments for Medicare’s Hospital Insurance [HI] program would total $8.8 billion in 1990. The actual spending was $65.7 billion (see Table 5). Today, Medicare outlays are growing at a rate of 7.2 percent per year, more than twice the average rate of current real GDP growth. Over the next 25 years, Medicare spending as a share of the economy will nearly triple – from 3 percent of GDP today to 8 percent by 2035. By 2080, it will have grown to 15 percent of GDP.

CLICK HERE TO VIEW TABLE

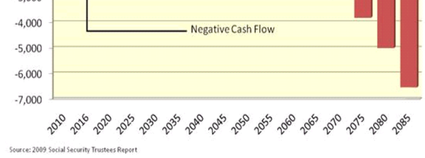
To rescue Medicare from financial collapse requires transforming the program to make it financially sustainable, and more consistent with the character of medical care in the
21st century.

RETIREMENT

In 1935, the year Social Security was enacted, there were about 42 working-age Americans for each retiree. The average life expectancy for men in America was 60 years; for women it was 64. With these demographics, it was easy for the program to generate sufficient revenue to meet its promises to those over 65. The initial Federal Insurance Contributions Act [FICA] tax rate was 1 percent each for workers and employers, up to $3,000 of income.

But even President Roosevelt knew this could not last. “Roosevelt himself saw that while the program’s revenues might cover its costs now, the numbers from the actuaries suggested that there would not be enough money for old-age pensions for future generations.”

President Roosevelt was right; and today, the challenge facing Social Security is more inexorable than at any time in the past – including its near-collapse of 1983. What’s more, the risk to Social Security is nearer at hand than most acknowledge. Due to the recession, Social Security surpluses will disappear in 2010 and 2011, with small and declining surpluses after that. By 2016, the program will hit a permanent “negative cash flow” – when annual benefit payments exceed annual payroll tax revenue – less than a decade from now. (See Figure 5.)



The cash flow trend is significant for the following reasons. Since the 1983 Social Security reform, the program’s trust fund has run substantial cash surpluses: it has been collecting significantly more in dedicated tax revenue than it needed to pay annual benefits. These cash surpluses were “borrowed” by the general fund to finance other government programs, and were replaced by government bonds that promised the cash would be returned when needed, with interest.

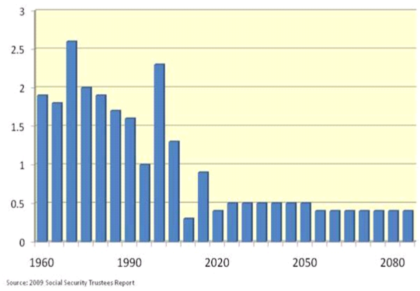
For the next 2 years, and starting permanently in 2016, Social Security will have to begin redeeming the trust fund bonds that have accumulated in recent decades. This will lead to one of four options, or some combination: 1) other government programs will have to be squeezed to finance Social Security; 2) taxes will have to rise sharply to cover benefits; 3) benefits will have to be cut; or 4) the government will have to run large and chronic deficits to pay Social Security benefits. By 2037, the Social Security Trust Fund will be exhausted and the program will be unable to pay all its promised benefits. Without reform, benefits will have to be cut by 24 percent, or payroll taxes raised by 31 percent.

The latter would tear the social fabric of the program itself. “Hiking payroll taxes is neither an economically sound nor a generationally equitable option.” says Robert L. Bixby, Executive Director of the Concord Coalition. “The burden will fall most heavily on lower- and middle-income workers and on future generations. Younger Americans in particular will be skeptical of any plan that purports to improve their retirement security by increasing their tax burden and by further lowering the return on their contributions.”

As is well known, a major part of the problem is demographic. The first members of the baby-boom generation – those born between 1946 and 1964 – are now eligible for early retirement. At the same time, life expectancies now average 75 years for men and
80 years for women – and these too are expected to lengthen. These factors result in a permanent, long-term shift in which the percentage of the U.S. population over 65 will grow from 12 percent in 2007 to 19 percent by 2030, and the share of those who are 20 years old to 64 years old is projected to decline from 60 percent to 56 percent. The effect on Social Security translate as follows: today there are only 3.3 workers for each Social Security beneficiary, and that number is projected to fall to 2.2 by 2030, and continue dropping thereafter. These figures compare with the 42 workers per Social Security-eligible retiree in 1935, and 16 workers per beneficiary in 1950.

This demographic realignment is not a temporary phenomenon, associated solely with the retirement of the baby boomers, but a long-lasting shift; and it is more than a problem just for Social Security or Federal Government spending: it poses a challenge to the economy to generate sufficient resources to support the income and health needs of a growing population of retirees. Long-term economic growth depends on two factors: employment growth and productivity growth. But employment growth is tied to an expanding labor force, which under current projections is expected to decline (see Figure 11). Additionally, there has been a demographic shift to a lower retirement age. In 1945, the average age of retirement was 69.6 years; in 2007, it was 63.6 years. As the nonworking-age population grows, there will be lower labor force participation and therefore lower per-capita output. The economy will need some means of boosting labor-force growth, or compensating for the lack of it, to support future retirees.

Figure 6
Historic and Projected Labor Force Growth
(As Percentage Change)



But even if the prospects for economic growth could be vastly improved – by enhancing productivity and wages, for example – it would not ease the problem with Social Security, because the program’s benefits are partly indexed to such economic factors. “[B]ecause of the structure of Social Security, that growth in productivity and wages automatically translates into higher future benefits, offsetting a significant portion of the fiscal gains from a larger economy,” says a recent paper by the Brookings-Heritage Fiscal Seminar. “In short, if the status quo continues and entitlement programs are not reformed, there is no feasible growth rate of the economy that will produce a sustainable budget path.”

The combination of demographic and benefit patterns will drive total Social Security spending to unprecedented levels. CBO estimates that: “[U]nless changes are made to Social Security, spending for the program will rise from 4.3 percent of GDP in fiscal year 2008 to 6.0 percent by 2035. Spending for Social Security will dip slightly as members of the large baby-boom generation die, but it will then resume its upward course because of increasing longevity, reaching 6.1 percent of GDP in 2080.”

There are other reasons to reform Social Security.

First, the current program is not a good deal for workers. For the average individual currently paying in to the system, the real rate of return from Social Security is between
1 percent and 2 percent. For some individuals, particularly younger ones, the rate of return is expected to be negative. By contrast, the average rate of return from the stock market since 1926 has been at least 7 percent, even taking into account significant stock market decline, including that of 2008.

Second, the current system is unfair to minorities. The projected shorter life expectancies of minorities significantly reduces their benefits compared with Caucasians. For example, a 30-year old white man with average earnings and average life expectancy will receive nearly $70,000 more in lifetime Social Security benefits than an African American man with the same characteristics.

Third, today’s workers have no legal rights to the taxes they have paid into Social Security. According to the Supreme Court in Flemming v. Nestor, workers and their families have no legal claim on the payments that they make into the U.S. Treasury. As a result, Congress is free to change these benefits at any time.

Finally, Social Security benefits are not inheritable. A worker may pay into the Social Security system for a lifetime and have nothing to pass on to heirs – in stark contrast with other types of retirement funds that are inheritable.

TAXES

While government spending drives the need to tax (or borrow), the Federal tax code as currently written will become a kind of “revenue machine,” claiming ever-growing shares of individuals’ income and the economy’s resources. Under current-law projections by CBO, tax revenue is scheduled to approach an unprecedented one-fourth of GDP by mid-century. To put this in context, Federal revenue has exceeded 20 percent of GDP only once since World War II, reaching 20.9 percent of GDP in 2000.

The start of this reckoning is near at hand. As Professor Michael J. Graetz of Yale Law School has put it:

> [T]he scheduled expiration in 2010 of large tax cuts enacted in 2001 and 2003 builds a large tax increase into the current tax law. If Congress fails to act, income tax rates will rise, as will tax rates on capital gains and dividends, and people will lose many current benefits, including credits for children and relief from marriage penalties. Under current law, the estate tax exemption rises to $3.5 million next year with a 45-percent top rate, the tax is repealed in 2010, and in 2011 the tax comes back with a $1 million exemption and a 55 percent top rate. . . . And, as this committee knows well, the alternative minimum tax [AMT] is currently structured in a way to catch millions more Americans and must be fixed or repealed.

The AMT is in fact a perfect example of the faulty assumptions in Federal tax law. When originally enacted, the tax was designed to prevent a small number of high-income individuals from avoiding taxes by manipulating the complex rules of an already flawed tax code. But because Congress failed to index the AMT for inflation, the tax threatens, every year, to ensnare millions of middle-income families. CBO estimates that, if left unchanged, the AMT would hit about two-thirds of American taxpayers by 2050. Nearly everyone agrees this scheduled AMT expansion is illegitimate; and though each year Congress has tried to "patch" the AMT, its expected revenue increase is built into current law projections, creating a presumption of higher revenue that masks the magnitude of budget deficits that the current path of government spending will create.

In addition, individual income taxes are needlessly complex, riddled with special provisions that manipulate individuals taxpayers' behavior and reduce economic efficiency. Professor Daniel N. Shaviro of the New York University School of Law has testified: "[T]he tax system needlessly aggravates and complicates the lives of lower and middle income taxpayers. Congress can and should address this, by making filing and compliance less painful, even insofar as taxes paid by such individuals remain approximately constant."

When the U.S. tax code was established in 1913, it contained roughly 400 pages of laws and regulations. Since then, the Federal tax code has grown exponentially and stands at more than 70,000 pages today. Since 2001 alone, there have been more than 3,250 changes to the code, or more than one per day. Many of the major changes over the years have involved carving out special preferences, exclusions, or deductions for various activities or groups. The special tax breaks and preferences now add up to more than $875 billion per year. These layers of carve-outs and changes have made the code unfair, inefficient, and wildly complex. The Treasury Department's guide book on tax regulations, issued to help users interpret the meaning of the code, comprises six full volumes and sums to nearly 12,000 pages.

The National Taxpayer Advocate at the Internal Revenue Service [IRS], Nina E. Olson, calls the complexity of the code "the most serious problem facing taxpayers" and says the only meaningful solution is a drastic simplification. The code is so complex that 60 percent of Americans have to use paid tax preparers to complete their forms correctly. Another 20 percent rely on tax preparation software, such as Turbo Tax, to complete their forms. Even the IRS commissioner admitted in a recent interview that he relies on a tax professional to complete his returns, in part because of the code's complexity.

The average tax preparation fee for a standard itemized 1040 Form and an accompanying State tax return is just over $200, while small businesses pay between $500 and $700 for help with their forms, according to the National Society of Accountants. The total cost of complying with the individual and corporate income tax (gathering the requisite information, preparing the forms, etc.) amounts to roughly $200 billion per year, or 14 percent of all income tax receipts collected. If tax compliance were an actual industry engaged in productive economic activity, instead of a metric of wasted time, energy, and money, it would be one of the largest in the U.S.

Taxpayers who are unwilling or unable to pay for outside help with their taxes must turn to an IRS whose level of service has been deemed "unacceptable" by the National Taxpayer Advocate. According to the Advocate's latest report to Congress, the IRS has a self-imposed goal of answering only about 70 percent of the phone calls placed through its toll-free help line this year The IRS says that its tax advisors have a high accuracy rating in terms of their tax advice, but that is small consolation for the portion of callers who cannot reach anyone. In fact, the share of callers who 1) connect to an IRS tax advisor (after waiting an average of 12 minutes) and 2) get a correct answer to their question is just 65 percent.

In the realm of tax policy, Congress sometimes focuses its efforts on improving tax compliance and trying to narrow the "tax gap" (i.e. the difference between what is owed in taxes and what is actually paid). Estimates suggest that the net tax gap is roughly $290 billion per year. But the tax gap is not the key underlying problem. It is merely a symptom of a complex and broken tax code. The most direct way to reduce this complexity, thereby improving tax compliance and easing the administrative burdens of the system, is to dramatically simplify the tax code.

Taxes impose two types of economic costs: the direct cost of the taxes themselves, and the indirect costs of the changes in behavior that result. For instance, taxes can affect the incentive to work. When marginal income tax rates are high, they penalize productivity, as people keep less of their earnings. This reduces the potential to maximize labor force participation.

The U.S. tax system also discourages capital investment, a necessary component of long-term growth and rising living standards, by essentially taxing savings twice. Individuals pay income taxes on their wages and salaries and, if they choose to save these funds, pay another round of taxes when they reap investment gains. This arrangement encourages individuals to consume their wages and salaries immediately rather than saving and investing them.

The double-taxation of corporate profits offers another example of the disincentive effects on investment of the current U.S. tax code. Corporate profits are taxed once at the business level and once again at the individual level, when the profits are distributed as dividends or capital gains. This double taxation boosts the cost of capital and leads to lower investment in the corporate sector.

In short, tax policy is a key element that will influence the two components of long-term economic growth: investment and labor force participation.

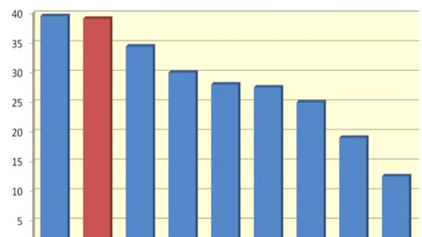
Here are several other factors that come into play in tax policy.

Tax Rates. The importance of taxes to competitiveness is echoed by a recent study released by the U.S. Treasury. Treasury finds that business location and investment decisions are becoming more sensitive to country tax rates as global integration increases. Foreign investment is important to an economy because it is a key source of innovation and jobs. In response, many countries have been lowering business taxes. But the U.S. risks falling behind: it already has the second highest corporate income tax in the Organisation of Economic Cooperation and Development [OECD] (see Figure 12). The U.S. may soon have the highest rate, as Japan and France have signaled their intention to lower their corporate income tax rates, joining the trend set by many other industrialized countries in recent years. As described in recent testimony by Robert J. Carroll, Vice President for Economic Policy at the Tax Foundation:

Figure 7

Corporate Income Tax Rates

(As Percent)



By standing still, the United States can expect to see reduced inflows of foreign capital and investment because the United States will be a less attractive place in which to invest, innovate and grow. U.S. firms will face a higher cost of capital than foreign firms, making it more difficult to compete in foreign markets. In the near-term, this would translate into slower economic growth, a slower advance in labor productivity, and less employment. The industries that are being hurt the most are those that manufacture or buy capital-intensive products.

Although corporate taxes may be a politically popular revenue source, they actually create perverse incentives that impede economic growth, and therefore penalize workers and consumers.

Economists are unanimous . . . that the corporate tax is a bad one. It creates incentives for investing in noncorporate businesses and housing instead of corporations, and it induces many distortions in corporate finance. For example, since interest but not dividends are deductible and thereby not subject to the corporate tax, the tax creates a bias in favor of debt over equity finance. The combination of individual and corporate income taxes also has created an advantage for corporations to repurchase shares rather than paying dividends. The invention and deployment of innovative financial products has added new distortions as companies structure their financial transactions to achieve income tax advantages. The internationalization of businesses, along with the greater mobility of capital, has made collecting corporate income taxes much more difficult. Companies, for example, now routinely manipulate their corporate structures, finances and inter-company prices to take advantage of lower corporate tax rates in other countries. These are just some of the reasons that economists hate a tax the public seems to love.

Elevated corporate tax rates hinder American competitiveness by making the U.S. a less desirable destination for investment and jobs. By deterring potential investment, the tax restrains economic growth and job creation. The U.S. tax rate differential with other countries also fosters a variety of complicated multinational corporate behaviors intended to avoid the tax – profit shifting, corporate inversions, and transfer pricing – which have the effect of moving the tax base offshore, costing jobs and decreasing corporate revenue.

U.S. tax policies also create an unlevel playing field in the international market. The overwhelming majority of America's competitors rely to some degree on consumption-based taxes, which, according to World Trade Organization rules, can legally be rebated on products leaving a country for export and imposed on products entering that country. The United States happens to be the only major industrialized country in the world that does not use a similar tax system and therefore cannot engage in the same practice. Hence, when Milwaukee-based Harley-Davidson makes a motorcycle it plans to sell overseas (to Japan, for example), the motorcycle is taxed once in the U.S. before being shipped, and once again when it reaches the Japanese border. In contrast, when a Honda motorcycle is shipped from Japan to the U.S., the Japanese government lifts the tax on the motorcycle before export, and it arrives in the U.S. essentially tax-free. This combination of tax policies gives foreign producers a clear cost advantage and hampers the ability of U.S. manufacturers, such as Harley-Davidson, to compete in the global market.

Tax Certainty and Consistency. Equally important over time is maintaining a consistent and predictable tax policy. Only in such an environment can businesses effectively plan the long-term investments needed to sustain economic growth. In addition, foreigners will be unlikely to invest in the U.S. if they conclude that U.S. tax laws are likely to keep changing, or rates to keep rising.

Flexibility and Adaptability. In an ever-changing international marketplace, economic flexibility and adaptability are increasingly important. The U.S. economy has been successful historically due in part to its flexible and efficient capital markets, which direct investment resources to their most productive uses – seeking out new and profitable ventures and redeploying investment from old industries into new fields. High tax rates on investment and capital can impair this innovation dynamic and can harm U.S. economic competitiveness.

A CHANGING ENVIRONMENT FOR WORKERS

As technological advancements and global competition churn through old jobs and create new and better ones, more workers from time to time will have to obtain additional skills to meet the changing demands of the modern job market. That is why it is vital to ensure Federal job training programs are effectively serving workers and continually improving. Unfortunately, training opportunities funded by the current system not only can be difficult to access, they often fail to benefit trainees, or provide only modest benefits.

The greatest challenges with the current system are lack of accountability and incentives to maximize effectiveness. There are 49 Federal job training programs, administered by eight different agencies. Each program has its own unique set of performance goals and requirements that States must follow. This makes it extremely difficult for administrators to avoid duplication, to be efficient with funding streams, and to tailor training to local needs. As summarized recently by Virginia Senator Warner, former Governor of the Commonwealth:

I can again recall as Governor one of the most frustrating areas that I found was how we could try to right-size and rationalize government training. I found at a State level we had a variety of different programs about employment and training. They were all siloed. And too often, as we tried to rationalize that approach, we found that the funding streams all led to Washington, and there was actually no collaboration at all..

Differing reporting requirements also make it virtually impossible to compare program performance and determine if the program is actually instilling trainees with the skills they need to achieve self-sufficiency. Finally, there exists little incentive to try new approaches and improve outcomes.

BROADER IMPLICATIONS

The problems of health care, retirement security, taxes, and job training all have broader effects – on the government's fiscal condition, and on America's ability to compete, and to lead, in the global marketplace.

Government Spending

One of the clearest indications of the government's impact on the Nation and the economy is government spending, because – whether it is financed through taxes or borrowing – spending reflects the amount of economic resources the government consumes; and those resources otherwise would be available for growth-producing activities in the private sector. In addition, taxing and borrowing occur only because government needs the resources to finance its spending (unlike a business, which raises revenue as an end in itself). In short, spending is the root cause of all government fiscal consequences.

According to CBO, government spending as a share of the economy is projected to double to more than 40 percent of gross domestic product by 2050. Raising taxes or borrowing to meet these spending needs will cripple the economy and destroy U.S. international competitiveness.

High government spending tends to crowd out more productive private sector investment, which leads to declines in productivity and lower GDP growth. Redistributive spending – the kind involved in Federal entitlement programs – also distorts the allocation of resources in the economy; and an increasing domination in the form of government intervention and spending can erode private markets. Redistributive government spending also sets up incentives to capture the benefits of government transfers and subsidies rather than engaging in productive behavior. As government grows and assumes increasing responsibility for services that could be more efficiently provided by private markets, diminishing rates of return on government spending set in. In addition, the high tax rates needed to fund government spending also depress the incentives to work, save, and invest. High tax rates dampen entrepreneurial activity and risk taking, factors that are particularly important in a modern, dynamic economy.

In short, higher tax rates discourage the forms of productive behavior that are crucial for long-term economic growth.

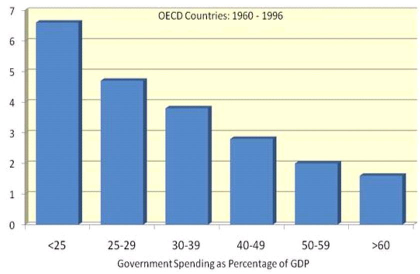
Figure 8 on the next page shows the general relationship between government spending and economic growth. Obviously, some government spending is necessary to foster a functioning market economy. Governments must provide for a limited set of public goods: they must build roads and other infrastructure, foster the protection of property rights, and maintain internal and external security. As the upward-sloping portion of the curve illustrates, this “core” government spending tends to foster economic growth. But when government spending increasingly exceeds these core functions, economic growth begins to suffer (i.e. countries reach the downward sloping portion of the curve). As the figure illustrates, past a certain level, more government spending and higher levels of taxation begin leading to slower rates of economic growth.

This general observation is borne out in the real world. The Joint Economic Committee has studied the relationship between the size of government and economic growth in 23 industrialized countries during 1960 through 1996. The results show, for instance, that countries with government spending in excess of 40 percent of GDP experienced less than half the rate of GDP growth, on average, than countries with leaner governments (i.e. between 25 percent and 39 percent of GDP). The committee’s econometric analysis of the international data yields a convenient rule of thumb: an increase in government spending of 10 percentage points tends to reduce a country’s annual rate of GDP growth by about 1 percentage point.

Figure 8

Size of Government and Annual Real GDP Growth

(Average Growth of Real GDP during Year)



Source: Joint Economic Committee

These kinds of studies show that America’s budgetary problems cannot be solved by simply increasing government and raising taxes. The economic cost of this route would be devastating.

The International Marketplace

In the 21st century, the oceans no longer separate national economies. With the deployment of broadband technology and a host of other, new technological advancements, the U.S. economy is part of an interrelated, international network. The force of competition is fierce, with the rapidly growing economies of China and India playing especially vigorous roles. Virtually no worker or industry is immune from these new competitive realities. In confronting this new economic environment, America needs a plan that not only helps workers cope with this new economic anxiety, but also wins this new international competition. In this respect, lessons from past failures and successes are instructive.

In the 19th and 20th centuries, America came into a league of its own in terms of rapid economic achievement, rising living standards, and international competitiveness. Several factors contributed – principally a reliance on the individual and private markets – which generated innovation and growth that laid the groundwork for increased prosperity.

Since 1995, The Heritage Foundation and The Wall Street Journal have published the Index of Economic Freedom, which tracks the economic progress of 162 nations. The results are clear: countries with relatively modestly sized governments that embrace economic and individual freedom are the wealthiest in the world. Consistently, America ranked among the top; and today, other nations are providing stiff competition to the U.S. by reforming their economic policies to emulate this economic strategy (see Table 6). In just the past year, the United States has dropped from fifth to sixth in the top ten list.

CLICK HERE TO VIEW TABLE

The Federal Reserve Bank of Dallas, which has been researching the link between global competition and pubic policy, concludes that in such a world, “countries win by instituting better policies and lose by overburdening their economies with taxes, regulations, trade barriers, and policy instability.” The Dallas Fed’s research shows that the most successful countries in this era are the ones that promote faster growth, lower inflation, higher incomes, and greater economic freedom.

Unfortunately, America’s status as the world’s leading economic power is clearly threatened by the trajectory of current Federal Government fiscal policies. As a result, to support continued prosperity and rising standards of living, it is crucial for the U.S. to embrace policies that will promote its leadership in the international marketplace, and to acknowledge the increasing importance of individual freedom and private markets.

DESCRIPTION OF THE LEGISLATION
A Roadmap for America’s Future

As noted in the introduction, this proposal is a comprehensive plan for restructuring health care, the Federal health entitlements, retirement security, and Federal taxation to put the Federal budget and the U.S. economy on a sustainable path. Its aim is not to back away from the missions of these programs and activities, but to fulfill them – which can only be done through reform.

The proposal should not be viewed as a rigid, absolute plan. It is built on a strategy for addressing America’s principal budget and economic concerns, and has flexibility built into it so that it can adapt to conditions that surely will change over the course of the century. Nevertheless, it is a complete and comprehensive approach.

Most important are the guiding principles underlying these proposals: focusing government on its proper role; rejuvenating America's vibrant market economy; and restoring an American character rooted in individual initiative, entrepreneurship, and opportunity – qualities that make each American's pursuit of personal destiny a net contribution to the Nation's strengths as well.

Details of the full legislative proposal are contained in Appendix I of this report. Below are summaries and explanations of the major components.

HEALTH CARE SECURITY

Every American should have access to affordable health insurance, and the ability to acquire preventive health care and treatment – regardless of employment, health status, or income level. No one should face bankruptcy because of a catastrophic illness; no one should be denied health coverage because they are branded "uninsurable." Yet few will be able to afford health care or insurance if rising costs continue to spiral out of control. The only way to ensure that all Americans have access to quality health care is to confront these rising costs and the market distortions that created them. Such an approach will not solve every problem in the complex network of health care delivery and financing, but it will correct the most fundamental flaws.

Central to this idea is putting American families and their doctors back in control of their health care needs. Current arrangements remove patients from the decision-making process and hide the true cost of services. In an effort to contain costs, employers have consistently limited choice, flexibility, and coverage options for their employees. Yet health coverage is currently linked to employment by the individual income tax exclusion for employer-sponsored health care. This tax treatment effectively discriminates against workers and families who do not have employer-sponsored health insurance. Compounding the problem, the number of employers providing health insurance has dropped 69 percent since 2000; and this alarming trend is continuing.

Equalizing the tax treatment of health care and coverage will give workers and families much more freedom to acquire a plan that best suits their needs. Making health insurance portable means an individual no longer will live in fear of losing his or her health care along with a job. As the marketplace begins to respond to this new patient-centered control, the resulting increase in competition will improve the quality of services and provide more options to meet the diverse needs of Americans, while lowering costs.

The Health Care Marketplace

Changing the Tax Treatment of Health Coverage. Ownership of health insurance must be shifted away from third parties to those who are actually using it. In place of the current Federal tax law creating the market distortion – the individual income tax exclusion for employer-sponsored health insurance – every American (except those enrolled in Medicare or a military health plan) will have the option to receive a refundable tax credit – $2,300 for individuals and $5,700 for families – to pay for health coverage. The tax credit is available solely for the purchase of health care. A family or individual may apply the credit to an employer-sponsored plan, if available, or to an alternative plan that better suits their needs. Employers continuing to offer insurance continue to claim contributions as a business expense deduction.

The payment will be made directly to the health plan designated by the individual, allowing those who use the health care to choose the insurance that best suits their needs. Any individual who obtains health coverage that costs less than the credit will receive any leftover amount as a payment from the health plan, to be used for other health expenses. Alternatively, those who choose to purchase policies with premiums higher than the credit will assume responsibility for the additional amount themselves. This will encourage individuals to shop for policies best suited to their needs, at the best prices; and as a result, every American will play a role in restraining health insurance premiums, and enhancing the quality of health care services.

There are several other advantages to this approach:

▫ **Universal Access**: Everyone, regardless of income, employment, or geography is eligible for the credit. There are no screenings, income-verification tests, or health criteria. Except those receiving Medicare or Tricare, every American citizen with a valid Social Security number may take advantage of the tax credit. Also, because it is refundable, ownership of health insurance is available to every American. The credit also is "advanceable," enabling individuals to purchase coverage at the beginning of a year, rather than waiting for their tax returns.

▫ **Portability**. Individuals will be able to take their health insurance from job to job. The choice of physician and insurance plan will belong to the employee, not the employer. This is especially important for younger Americans who change jobs more frequently and are more apt to start their own businesses. It is also an important advantage for individuals with pre-existing health conditions, who may feel less free to change jobs for fear of losing health coverage.

▫ **A More Responsive Market**. Because current tax law encourages the employer, not the individual, to be the purchaser and owner of health insurance, insurance companies tend to market their products to employers, whose chief concern is keeping operating costs low. Placing those decisions in the hands of individuals and families will encourage insurance companies to offer more variety, higher quality, and more cost-effective plans to meet the needs of their customers.

▫ **Greater Opportunity for Small Business Coverage**. The proposal creates an alternative for small businesses to offer health benefits. Currently, unless a business can afford to offer a full-scale health insurance plan, its options are limited. The refundable tax credit model allows employees to take responsibility for purchasing their own health care with the credit, but also allows small businesses to make defined contributions to accounts – such as Health Savings Accounts [HSAs] – to help fund their employees' health care expenses.

▫ **Enhanced Health Care Quality**. Health care quality will improve under this proposal due to increased competition among providers. The current market reimburses providers at a specified rate set by health insurance companies almost irrespective of the quality of the care they provide their patients, or the efficiency with which they deliver the care. With individuals controlling their own health care dollars, providers will be encouraged to compete for business by increasing quality and charging more competitive prices. For providers, increased competition will mean they are less likely to be locked in to prices set by insurance plans, and will have more flexibility to determine the appropriate charges for services based on quality and demand.

State-Based Exchanges. Health care services should be easier to use, should be more predictable, and should provide integrated care in a more equitable manner. The current regulation of the insurance market does not give health plans incentives to cover sick patients. When patients do get sick, insurance companies have an incentive find ways of preventing that person from re-enrolling in the insurance plan. Insurance reform must be the linchpin of any health care reform. A one-size-fits-all approach dictated by Washington cannot solve the diverse problems that citizens in various States face. What is needed is a consistent and fair market, so everyone can afford coverage. Patients should choose which health care provider they trust. The freedom to choose creates enhances competition, fosters higher quality care, and puts downward pressure on costs, making care more affordable.

Geographic differences are a significant driver of current health care problems. The characteristics of patient populations differ from State to State. This means the type of basic medical care also differs from State to State. A uniform, national health care plan ignores these regional differences and lowers the standard of care the medical community can provide. Allowing each State to develop and regulate health coverage that meets the unique characteristics of its population and economy will encourage the innovative and patient-oriented health care that should be the hallmark medicine in America.

A Roadmap for America's Future ensures a partnership between the Federal Government and States to create State Health Insurance Exchanges with the following benefits:

▫ **Establishing High-Risk Pools**. State health insurance high-risk pools will offer affordable coverage to individuals who would otherwise be denied coverage due to pre-existing medical conditions, making coverage affordable for those currently deemed "uninsurable." States may offer direct assistance with health insurance premiums and/or cost-sharing for low-income and/or high-cost families.

▫ **One-Stop Marketplace for Health Insurance**. Each individuals will get an opportunity to choose the plan that best meets his or her needs through a State-based Exchange.

▫ **Benefits by the Same Standard Used For Member of Congress**. Plans offering coverage through an Exchange will have to meet the same statutory standard used for the health benefits given to Members of Congress.

▫ **Guaranteed Access to Care**. The Exchange will require all participating insurers to offer coverage to any individual regardless of the patient's age or health history.

▫ **Affordable Premium**. Under the status quo, plans offering coverage to individuals often charge exorbitant premiums. This proposal solves the problem through independent risk-adjustment among insurance companies. A non-profit, independent board will penalize insurance companies that cherry-pick healthy patients while rewarding companies that seek patients with pre-existing conditions. This solution will ensure health insurers compete based on superior products and price.

▫ **Simple Auto-Enrollment**. An Exchange would make it easy for individuals to obtain health insurance by providing new and automatic opportunities for enrollment through places of employment, emergency rooms, the Division of Motor Vehicles, and the like. If individuals do not want health insurance, they will not be forced to have it. Research has shown that auto-enrollment mechanisms have achieved near universal levels of coverage. An auto-enrollment mechanism has also been demonstrated to increase the percentage of employee-participation in employer provided 401(k) plans by 70 percent – from 20 percent of new employees enrolled after 3 months under self-employment, to 90 percent of new employees participating under auto-enrollment.

Interstate Purchasing. Currently, individuals and families can purchase health insurance only in the States in which they live, because insurance companies are prohibited from selling polices outside their respective States. Thus the consumer is prevented from purchasing coverage from another State that might offer more suitable, or more affordable, coverage.

This proposal breaks the lock, allowing each individual to use the refundable tax credit toward the purchase of health insurance in any State. This will greatly expand the choices of coverage available to the consumer, and also will encourage broader competition and diversity among insurers, who will be able to sell their policies to individuals and families in every State, as other companies do in other sectors of the economy. After analyzing Federal Employee Health Benefits Program [FEHBP] preferred provider organization [PPO] prices, the Government Accountability Office reports: "We found that FEHBP PPO hospital prices differed by 259 percent and physician prices differed by about 100 percent across metropolitan areas in the United States, after we removed the geographic variation associated with the costs of doing business such as rents and salaries, and differences in the types of services provided."

Allowing consumers to shop across State lines will balance State regulation of health insurance. Individuals no longer will have to pay for health benefits mandated by their home States that they do not need; they will be able to choose policies from States whose mandates better fit their personal circumstances. States will then have an incentive to balance their insurance mandates against costs to remain competitive with other States.

Making Price and Quality Data Available to All. For individuals and families to shop for their health care, they must have a better sense of what they are expected to pay – and what they are getting for their money. Making data on the pricing and effectiveness of health care services widely available is critical to the success of an effective health care marketplace. So far, however, the market has been unable to develop a process for defining industry-accepted metrics that measure "quality" and define "price." The result has been a flurry of reports by trade organizations, specialty groups, and government agencies, each using different terminology and definitions. The lack of uniform standards has prevented effective, "apples-to-apples" comparisons.

The environment resembles what existed in the securities markets before the stock market crash of 1929. Abuse, fraud, and misinformation about the nature of stocks and the rules governing their purchase were rampant. In response, the Securities and Exchange Commission [SEC] was formed with the main purpose of bringing transparency to the market and restoring consumer confidence.

With the increasingly rapid transformation of the financial markets and the growing complexity of financial transactions, the private sector began to take a more prominent role in developing accounting guidelines; and eventually the SEC began relying on the private sector to establish the basic standards by which it would be regulated. Since 1973, the SEC has recognized the nongovernment Financial Accounting Standards Board [FASB] as the authoritative standard-setting organization for financial accounting and reporting information. While the SEC has statutory authority to establish such financial standards, it has historically adopted FASB rules. The SEC allows the private sector to establish its own disclosure standards, so long as it demonstrates the ability to fulfill the responsibility in the public interest. The authority to enforce the standards, however, falls solely to the SEC.

Applying this model to the health care industry will allow all stakeholders to come together, without heavy-handed government intervention, to establish uniform and reliable measures by which to report quality and price information. To accomplish this goal, this proposal restructures the current Agency for Healthcare Research and Quality [AHRQ] and removes it from the Department of Health and Human Services. The new agency, renamed the Healthcare Services Commission [HSC], will be governed along the same lines as the SEC, and managed by five commissioners chosen from the private sector (with no more than three from the same political party), appointed by the President, and approved by the Senate.

The HSC's purpose – to enhance the quality, appropriateness, and effectiveness of health care services through the publication and enforcement of quality and price information – will be guided by a standard-setting Forum for Quality and Effectiveness in Health Care. The group will play a role similar to that of FASB in establishing accounting principles. The forum will consist entirely of private-sector representation, with the authority to establish and promulgate metrics to report price and quality data. Forum members will represent views from medical providers, insurers, researchers, and consumers, and will serve independently of any other employment. The forum, designed to keep pace with innovation, will publish, for public comment, a preliminary analysis on standards for reporting price, quality, and effectiveness of health care services. After the comment period, the group will publish a final report containing guidelines for regulating the publication and dissemination of health care information. The HSC will be authorized to enforce these standards.

Protection for Those Who Need It Most. Uninsured individuals with pre-existing health conditions have the most difficult time finding and affording health care coverage. As a result, many individuals with pre-existing conditions often face bankruptcy to pay for health care expenses or, worse, go without treatment. If these individuals are fortunate enough to have group health insurance, their high costs are spread among their coworkers and employers in the form of ever-higher premiums, making coverage expensive for all.

Ensuring that “high-risk” individuals – those with the greatest medical costs – can obtain high-quality coverage is critical to the success of any plan to reform health care. High-risk individuals face an insurmountable burden in medical expenses themselves, and that burden is often transferred to taxpayers in the form of uncompensated care expenses from hospitals, or the placement of these individuals in Medicaid after having exhausted their financial resources paying for their medical costs.

Affordability for Small Businesses. The problem of rising health care costs is especially acute for small businesses, who cannot pool risks of thousands of employees, as large companies do – and therefore cannot afford group coverage for their workers. To correct the problem, this proposal allows the establishment of association health plans [AHPs], giving small businesses a means of offering health coverage to their employees. Under this strategy, small businesses will be able to pool together nationally to offer coverage to their employees. The plans offered will be subject to the same new rules for flexibility (using the tax credit to pay for health insurance at the workplace) and portability (being able to take insurance from job to job) described above.

Encouraging the Adoption of Health Information Technology. Just as individuals should own their own health coverage, they also should own their health records. By establishing a modern market-driven approach to building a National Health Information Network, this plan will give every American ownership over his or her own medical record, transitioning the health care industry from paper-based medical records to electronic medical records through the creation of Independent Health Record Trusts. With electronic accounts, medical records travel with the individual, allowing timely and more accurate diagnoses and treatments. The Health Record Trusts, modeled on the framework of credit unions, will allow medical information to be managed in the same manner that financial institutions, such as banks and credit card companies, manage financial data – establishing a nationwide health information technology network designed to improve health care quality, reduce medical errors, and ensure that appropriate information is easily accessible.

Medicaid

Modernizing the Benefit. Medicaid, the Federal-State health care entitlement program for qualifying low-income and indigent individuals, is outdated and fiscally unsustainable, and it is a leading cause of State budget deficits. Even worse, the program serves its intended beneficiaries poorly: Medicaid patients only receive the basic treatment they require, with costs set by Washington or State bureaucrats; and Medicaid patients often end up in the emergency room for basic needs simply because they cannot get access to up-front health care services. The right changes can form a more effective program, strengthen the health care safety net for the neediest populations, and bring fiscal relief to States.

This proposal transitions Medicaid from an open-ended entitlement to one that is patient-centered. Below are some of the particular benefits of this approach.

Direct Assistance. Providing low-income families with dependent children the financial assistance to purchase high quality private plans will end the two-tiered health care system that exists today. In addition to the health care tax credit, this individual Medicaid payment will provide Medicaid beneficiaries with nearly $11,000 that can be applied to health care costs. Additional assistance is provided for pregnant women and families with children younger than 1 year old. This will ensure families stay together within one provider network and foster coordinated and personalized health care as well as promote new and innovative care models for patients.

Realignment of Federal and State Responsibilities. In 2008, Medicaid’s total costs were $333.2 billion. According to the Department of Health and Human Services, the Medicaid improper payment rate is 10.5 percent, or $32.7 billion. That is more than three times the average improper payment 3-5-percent rate of other Federal agencies. With the Federal Government assuming responsibility for the distribution and coordination of the individual Medicaid payments, States’ budgets are freed from having to account for this burden. In return, States contribute 50 percent of the individual payment amount.

Removal of the Stigma. Medicaid recipients deserve to choose their own doctors and make their own health care decisions, instead of having the government dictate those decisions for them. But instead of helping the neediest gain access to the same level of care available to those with private insurance, the current Medicaid Program forces both doctors and patients to accept bureaucratically determined standards of care at government-set prices. The result has been a fraying safety net that fails to sustain the most vulnerable; forces the medical community into making the impossible choice of denying care or absorbing the financial loss (more than half of doctors will not take Medicaid recipients); and threatens to overrun State budgets. Additionally, Medicaid often fails to offer vision and dental care and various other services available in private health plans.

Low-income individuals should not be subject to second rate care simply because they receive more assistance from the government. Offering Medicaid beneficiaries the option to enroll in private plans with the refundable tax credit will remove the stigma Medicaid recipients face, and allow them to take advantage of the same range of options available to those with private plans.

Retention of Medicaid for Specific Populations. States’ long-term care and disabled populations do not take part in the tax credit, but continue in the current Medicaid program, with each State receiving a block grant of this portion of its Medicaid funds. This change allows States maximum flexibility to tailor their Medicaid programs to the specific needs of their populations. The long-term care block grant is indexed for inflation by a blended rate of the consumer price index [CPI] and the medical care component of the CPI, and adjusted for population growth.

State Children’s Health Insurance Program [SCHIP]. The current SCHIP population becomes eligible for the health care tax credit. This ensures that the children who need it most have access to the same variety of options and high quality care.

Medicare

A Medicare Program for the 21st Century. As the long-term fiscal burden of Medicare becomes more unsustainable, it is clear that – to fulfill the mission of Medicare – small and gradual changes to the program will not suffice. The entire methodology of the program must be converted away from a program that shelters providers and consumers from prices – and is therefore inefficient in restraining rising costs – into one in which beneficiaries choose the most affordable coverage that best suits their needs.

Just as the Medicare Program requires a new methodology, so too does its structure of financing. In this proposal, the Part A and Part B trust funds are combined to create one unified trust fund. The new Medicare Program and the existing program continue to be financed by trust fund revenues, Medicare payroll taxes, and general revenue contributions. The measure of solvency is converted away from one based on the unfunded liability of the Part A trust fund and into one in which the program's solvency is measured as a percentage of gross domestic product [GDP].

Medicare Payment. For future Medicare beneficiaries who are now under 55 or younger (those who first become eligible on or after 1 January 2021), the proposal creates a standard Medicare payment to be used for the purchase of private health coverage. Currently enrolled Medicare beneficiaries and those becoming eligible in the next 10 years (i.e. turning 65 by 1 January 2021) will see no changes in the current structure of their Medicare benefits. The payment will be made directly to the health plan designated by the beneficiary (similar to the administration of the refundable health care tax credit), with the beneficiary receiving any leftover amount as a payment from the health plan, or assuming financial responsibility for any difference in the payment and the total cost of the premium. This allows the Medicare beneficiary to invest the leftover amount in a Medical Savings Account [MSA] to pay for other medical expenses, or to purchase long-term care insurance.

Each Medicare beneficiary becomes eligible for the payment by enrolling in a health insurance plan. Medicare will publish an annual list of plans that are "Medicare certified." Medicare enrollees are able to use their payment to pay for one of the Medicare certified plans, or any other plan, such as those offered by former employers or available from the private market.

When fully phased in, the average payment is $11,000 per year (the average amount Medicare currently spends per beneficiary), and is indexed for inflation by a blended rate of the CPI and the medical care component of the CPI. For affected beneficiaries, the payment replaces all components of the current Medicare Program (Medicare fee-for-service, Medicare Part B, Medicare Advantage, and Medicare Part D). Payment amounts are income-related and risk-adjusted. They also are partially geographically adjusted, with the geographic adjustment phasing out over time.

Risk Adjustment. When the plan is fully implemented, Medicare beneficiaries will receive on average the standard $11,000, with the flexibility to receive a positive adjustment of that amount based on a risk-assessment from their chosen health plan. Once enrolled, beneficiaries may complete initial health exams through their insurance plans to determine whether they are eligible to receive a higher risk-adjusted payments. Each health plan must submit to the Medicare program any necessary results of the exam for Medicare to determine an adjusted risk-assessment.

Under the current system, Medicare frequently overpays for some services and beneficiaries and underpays for others. By risk-adjusting beneficiaries' payments based on their health condition, this reform targets support to those who truly need additional help.

Income-Relating. The payment amount is modified based on income, in a manner similar to that for current Medicare Part B premium subsidies. Specifically: beneficiaries with incomes below $80,000 ($160,000 for couples) receive full standard payment amounts; beneficiaries with annual incomes between $80,000 and $200,000 ($160,000 to $400,000 for couples) receive 50 percent of the standard; and beneficiaries with incomes above $200,000 ($400,000 for couples) receive 30 percent.

Enhanced Support for Low-Income Beneficiaries. While any Medicare beneficiary, regardless of income level, is able to set up a tax-free MSA if he or she desires, the new Medicare Program establishes and funds an MSA for low-income beneficiaries. Specifically, for those who are fully "dual eligible" (eligible under current policies for both Medicare and Medicaid), and beneficiaries with incomes below 100 percent of the poverty level, the plan provides an MSA payment equal to the amount of the deductible for the average Medicare high-deductible health plan. Those with incomes between 100 percent and 150 percent of poverty receive 75 percent of the full deposit.

Retention of Medicare for Those 55 and Older. Clearly, the transition to this restructured Medicare Program should protect those at or near retirement – people who have long planned on the existing Medicare Program for their retired years. That is why the transition to the individual purchase of private health insurance applies to those eligible starting on 1 January 2021. For those eligible prior to that date (those 55 and older), the existing Medicare Program remains, and is strengthened with changes, such as income-relating of drug benefit premiums, to ensure its long-term sustainability.

Premiums continue to be based on an all-beneficiary average, so the phasing of the younger population into the new program will not increase premiums for the population continuing in the existing program. The proposal also retains the Medicare payroll tax of 2.9 percent of the Federal Insurance Contributions Act [FICA] and Self-Employed Contributions Act [SECA] payroll tax, as is the case now.

For individuals now younger than 55 only, the proposal adapts Medicare's eligibility age to reflect Americans' improving lifespans, raising in gradually, and in modest steps, from the current 65 to 69 years and 6 months.

Fail-Safe Mechanism. The proposal would establish a mechanism that would be activated in the Medicare trustees determined that the percentage of funding from general revenues exceeded 45 percent in the prior fiscal year. If activated, on 1 July or 2 months after the Medicare trustees' report is released, whichever comes later, the mechanism would apply an automatic 1-percent reduction in payments for services provided in Medicare's fee-for-service sector.

The plan was developed in consultation with the Congressional Budget Office [CBO] Office of the Chief Actuary of the Centers for Medicaid and Medicare Services, and would assure the solvency of the overall Medicare Program for the long term.

RETIREMENT SECURITY

More than 30 million Americans depend on Social Security to provide a significant share of their retirement income. Since the program was enacted in 1935, it has served as a vital piece of the "three-legged stool" of retirement security, which today includes employer-provided pension plans and personal savings. Still, President Roosevelt himself viewed Social Security as an evolving program. As he wrote in a 1939 message to Congress: "We shall make the most orderly progress if we look upon Social Security as a development toward a goal rather than a finished product. We shall make the most lasting progress if we recognize that Social Security can furnish only a base upon which each one of our citizens may build his individual security through his own individual efforts." In this regard, Social Security is one critical piece of the retirement security safety net for seniors – especially those with limited incomes.

As currently structured, however, Social Security is going bankrupt and cannot fulfill its promises to future retirees. Without reform, future retirees face benefit cuts of up to 24 percent in 2037. Attempts to fix the problem without fundamental reform will excessively burden future workers and sacrifice U.S. prosperity.

Further, even if the current system could be sustained, it is no longer a good deal for American workers. The real rate of return for current workers is only about 1 percent to
2 percent, and the expected rate of return for today's children is expected to fall below

1 percent.

Social Security's shrinking value and fragile condition pose a serious problem that threatens to break the broader compact in which workers support the generation preceding them, and earn the support of those who follow. To maintain the program's significant role as a part of the retirement security safety net, Social Security's mission must be fulfilled somehow. The legacy envisioned by President Roosevelt must be completed without bankrupting future workers.

This proposal addresses the shortcomings of the current system and strengthens the retirement safety net by providing workers with the voluntary option of investing a portion of their FICA payroll taxes into personal savings accounts. Due to the higher rate of return received by investments in secure funds consisting of equities and bonds, these accounts would allow workers to build a significant nest egg for retirement that far exceeds what the current program can provide. Each account will be the property of the individual, and fully inheritable, which will allow workers to pass on any remaining balances in their accounts to their descendants.

Individuals 55 and older will remain in the current system and will not be affected by this proposal in any way: they will receive the benefits they have been promised, and have planned for, during their working years. All other workers will have a choice to stay in the current system or begin contributing to personal accounts. Those who choose the personal account option will have the opportunity to begin investing a significant portion of their payroll taxes into a series of funds managed by the U.S. government. The system would closely resemble the investment options available to Members of Congress and Federal employees through the Thrift Savings Plan [TSP]. As these personal accounts continue to accumulate wealth, they will eventually replace the funding that comes through the government's pay-as-you-go system. This will reduce the demand on government spending, lead to a larger overall benefit for retired workers, and restore solvency to the Social Security Program.

As with Medicare, the Social Security component of this plan will make the program sustainable for the long run. It will do so without overtaxing future workers and crippling the economy. Based on estimates by the CBO, the program will be solvent with permanent and growing surpluses by 2069, without requiring general fund transfers. While not incorporated in the plan, these surpluses will make it possible to reduce the regressive payroll tax in the future.

In addition, the creation of personal investment accounts for future retirees will provide additional capital stock for the U.S. economy, increasing the potential for growth. This will be especially important in coming decades in helping compensate for the projected slowdown in labor force growth, a key component to increases in GDP.

Guarantee of Contributions. Individuals who choose to invest in personal accounts will be ensured every dollar they place into an account will be guaranteed, even after inflation. With the recent market downturn, individuals must be assured their retirement is secure. By guaranteeing the dollars put into an account, individuals can be assured that a large-scale market downturn will not cost them their Social Security personal accounts.

Personal Choice in Retirement Accounts. Beginning in 2012, the proposal allows each worker younger than 55 to shift a portion of his or her Social Security payroll tax payment into a personal retirement account, chosen from a group of investment funds approved by the government (see below). When fully phased in, the personal accounts will average 5.1 percentage points of the current 12.4-percent Social Security payroll tax.

The personal investment component is phased in to allow a smooth transition. Initially, workers are allowed to invest 2 percent of their first $10,000 of annual payroll into personal accounts, and 1 percent of annual payroll above that up to the Social Security earnings limit. The $10,000 level will be indexed for inflation. After 10 years, the amount that workers can invest will be increased to 4 percent up to the inflation-adjusted level, and 2 percent above that. After 10 more years, these amounts will be increased to 6 percent and 3 percent. Eventually, by 2042, workers will be able to invest 8 percent up to the inflation-adjustment level, and 4 percent of payroll above that, for an account averaging 5.1 percent.

The choice of personal retirement accounts is entirely voluntary. Even those under 55 can remain in the current system if they choose. Further, those who choose to enter the personal account system also have an opportunity to leave the system, and those who initially opt out of the system of personal accounts can enter into it later on.

Property Right. Each personal account is the property of the individual, and the resources accumulated can be passed on to the individual's descendants. This contrasts with current government Social Security benefits, which are subject to reductions or other changes by Congress, and which cannot be passed on. The benefits of the personal accounts are tilted in favor of low-income individuals who do not have disposable income to invest. As a result, these individuals will be able to join the investor class for the first time. As Social Security benefits become an individual's property, the government no longer will be able to raid this money to pay for spending on other programs.

Soundness of Accounts. Those choosing the personal account option will select from a list of managed investment funds approved by the government for soundness and safety. After an account reaches a low threshold, a worker will be enrolled in a "life cycle" fund that automatically adjusts the portfolio based on age. A worker may continue with the life cycle option or choose from a list of five funds similar to the Thrift Savings Plan options. After workers accumulate more than $25,000 in their account, they can choose to invest in additional nongovernment options approved by the Personal Social Security Savings Board.

Protection for Current Retirees and Those Nearing Retirement. As with Medicare, this plan recognizes the obligation to preserve the existing Social Security Program for those who already are retired, and for those near retirement who have planned on its benefits for most of their working lives. Therefore, persons now retired and receiving Social Security benefits, and those currently 55 and older, will remain in the existing system and will receive their promised benefits. Their benefits will in fact be more secure because the transformation of the program, along with other reforms in this proposal, ensures the Federal Government will be able to pay promised benefits.

Enhanced Benefits for Low-Income Americans. Low-income Americans are likely to benefit most from the personal account arrangement, should they choose it. They will have an unprecedented opportunity to join the investor class and increase their personal wealth, and also will be allowed to have larger personal accounts than others. Further, both those who remain in the current system, and those who opt for personal savings accounts, will receive increased benefits. All individuals in the traditional system who meet certain working requirements will be ensured that their minimum benefits are equal to at least 120 percent of the Federal poverty level, an improvement from current law. Those in the personal account system will be guaranteed a minimum of at least 150 percent of the Federal poverty level.

The use of progressive price indexing for lower-income workers (see below) will also allow the benefits for lower-income workers to grow faster than those who have greater means to provide for their retirement. These changes will ensure the system favors those individuals who are most reliant on it for support. In fact, according to a distributional analysis by the CBO, lower-income workers should see an increase in their benefits above currently scheduled benefits.

No Change for Survivors and the Disabled. Those receiving survivor and disability benefits will see no change.

Fiscal Sustainability. The plan makes adjustments in the determination of future initial Social Security benefits that will modernize the program, provide greater support for lower-income beneficiaries, and at the same time make the program's overall spending sustainable for the long run. This would continue to allow benefits to grow for all individuals. Further, it would only affect individuals under 55. To accomplish these objectives, the proposal uses progressive price indexing and modernizes the Social Security retirement age.

▫ **Progressive Price Indexing**. At present, an individual's initial level of Social Security benefits are based on the individual's average career earnings. To determine average career earnings, an individual's income from previous years is adjusted upward by the rate that average American wages have increased over time. This approach, called "wage indexing," exceeds the amount of initial benefit growth needed to keep pace with economic conditions, and contributes to the unsustainable projected burden on Social Security. An alternative approach is "price indexing," under which initial benefits are adjusted according to the consumer price index.

This reform, starting in 2018, employs "progressive price indexing" – a mix of wage indexing and price indexing – for initial Social Security benefits. Individuals who make less than approximately $27,700 per year will continue to receive initial benefits based on wage indexing. Those who make between $27,700 and $149,900 (in 2018) will have their initial benefits adjusted upward by a combination of wage and price indexing that becomes more oriented toward price indexing as they move up the income scale. For example, an individual whose income is half way between roughly $27,700 and $149,900 will have his initial benefit adjusted upward approximately 50 percent by wage indexing and 50 percent by price indexing. Individuals making more than $149,900 will have their initial benefits adjusted upward by price indexing. These amounts will be indexed for inflation.

As a result, all future Social Security beneficiaries will see their benefits grow by an amount at least equal to inflation over time. The reform will not affect the cost-of-living adjustment that Social Security beneficiaries receive each year once they have begun receiving benefits. The use of progressive price indexing will peg the growth of future Social Security outlays to a realistic index of the cost of living, while rescuing the program from the insolvency that will otherwise occur. It will place the program on a sustainable fiscal and economic course.

▫ **Modernizing the Retirement Age**. When Social Security was enacted, the average life expectancy for men in America was 60 years; for women it was 64. Today, average life expectancy has increased to 75 years for men and 80 years for women (2007 figures). Life expectancies are expected to continue lengthening throughout the century. Given these facts, and the choice among many Americans to work additional years, this proposal extends the gradual increase in the retirement age, from 65 to 67, occurring under existing policies, and speeds it up by 1 year. Once the current-law retirement age reaches 67 in 2026, this proposal continues its progression in line with expected increases in life expectancy. This will have the effect of increasing the retirement age by 1 month every 2 years. The retirement age will gradually increase until it reaches 70 in the next century.

The modernization of the retirement age will not affect the ability of an individual who chooses the personal account system to retire early, as long as his or her account has accumulated enough funds to provide an annuity equivalent to 150 percent of poverty.

FEDERAL TAX REFORM

As is true of the major Federal entitlement programs, Federal tax law cannot be corrected by merely tinkering with an excessively complex and burdensome tax code. What is needed is a thorough restructuring of the tax laws – one that is broad and yet achievable.

This proposal eliminates the alternative minimum tax [AMT] and allows individuals to choose how they will pay their Federal income taxes. It eliminates the tax on savings and shifts toward a consumption tax for businesses, making it easier for U.S. businesses to invest and create more jobs in the U.S. Most important, this plan is designed to hold down the tax burden on the economy, limiting it to 19 percent of GDP – rather than allowing the tax burden to rise to unprecedented levels, as assumed under current tax law.

Individual Income Taxes

A world-class tax system should be simple, fair, and efficient. The U.S. tax code fails on all three counts. The system is notoriously complex, as families must spend significant time and money negotiating a labyrinth of deductions and credits, a tangle of different rules for characterizing income, and a variety of schedules for taxing that income. The code is also patently unfair, as many of the deductions and preferences in the system – which serve to narrow the tax base – are mainly used by a relatively small class of mostly higher-income individuals. It is also highly inefficient, as tax considerations, rather than economic fundamentals, often distort individual decisions to work, save, and invest, leading to a misallocation of resources and slower economic growth.

Individuals react negatively toward the tax code partly because it is complex and attempts to steer them toward certain activities and away from others. In addition, there are always a few "surprises" – such as the AMT – that end up raising their tax bills. They lack control over their own financial lives.

This reform proposal responds in a fundamentally American way: it offers individuals a choice. Individuals can choose to pay their Federal taxes under the existing code, with all the familiar deductions and schedules; or they can move to a highly simplified income tax system. The simplified plan broadens the tax base by clearing out nearly all of the existing deductions and credits, compresses the tax schedule down to two low rates, and retains a generous standard deduction and exemption level. The tax form for this system would fit on a postcard. The goal is a more simple, fair, and efficient tax code, the components of which are described below.

Full Repeal of the AMT. The alternative minimum tax originally was intended to apply to a small fraction of wealthy taxpayers. But because it was never indexed for inflation, it has in recent years threatened to ensnare millions of middle-income filers. To date, Congress has only extended protection from this AMT expansion on a year-by-year basis. This proposal eliminates the AMT entirely and permanently.

Elimination of Double Taxation of Savings. The current system essentially taxes savings twice: individuals pay tax on their earnings and, if they choose to invest those after-tax funds, they pay another tax on the return from their savings (i.e. interest, capital gains, or dividends). This proposal eliminates the second layer of taxation. Not only is this fair to individual taxpayers, it also is good for the economy. Greater savings leads to more investment and higher rates of productivity. Higher productivity ultimately drives increased living standards. The plan also eliminates the estate tax, another form of double taxation that is particularly harmful to small businesses.

Taxpayers Choice. The proposal allows individual income taxpayers to make their own choice about how best to pay their taxes. Within 10 years of enactment of this legislation, individuals choose one of the two tax systems. But they are allowed one additional changeover between the two systems over the course of their lifetimes. Individuals are also allowed to change tax systems when a major life event (death, divorce, or marriage) alters their tax filing status.

Simplified Income Tax Rates. In contrast to the six tax rates in the current code, the simplified tax has just two rates: 10 percent on adjusted gross income [AGI] (as defined below) up to $100,000 for joint filers, and $50,000 for single filers; and 25 percent on taxable income above these amounts. These tax brackets are adjusted each year by a cost-of-living adjustment as measured by increases in the consumer price index [CPI]. (See Table 7 and Table 8 on the next page for comparisons with current tax brackets.) Taxable income equals gross earnings minus a standard deduction and personal exemption.

CLICK HERE TO VIEW TABLE

Broader Tax Base. The new, simplified code eliminates nearly all existing tax deductions, exclusions, and other special provisions, but retains the health care tax credit described above. As a result, it broadens the base of taxable income, allowing for lower income tax rates. Lower rates reduce disincentives to work and increase earnings.

Generous Standard Deductions and Personal Exemptions. The standard deduction is $25,000 for joint tax filers, $12,500 for single filers. The personal exemption is $3,500. The combination is equivalent to a $39,000 exemption for a family of four.

Prevention of Future Increase in Tax Burdens. This individual tax system – in combination with the business tax described below – is designed to keep the Federal tax burden at its current level; and as the economy recovers from the recession, it caps revenues at 19 percent of GDP.

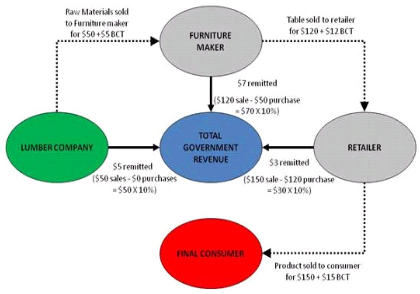
Greater Certainty. Under current law, the scheduled expiration of the 2001 and 2003 tax relief measures, along with a growing expansion of the AMT, will push overall tax burdens to an unprecedented level in the coming years. By reforming the entire tax code and removing these upward pressures on taxes, this plan offers greater certainty so taxpayers can better plan for their financial futures.

Business Taxation

In addition to creating a simpler and fairer income tax system for individuals and families, this plan does away with the corporate income tax, which discourages investment and job creation, distorts business activity, and puts American businesses at a competitive disadvantage against foreign competitors. In its place, the proposal establishes a simple and efficient business consumption tax [BCT] that will enhance the international competitiveness of U.S. businesses and put the economy on solid footing to meet the challenges of the 21st century.

Business Consumption Tax. The proposal creates an 8.5-percent BCT on goods and services. The tax is calculated and administered based on the "subtraction method," under which a business determines its tax liability by subtracting its total purchases from its total sales. The BCT is then imposed on this net receipts figure (i.e. the firm's value added) and paid to the Federal Government once each reporting period (i.e. each business quarter). Analysts generally point out that a "subtraction-method" BCT is simpler and easier to administer than a "credit-invoice method" tax. For instance, Gary Clyde Hufbauer of the Peterson Institute for International Economics notes that a "subtraction-method" BCT more closely resembles the existing U.S. corporate income tax. Because businesses will calculate and pay their BCT based on their total business purchases and sales information, they can rely on their existing books and accounts. Under the "credit-invoice method," a business would calculate and pay its BCT on each individual transaction, which would require a host of new additional records, such as invoices, and tracing rules.

Figure 9
How The Business Consumption Tax Works



Source: Government Accountability Office Note: Illustration based on 10-percent BCT rate.

Figure 15 presents a stylized example of how the BCT would operate for a business involved in the production of a wood table. Revenues are remitted to the government at each stage of the production process and the BCT is incorporated in the final sale price to the end consumer.

Transition to the BCT. The plan incorporates temporary "transition relief" to facilitate the switch from the current tax system to the BCT. The plan also addresses complications in the treatment of the financial services industry under a tax system such as the business consumption tax.

Leveling of the Playing Field. To level the playing field and eliminate the competitive disadvantage on American businesses and American-made products, the BCT is not imposed on U.S. exports when they leave the U.S. It is instead imposed on foreign imports when they enter the U.S. Thus, the BCT is "border adjustable."
Currently, the U.S. corporate income tax is not border adjustable (i.e., the tax cannot be removed from exports or imposed on imports). In contrast, foreign competitors in Europe have the advantage of removing their own taxes on their exports. The World Trade Organization [WTO] established the requirements for a border adjustable tax system. Direct taxes, such as the corporate income tax, are not border adjustable, but indirect taxes, such as the BCT, are border adjustable.

Encouragement of Investment. Under the current corporate income tax, an investment is typically depreciated gradually over the life of an asset. A portion of the cost of the investment is deducted from revenues each year until the full price is recaptured over time (depending on the length of the depreciation schedule).

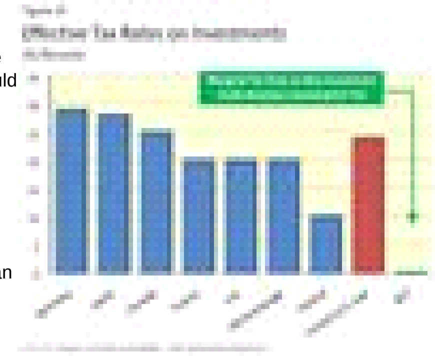
Under the BCT, the cost of an investment is fully deducted immediately – in other words, investments are "expensed." That becomes important from a tax perspective because a dollar's worth of tax benefit today is worth more than a tax benefit in the future for any business. Expensing becomes the key element in shifting from a system that taxes income to a system that taxes consumption (i.e. income less investment). This will boost overall investment in the economy, spurring job creation, productivity and rising living standards.

Elimination of the Corporate Income Tax. Like the individual income tax, the corporate income tax contains a host of tax preferences that end up narrowing the corporate tax base by up to 25 percent, according to the Treasury Department. That narrow tax base requires higher tax rates to raise a given amount of revenue. The current statutory U.S. corporate tax rate (including State corporate taxes) is 39 percent, the second highest tax rate in the Organisation for Economic Cooperation and Development [OECD] and 8 percentage points higher than the OECD average. This adds to the disadvantage already placed on American businesses and, in turn, American jobs. In addition, a country's corporate income tax rate can become one of the key determinants of where businesses choose to locate and invest.

The plan eliminates the corporate income tax entirely, replacing it with the business consumption tax on a broad tax base. The tax base is broadened by eliminating various business tax preferences in today's system, which allows for a significantly lower tax rate under the BCT.

Boost to Competitiveness. By eliminating the corporate income tax and instituting a single-digit business consumption tax with immediate expensing, the U.S. would dramatically enhance its investment climate.

The figure alongside gives a sense of how much. It shows a cross-country comparison of the marginal effective tax rates on new business investment. Effective tax rates are a useful way to distill all of the elements of the tax code that influence the burden on new investment (e.g. statutory business tax rates and depreciation treatment). Currently, the marginal effective tax rate on new business investment in the U.S. is roughly 25 percent, above the OECD average of 20 percent. By implementing the BCT, the U.S. would essentially drive down the marginal effective rate to zero. In other words, the BCT will essentially eliminate the tax distortion on new business investment in the U.S. The result will be a quantum leap in terms of establishing a competitive business tax for the 21st century.



The move will also help to level the playing field so American businesses and American-made products are no longer at a competitive disadvantage against foreign competitors. In fact, this plan gives the U.S. a leg up on its foreign competitors by only taxing investment once – at the business level. Foreign competitors will continue to tax investment twice – at the business level and at the individual level via a tax on capital gains or dividends – which has the effect of raising their cost of capital.

One further metric of the enhanced competitiveness of U.S. businesses under this plan is the level of the consumption tax itself. A U.S. business consumption tax of 8.5 percent is roughly half that of the OECD average. (Other countries typically employ a consumption tax along with a corporate income tax and their business taxes as a whole typically raise more revenues as a share of their overall economy than the U.S.)

Key Benefits of the Business Consumption Tax

To summarize some of the principal benefits of the tax policy described above:

▫ An uncompetitive business tax climate has forced many U.S. companies to relocate and send jobs abroad, often through mergers and acquisitions with foreign companies. This tax plan reverses the trend.

▫ With an enhanced investment climate, international businesses, particularly capital-intensive industries such as manufacturing, will have a greater incentive to invest in the U.S. and expand production here, which creates jobs.

▫ The United States' relatively high statutory corporate income tax has led to multinational corporations shifting their profits to lower-tax countries, essentially shifting the tax base overseas. Many U.S. businesses also delay the repatriation of earnings from their foreign affiliates. This plan brings these earnings and profits back to the U.S.

▫ Greater investment in the U.S. will also help to speed the pace of technological innovation in the U.S. economy, a key factor in raising productivity.

▫ There is a clear link between investment and capital formation on the one hand, and productivity and rising living standards on the other. Between 1973 and 1995, for instance, productivity grew at just under 1.5 percent, implying that living standards in the U.S. would double every 50 years. Since 1995, productivity, spurred by technological innovation and investment, has increased at a 3.0-percent rate. This rate implies it will take only 25 years for living standards to double, half as long as under a slower rate of productivity. A business climate that fosters investment, therefore, is one of the keys to future U.S. prosperity.

▫ The way the U.S. taxes international business operations is important because roughly two-thirds of U.S. export trade (a growing share of the U.S. economy) is facilitated by U.S. multinational companies and their foreign affiliates.

JOB TRAINING

The days when a college graduate could expect to join a company and climb its ladder for an entire career are gone. Also evaporating are the jobs on production lines that could instantly lift any high school graduate securely into the middle class. Regardless of how well or poorly the economy is doing, most Americans already know they will likely have to switch jobs, and even careers, more than once during the course of their lifetimes.

One reason is globalization. The world's economies have become irrevocably interconnected from forces such advances in transportation, technological gains, the explosion of the Internet, and lowered trade barriers. All these have served to open the global economic playing field. Now that new markets have emerged in other countries, and money and work assignments can move around the world in a matter of seconds, Americans no longer compete only with their fellow citizens for jobs; they also are challenged by workers in India, China, Europe, and the rest of the world.

Further, as the U.S. economy becomes more complex and innovative, workers will have to be more knowledgeable and flexible to succeed – which means they will need additional education and/or job training throughout their careers. Life-long learning will be a necessary part of career development. Government cannot insulate workers from the forces of globalization, but it can help facilitate the training needed to avoid, or push through, any period of uncertainty or unemployment. While the Nation's existing job training system has been improved over ineffective strategies of the past, the government can better leverage and target existing resources, and make it more responsive to the effects of globalization.

Existing Education and Training Opportunities

Globalization will increase the demand for educational institutions that are able to effectively anticipate the labor market and quickly train workers to take advantage of them. In the meantime, the United States has an abundance of opportunities for those seeking additional education beyond high school. There are thousands of public and private colleges and universities. There is a robust system of community colleges that offer vocational training, 2-year degrees, and established ladders to 4-year institutions. There are also a number of for-profit and non-profit organizations that offer in-class and on-line instruction to advance basic literacy and various job skills. Citizens also can enter military service, and obtain some of the best job experience and training the world has to offer.

To help pay for this, Congress has steadily increased the number and amount of Pell Grants it offers to the disadvantaged. Students can also save for their education in tax-deferred 529 accounts and compete for scholarships.

Government Job Training Programs

In addition to these opportunities, Congress passed the Workforce Investment Act [WIA] in 1998. This law consolidated a number of disparate Federal Government job training programs and in their place established a nationwide system of "One-Stop" centers. These centers are required to help all job seekers with their resumes and job placements. In addition, if it is determined that additional training is needed to obtain employment, a job-seeker can receive a voucher to help purchase needed classes. WIA set the stage for a nationwide transformation toward a greater system of universal employment and job training assistance by harnessing the forces of customer choice, system accountability and efficiency.

Nevertheless, there is much room for improvement. A study recently released by the Department of Labor [DoL] found that the benefits of WIA job training programs were “small or nonexistent” for laid-off workers. Similarly, the Government Accountability Office [GAO], in a September 2008 report, concluded the Department of Labor did not set up comparable performance measures for $900 million in WIA grants that it awarded over 7 years, so there is no way to evaluate their impact. Finally, even though WIA consolidated a number of job training programs, a great deal of duplication remains. There are 49 Federal programs, administered by eight different agencies, that provide a range of employment and training services.

Strengthening Federal Job Training Programs by Requiring Continual Improvement in Outcomes

This legislation establishes requirements to increase job training outcomes across the board. First, it improves accountability by creating a common set of metrics for all of the 49 existing Federal job training programs so that policymakers and the public can see whether, and how well, individuals are benefitting from the training. It also requires that both training outcomes and the spending data for programs are placed on a centralized website for public access. It requires the GAO and the Department of Labor’s Inspector General to conduct routine audits and studies on these data, to ensure programs are successfully serving all participants.

The legislation also maximizes the effectiveness of Federal dollars by requiring competitive bidding for all job training grants to private contractors, giving preference to proposals that leverage private investment, and prohibiting renewal of grant contracts that fail to produce results. The bill institutes public awareness campaigns about the training opportunities available in local communities and the need for workers to continually invest in their education and skill sets so that they prosper in the global economy. It makes training more accessible for those in need. Most important, it allows each State to work with the Department of Labor [DoL] on a viable plan to improve job training outcomes and receive a 3-year block grant that waives the silos and red tape associated with existing Federal job training funding to accomplish their goals.

Streamline and Improve Performance Metrics. The challenge with current law is that each of the 49 existing Federal job training programs has its own unique set of performance measures. Several programs allow grantees to define their own outcome measures. Some allow the measures to be negotiated with the Federal Government each year. The Food Stamp Employment and Training Program does not even bother to consistently track outcomes.

This legislation addresses the problem by requiring every Federal job training program to track the following:

▫ The type of training provided and the cost per student.

▫ The employment status immediately after training, and then 1 year, 3 years, and 5 years after training.

▫ Whether or not trainees are working in the field for which they were trained in order to determine whether the training led directly to employment.

▫ The participant’s income level two years before and up to 5 years after training to determine if the training led to increased income.

▫ The participation level in Federal support programs (i.e. Temporary Assistance for Needy Families [TANF], the Supplemental Nutrition Assistance Program [SNAP], Supplemental Security Income, and the like) before and up to 5 years after training to determine if it led to self sufficiency.

In addition, the legislation clarifies that these performance measures do not prohibit programs from creating or continuing their own additional outcome measures. Further, the legislation requires the DoL to do a periodic control group study, where it compares the performance measure outcomes of those who have participated in subsidized training against similarly situated individuals who did not receive any training. In cases in which training is obtained with a WIA voucher, the legislation limits performance tracking only to the subsidized trainee. This is designed to prevent the current problem of voucher-holders from being denied access to private-sector training programs where the program administrator does not want to bear the burden of reporting on the rest of the unsubsidized trainees.

To prevent program administrators from artificially inflating their performance outcomes by selecting job training participants based on their likelihood of success, or only formally enrolling those individuals who successfully completed the training, this legislation creates an explicit prohibition on such behavior and requires the Department of Labor’s Inspector General and the GAO to conduct periodic audits to ensure compliance.

These common-sense measures together will enable policymakers to determine whether a training program is effective. If a program is not resulting directly in job placement, and not putting participants on a path to financial self-sufficiency, then it must be reformed until does.

Increased Transparency. The legislation requires the DoL to publicly provide annual performance and spending data from all federally subsidized job training programs on a centralized and easily accessible DoL website. The spending data must include how much program administrators spend on their own salaries, on administrative expenses, and on students. This approach will help ensure that Federal job training dollars are focused on students and spent efficiently. It will also go a long way to prevent and address unjust enrichment, without the unintended consequences of salary caps.

Improve Effectiveness Through Competition. Current law recommends, but does not require, that all job training grants be awarded competitively. A May 2008 GAO report revealed that since 2001, the DoL spent nearly $900 million on grant initiatives, most of which were awarded without competition. This legislation ends this problem by requiring that all job training grants (excluding block and formula grants) issued to private contractors be competitively bid. It also encourages stretching Federal dollars farther by requiring that DoL give priority to grant proposals that leverage private sector investment. Finally, the legislation prohibits the DoL from renewing any job training grants that fail to help participants succeed.

Increased Awareness of Opportunities for Life-Long Learning. With technological advancements and globalization churning through old jobs and creating newer and better ones, workers will have to acquire a range of skills and be ready to meet the more sophisticated demands of the job market. This will require a commitment to life-long learning. This legislation will take two significant steps to raise awareness about the need for life-long learning and about training opportunities available in local communities. First, the bill provides incentives to public broadcasters to spread awareness through their system of PSAs. In addition, it requires all those who receive grant money for job training programs to conduct life-long learning awareness campaigns. These provisions will serve to continually reminded the American workforce of the need to keep tabs on their skill sets, on the demand for their skills in the marketplace, and on how to get additional training if needed.

Increased Access to Training for WIA Participants. Current law implies that States must provide WIA services in a sequence. In practice, this often causes career counselors to make training-seekers wait and look for a job for an extended period of time, and only offer a training voucher as a last resort. This legislation reforms the statutory bias toward providing WIA services in a sequence, and encourages One-Stop centers to offer services in any order or combination based on the needs of the individual job seeker and the local job market. This will give flexibility to career counselors and enable them to get job seekers the right kind of training in a timely fashion. This can be especially helpful for areas where significant layoffs have occurred or are anticipated.

Third-Party Evaluation. The legislation requires the GAO to conduct a study of all the job training programs and identify duplications and report back to Congress within 1 year. It also requires the GAO to prepare a report every 2 years analyzing the results of the various Federal job training programs based on the new performance metrics. This information will arm policy makers with the necessary information to continually improve Federal job training programs.

State Innovation. Every State and locality has its own unique set of challenges to address when it comes to job training, as well as a strong incentive to make their areas as attractive to capital investment and economic growth as possible. Some States may see ways to improve upon approaches dictated by the 49 existing Federal programs and should be given the chance. That is why this legislation includes a new block grant option for States. Under this option, a State may present to the DoL a viable 3-year plan to improve upon existing outcomes, and obtain a 3-year waiver from the silos and red tape of existing Federal job training programs. If the State fails to demonstrate significant improvement at the end of 3 years, the waiver is removed and job training funding reverts to its original program tracks. If the State improves on the status quo, it can continue with 3-year waivers and may become a model of best practices for other States.

REFORMING THE BUDGET PROCESS

One reason the Federal Government's major entitlement programs are difficult to control is the way they are designed. A second is that current congressional budgeting lacks a means of identifying the long-term effects of near-term program expansions. A third is that these programs are not subject to regular review, as annually appropriated discretionary programs are; and as a result, Congress rarely evaluates the costs and effectiveness of entitlements except when it is proposing to enlarge them.

Nothing can substitute for sound and prudent policy choices. But an improved budget process, with enforceable limits on total spending, would surely be a step forward. This proposal calls for such a reform.

The Fundamental Problem of Entitlement Spending

Entitlement spending has become an increasingly dominant part of the Federal budget over the past several decades. As then-Congressional Budget Office Director Peter R. Orszag noted:

> Spending for mandatory programs has increased from less than one-third of total Federal outlays in the early 1960s to more than one-half in recent years. Most of that growth has been concentrated in Medicare, Medicaid, and Social Security. Together, gross outlays for those programs now account for about 45 percent of Federal outlays, compared with 2 percent in 1950 (before the health programs were created) and 25 percent in 1975.

Within the next 10 years, gross entitlement outlays (excluding offsetting receipts) are projected to exceed 60 percent of the budget; and the largest contributors will be Social Security, Medicare, and Medicaid, which are growing faster than the economy.

For the purposes of current budget rules and conventions, entitlement spending is projected to grow according to the formulas established in permanent law, regardless of the rate of growth and whether the government has the means to support it. Benefits to individuals are guaranteed, so that total spending for any one program depends on factors outside the control of Congress – such as caseloads, inflation, and other economic and technical factors. This is a prescription for losing control of such spending. In addition, any proposal to slow the growth in this spending is characterized as a "spending cut."

In most cases, once an entitlement program is enacted, there is no additional review or approval required by Congress – it simply keeps running – and the President cannot veto an increase that arises from existing law. The only way to slow the growth in mandatory spending is through a change in law.

Weaknesses in the Budget Process

The current Federal budget process has a short-term focus and does not systematically review the huge and growing commitment the Federal Government is making for entitlement programs. While Congress and the administration thoroughly review discretionary programs annually and this spending must be appropriated in laws annually, discretionary spending represents less than half of the Federal budget.

Although both the Office of Management and Budget and the Congressional Budget Office make long-term projections, the current budget process lacks a comprehensive and enforceable mechanism for current-law mandatory spending and its long-term impact. Current budget rules are designed to enforce discretionary spending levels on an annual basis and mandatory revenue levels over a 10-year period. Under the current process, it is difficult to make trade-offs between discretionary and mandatory spending, and there is no current enforcement on spending levels beyond the 10-year budgeting period.

The current budget process uses a "baseline" to measure the budgetary impact of legislation that instills an upward bias in mandatory spending. For example, the baseline projects the automatic growth in entitlement spending that will occur under current-law formulas, regardless of whether the government has the means to finance this spending. If legislation slows the growth of spending for a program relative to the baseline, it is considered a "cut in spending."

As a result, the current budget process does not fully capture the long-term cost of these programs and shields them from changes to address their unsustainable growth. Unfortunately, Congress is more likely to take action to aggravate the problem. At best, Congress will attempt to offset the cost according to current rules that cover the 1- or 10-year timeframe, but usually uses revenue, spending gimmicks or both to offset the cost, which hides the long-term spending impacts.

Proposed Reform

In their report, Taking Back Our Fiscal Future, a diverse group of 16 budget experts included a recommendation to reform the Federal budget process, focusing especially on Social Security, Medicare, and Medicaid. They wrote:

> We believe that these three programs must be subjected to serious periodic review and decision. Their estimated future costs must be shown clearly and budgeted in advance. If they run significantly over budget, a triggering mechanism should force the President and Congress to deal with the shortfall. This requirement would give the public and their

elected representatives a chance to decide explicitly how much they want to spend on these three entitlements, how much on other priorities – such as national defense, education, and scientific research – and what level of taxes they are willing to pay to support these programs.

Based on this recommendation, A Roadmap for America's Future establishes a binding cap on total spending as a percentage of GDP at the spending levels that are projected to result from the plan. It requires the President's budget and the CBO to make projections annually in comparison to these spending limits. It requires a comprehensive review of the long-term budget outlook every 5 years. If spending gets out of control again, and Congress fails to address the problem during the 5-year review, the proposal provides a mechanism to slow the growth in faster spending programs by no more than 1 percent, to bring spending back in line with the spending limits.

Over the past 2 years, non-defense discretionary spending, has grown at double-digit rates, even after excluding "stimulus" and emergency funding. As Senator Bayh of Indiana has said, Washington is "serially incapable of getting Federal spending under control." In addition to caps on total spending, the Roadmap establishes enforceable caps on discretionary spending.

The proposal also requires a three-fifths supermajority vote in the House and Senate to pass legislation that increases revenue.

APPENDIX I
Summary of the Legislation

TITLE I: HEALTH CARE REFORM

▫ *Refundable Credit for Health Insurance Coverage.* Provides a flat, refundable income tax credit for individual and family purchase of health insurance. The credit may not be used by those enrolled in Medicare or a military health coverage plan.

- **Credit Amount**. The tax credit equals $2,300 for individual tax filers and $5,700 for joint filers and families.

- **Refundable and Advanceable**. The credit is refundable, and therefore available to low-income persons with no tax liability. Credit also is "advanceable," enabling individuals to purchase coverage at the beginning of a year, rather than waiting for their tax returns.

- **Assignable**. The credit would be forwarded directly to the insurer of the tax credit recipient's choice, leaving the balance, if any, refunded or billed to the recipient.

- **Inflation Adjustable**. The credit is adjusted for inflation: specifically, by an average of consumer price index and the percentage increase in the medical care component of the consumer price index.

▫ *Repeal of Employer Exclusion for Group Health Insurance*. Repeals, for purposes of income taxes, the current-law exemption of employer-sponsored health coverage. Employers that continue to provide group health insurance to employees continue to claim contributions as a business expense deduction.

▫ *Other Tax Components*. Retains current-law tax preferences for Health Savings Accounts. Retains the 7.5-percent itemized deduction for medical expenses, but provides that taxpayers who claim the new health care tax credit may not take into account premiums for such coverage for purposes of the tax deduction.

▫ *Portability*. Allows individuals to carry personally owned insurance through changes of jobs or residences.

▫ *Interstate Purchasing*. Allows individuals who reside in one State to buy a more affordable health insurance plan in another State. Likewise, health insurance plans would be able to sell their policies to individuals and families in every State, as other companies do in every other sector of the economy.

▫ *Small Business Relief*. Allows small businesses to pool together nationally to offer coverage to their employees through association health plans [AHPs]. Plans are regulated at the Federal level and would have advantages similar to those of larger employer plans.
▫ Health Information Technology. Establishes a market-driven National Health Information Network, providing for individual ownership of medical records, and transitioning the health care industry from paper-based medical records to electronic medical records.

▫ *Transparency*. See details in the Medicare component of this legislation.

▫ *State-Based Health Exchanges*. Requires States to contract with health insurance plans or third-party administrators to run exchanges. Encourages States to form inter-state compacts, increasing their negotiating abilities and enhances risk-pool sizes. Requires exchanges to offer insurance plans with the same standard health benefits available to Members of Congress. Requires all health plans on an exchange to provide annual open enrollment periods and enroll newly eligible individuals. Prohibits plans offers through an exchange from discriminating based on pre-existing conditions, and allows individuals to opt out of health care. Exchange requirements include:

- **Auto-Enrollment**. Each State is to develop auto-enrollment health insurance procedures (similar to those for dual-eligibles under the Medicare Modernization Act) for previously eligible Medicaid recipients.

- **High Risk Pools**. Funds are to be used to help low-income individuals and families (as defined by the State) and high-cost individuals and families (those for whom insurance is unavailable or highly expensive due to health status) purchase qualifying insurance. Eligible expenses shall include, but not be limited to, direct assistance with premiums and cost-sharing for low-income and/or high-cost families.

- **Reinsurance Mechanisms**. Each State is to establish and finance reinsurance mechanisms, ensuring high risk pools are adequately funded and that individuals receiving coverage through high risk pools are not subject to prohibitively high premiums.

- **Transparency Networks**. Each State is to establish and maintain a network designed to improve consumer information, transparency in price and quality data, and reductions in transition costs associated with health insurance enrollment.

TITLE II: MEDICAID AND SCHIP REFORM

▫ *Modernizing the Medicaid Benefit*. Converts the delivery of Medicaid benefits into an ownership system. Provides beneficiaries with health care debit cards with adjustable fund amounts, and allows recipients to combine these amounts with support from the health care tax credit.

- **Income Limits**. Eligible families must have gross incomes not exceeding 200 percent of the poverty line; must include at least one dependent individual under the age of 19; and must have no health insurance.

- **Application of Debit Card**. The debit card may be applied to health care expenses including the purchase of health insurance, the direct purchase of health care services and supplies, and any cost sharing. It may not be used for non-health-related purchases.

- **Debit Card Amounts**. In addition to the tax credit, the additional support available to eligible families is as follows: $5,000 for families with incomes not exceeding 100 percent of the poverty level; $4,000 for families with incomes between 100 percent and 120 percent of the poverty level; $3,500 for families with incomes between 120 percent and 140 percent of the poverty level; $3,000 for families with incomes between 140 percent and 160 percent of the poverty level; $2,500 for families with incomes between 160 percent and 180 percent of the poverty level; and $2,000 for families with incomes between 180 percent and 200 percent of the poverty level. An additional $1,000 is made available for each family in which there is a pregnancy during a 12-month period, and an additional $500 is made available for each family member under the age of 1. Beneficiaries are allowed to roll over up to one quarter of unexpended debit card amounts at the end of each 12-month period.

- **Enrollment**. Open enrollment is available for up to 4 months per year. All persons predetermined as eligible for Medicaid or SCHIP – except those who qualify as disabled, elderly, or members of special populations – are automatically enrolled in the supplemental debit card plan.

▫ *Health Insurance Education*. Provides access for qualifying families to education services regarding plan options and assistance in enrollment in the supplemental debit card plan.

▫ *Retention of Medicaid for Specific Populations*. Retains the current Medicaid Program for States' long-term care and disabled populations, who do not take part in the tax credit. Provides to each State a block grant for such funds. Allows States maximum flexibility in tailoring Medicaid programs to the specific needs of the State. Indexes the long-term care block grant for inflation and adjusts for population growth in the same manner as the block grant option described above.

▫ *SCHIP*. Makes the current SCHIP population eligible for the health care tax credit and supplemental debit card.

TITLE III: MEDICARE REFORM

▫ *New Medicare Program*. Establishes a new Medicare Program – applicable for beneficiaries eligible on or after 1 January 2021 – transitioning to a program in which Medicare beneficiaries receive standard payments to pay for their health care coverage.

▫ *Eligibility for Payment*. Makes Medicare beneficiaries eligible for payments by enrolling in a health insurance plan. Pays the amount in each case directly to the health plan designated by the beneficiary (similar to the mechanics of the administration of the health care tax credit), with the beneficiary receiving any leftover amount as a refund payment from the health insurance plan, or assuming financial responsibility for any difference between the payment and the total cost of the premium.

▫ *Medicare Payment*. For beneficiaries first becoming eligible on or after 1 January 2021, creates a standard Medicare payment to be used for the purchase of private-sector health coverage.

- **Payment Amount**. Standard payment is the average amount Medicare currently spends per beneficiary, and is indexed for inflation by the projected average of the consumer price index and the medical economic index. For affected beneficiaries, the payment replaces all components of the current Medicare program (Medicare Part A fee-for-service, Medicare Part B, Medicare Advantage, and Medicare Part D).

- **Risk and Geographical Adjustments**. Payment amounts are risk-adjusted and partially geographically adjusted, with the geographic adjustment phasing out over time. Medicare beneficiaries received the standard amount once they enroll for the benefit, with the flexibility to receive a positive adjustment of that amount based on a risk-assessment from their chosen health plan.

- **Income-Relating**. Payment amount is modified based on income, in a manner similar to that for current Medicare Part B premiums subsidies. Specifically: beneficiaries with incomes below $80,000 ($160,000 for couples) receive the full standard payment amount; beneficiaries with annual incomes between $80,000 and $200,000 ($160,000 to $400,000 for couples) receive 50 percent of the standard amount; beneficiaries with incomes above $200,000 ($400,000 for couples) receive 30 percent.

▫ *Extra Support for Low-Income Beneficiaries*. Establishes and funds Medical Savings Accounts [MSAs] for low-income beneficiaries. (Current law allows any Medicare beneficiary to set up a tax-free MSA; the reform proposal provides the additional support for low-income beneficiaries.)

- **Dual-Eligibles and Incomes Below 100 Percent of Poverty**. For those fully "dual eligible" (eligible under current policies for both Medicare and Medicaid), and beneficiaries with incomes below 100 percent of the poverty level, an MSA subsidy is provided equaling the full deductible amount of an average high-deductible health plan.

- **Incomes Between 100 Percent and 150 Percent of Poverty**. Those with incomes between 100 percent and 150 percent of poverty receive 75 percent of the full deposit.

▫ *Retention of Existing Program*. Retains current Medicare Program for those eligible prior to 1 January 2021. Premiums for Part A, Part B, and Part D are not affected by the phasing of the younger population into the new program. Strengthens the current program with changes such as income-relating drug benefit premiums to ensure long-term sustainability.

▫ *Continuation of Medicare Financing at Current Tax Rates*. Retains the Medicare payroll tax of 2.9 percent of the FICA and Self-Employed Contributions Act [SECA] payroll tax, as is the case now.

▫ *Transparency*. Restructures the current Agency for Healthcare Research and Quality [AHRQ] and removes it from the Department of Health and Human Services. Renames it the Healthcare Services Commission [HSC] governed along the same lines as the Securities and Exchange Commission, and managed by five commissioners chosen from the private sector, appointed by the President, and approved by the Senate.

- **Purpose**. The purpose of the HSC is to enhance the quality, appropriateness, and effectiveness of health care services through the publication and enforcement of quality and price information.

- **Standard-Setting Group**. Similar to the Financial Accounting Standards Board [FASB] role in establishing accounting principles, the bureau will have a standard-setting body – a Forum for Quality and Effectiveness in Health Care – consisting entirely of private-sector representation, with the authority to establish and promulgate metrics to report price and quality data. The forum members will represent views from medical providers, insurers, researchers, and consumers, and will serve independently of any other employment. The forum will publish, for public comment, a preliminary analysis on standards for reporting price, quality, and effectiveness of health care services. After the comment period, the group will publish a final report containing guidelines for regulating the publication and dissemination of health care information. The HSC is authorized to enforce these standards.

TITLE IV: SOCIAL SECURITY REFORM

▫ *Creation of Personal Accounts*. Beginning in 2012, provides workers under 55 the option of dedicating portions of their FICA payroll taxes toward personal accounts, or remaining in the current Social Security system. Individuals retain the ability to choose shift in or out of their accounts as their tax filing status changes.

▫ *Account Phase-In*. Gradually phases in accounts equivalent to 5.1 percent of the current 12.4-percent payroll tax over a 30-year period. Allows lower-income workers to contribute a higher percentage of their payroll taxes than high-income workers. Phase-in proceeds in four periods, as follows:

- **First-Stage Initial Phase-In**. For the first 10 years of the program, workers are allowed to invest 2 percent of their first $10,000 of annual payroll into personal accounts, and 1 percent of annual payroll above that up to the Social Security taxable maximum amount of $147,900. The $10,000 level is indexed to inflation. Taxable payroll also is indexed for inflation, as under current law.

- **Second-Stage Phase-In**. Beginning in 2022, workers are allowed to invest up to 4 percent of payroll of the first $10,000 (indexed to inflation), and 2 percent of payroll above that up to the Social Security taxable maximum amount (indexed to inflation).

- **Third-Stage Phase-In** Beginning in 2032, workers are allowed to invest up to 6 percent of payroll of the first $10,000 (indexed to inflation), and 3 percent of payroll up to the Social Security taxable maximum amount (indexed to inflation).

- **Fourth-Stage Phase-In**. Beginning in 2042, workers are allowed to invest up to 8 percent of payroll of the first $10,000 (indexed to inflation), and 4 percent of payroll up to the Social Security taxable maximum amount (indexed to inflation).

▫ *Personal Accounts Deposits*. Deposits each personal account contribution into a Social Security Savings Fund, bearing the individual's name. Converts individual accounts into annuities upon retirement.

▫ *Guarantee of Contributions*. Individuals who choose to invest in personal accounts will be ensured every dollar they place into an account will be guaranteed, even after inflation. With the recent market downturn, individuals must be assured their retirement is secure. By guaranteeing the dollars you put into an account, individuals can be assured that they are protected against large-scale market downturns.

▫ *Property Right*. Provides that each account is the property of the individual, allowing holders to pass on accumulated wealth to descendants.

▫ *No Change for Those Over 55*. Retains the current system for those currently over 55, with no changes.

▫ *No Change for Survivors and the Disabled*. Retains current survivor and disability benefits as under the current system, without change.

▫ *Increased Minimum Benefits for Low-Income Individuals*. Provides that all individuals choosing personal accounts receive annuity payments of at least 150 percent of the poverty level. Increases to at least 120 percent of the poverty level the benefits for low-income individuals who choose to remain in the current system and meet certain working requirements.

▫ *Social Security Personal Savings Account Board*. Creates a Board to administer the Savings Fund into which contributions to the personal accounts are deposited. Makes the Board responsible for paying administrative expenses and regulating investment options offered by nongovernment firms. Provides that the Board consist of five members – required to have substantial experience, training, and expertise in the management of financial investments and pension benefit plans – appointed by the President, two of whom are appointed after consideration of the recommendations by the House and Senate. Establishes 4-year terms for Board members.

▫ *Three-Tier Structure*. Structures individual accounts in three tiers, with investment options similar to the Thrift Savings Plan [TSP].

- **Tier One.** Originally, the Board invests the contributions in regulated, low-risk instruments until the personal account reaches a low threshold.

- **Tier Two**. Once this threshold is reached, individuals are automatically enrolled into a "life cycle" fund that adjusts for risk and automatically invests the portfolio in a blend of equities and bonds appropriate for the individual's age. An individual can remain in the "life cycle" fund or choose from five different options that are the same as offered under the TSP: 1) a Government Securities Investment Account; 2) a Fixed Income Investment Account; 3) a Common Stock Investment Account; 4) a Small Capitalization Stock Index Investment Account; and 5) an International Stock Index Investment Account.

- **Tier Three**. Once an account accumulates more than $25,000 in inflation-adjusted dollars, an individual can choose an option provided by a non-government firm certified by the Board. The Board certifies only those firms meeting a set of standards. These nongovernment funds also are subject to regulation by the Board to ensure their safety and soundness.

▫ *Purchase of Annuity*. Provides that, when an individual either reaches the normal retirement age or decides to retire early, the individual will purchase an annuity to provide monthly payments equivalent to at least 150 percent of poverty. An individual may purchase a larger annuity if they choose. If an individual has excess money in their account, they may receive it in a lump sum payment and use it as they choose.

▫ *Early Retirement for Personal Account Participants*. Allows an individual to retire and begin receiving an annuity at any time that their personal account has accumulated enough funds to purchase an annuity equivalent to at least 150 percent of poverty.

▫ *Annuity Purchase and Regulation*. Establishes within the Office of the Board, an Annuity Issuance Authority [AIA], which will provide annuity options to be purchased by retiring individuals.

▫ *Provision for Early Death*. Provides that, if an individual dies before their full annuity has been paid, the amount of funds left over in their annuity or personal account will be made available to their designated beneficiaries or estate.

▫ *No Taxation of Personal Account Benefits*. Provides that no tax will be paid on the receipt of Social Security benefits generated from personal account payments either as a part of an individual's Federal income tax or estate tax.

▫ *Progressive Price Indexing*. Excluding those now over 55, employs, starting in 2018, a mix of wage indexing and "progressive price indexing" for calculating initial Social Security benefits under the traditional system, with adjustments for income levels as follows:

- **Low-Income**. Individuals making less than a certain threshold level (approximately $27,700 per year in 2018) will continue to receive initial benefits based on wage indexing. Threshold indexed for inflation.

- **Middle-Income**. Individuals who make between the minimum threshold and the maximum taxable amount (approximately $27,700 and $147,9000 in 2018) will have initial benefits adjusted upward by a combination of wage and price indexing that becomes more oriented toward price indexing as they move up the income scale. For example, an individual whose income is half way between $27,700 and $147,900 (in 2018 dollars) will have his initial benefit adjusted upward approximately 50 percent by wage indexing and 50 percent by price indexing. These amounts will also be adjusted for inflation.

- **Upper-Income**. Individuals who make more than the taxable maximum amount (approximately $147,900 in 2018) will have initial benefits adjusted upward by price indexing, also adjusted for inflation.

- **No Effect on Colas**. The proposal does not affect the cost-of-living adjustment [COLA] that Social Security beneficiaries receive each year once they have already begun receiving benefits. Further, it does not affect any individuals over 55, as it is not applied to Social Security beneficiaries until 2018.

▫ *Acceleration of Ongoing Retirement Age Increase*. Advances by 1 year the current retirement age adjustment, which, under current law, gradually rises to
67 years of age for those who reach that age in 2027.

▫ *Modernizes the Retirement Age.* After the normal retirement age of 67 is reached in 2026, indexes further adjustments in the retirement age in accordance with the Social Security Administration's projected life expectancy, which is expected to gradually increase the normal retirement age by 1 month every 2 years. At this rate, the normal retirement age would remain below 70 years until the next century. Does not affect the ability of an individual to retire early if he or she elects to retire early and has accumulated enough wealth to retire early.

TITLE V: SIMPLIFIED INCOME TAX

▫ *Revenue Projections*. In combination with Title VI below, holds total Federal revenue to no more than 19.0 percent of gross domestic product [GDP] for the foreseeable future.

▫ *Offers Individual Taxpayers a Choice*. Provides individuals the choice of paying income taxes in either of two ways: 1) under a new Simplified Tax, or 2) under the existing tax code.

- **Current Code Taxpayers**. Those choosing the current code will pay their income taxes with existing tax forms, the current set of exemptions, exclusions, deductions, and credits; but the alternative minimum tax [AMT] is eliminated.

- **Individuals Choosing Simplified Tax**. The new Simplified Tax broadens the tax base by clearing out nearly all of the existing tax deductions and credits, compresses the tax schedule down to two low rates, and retains a generous standard deduction and personal exemption.

▫ *AMT Repeal*. Eliminates the alternative minimum tax [AMT] entirely and permanently.

▫ *Selection of Simplified Individual Income Tax*. Applies the following rules for choice of individual income tax:

- **Initial Election**. The election must be made within 10 years from the time that the Simplified Tax is established. Individuals are not allowed to switch between tax systems on a year-by-year basis.

- **Changeover Options**. After the initial choice is made, however, individuals are allowed one additional changeover between the two tax systems over the course of a lifetime. Individuals are also allowed to change tax systems when a major life event (death, divorce, marriage) alters their tax filing status.

Applies the Simplified Tax solely to Federal individual income taxes. Does not affect other Federal individual taxes, such as payroll taxes and excise taxes.

▫ Two-Rate Tax Schedule. Creates the following Simplified Tax rates:

- **Ten-Percent Rate**. A rate of 10 percent applies to adjusted gross income [AGI] (defined below) up to $100,000 for joint filers, and $50,000 for single filers.

- **Twenty-Five Percent Rate**. A rate of 25 percent applies to taxable income above $100,000 for joint filers and $50,000 for single filers. (See Table for a comparison with current tax brackets.)

▫ *Adjusted Gross Income, Standard Deductions, and Personal Exemptions*. Defines taxable income as equal to earnings minus a standard deduction and personal exemption. The standard deduction is $25,000 for joint tax filers, $12,500 for single filers. The personal exemption is $3,500. The combination is equivalent to a $39,000 exemption for a family of four.

▫ *Returns to Savings Tax Exempt*. Contains no tax on interest, capital gains, or dividends.

▫ *Broader Tax Base*. Eliminates, in the Simplified Tax, virtually all of the credits and deductions in the existing tax code, but retains a generous standard deduction amount while lowering tax rates. Retains health care tax credit described above.

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TITLE VI: BUSINESS CONSUMPTION TAX

▫ *Business Consumption Tax*. Eliminates the current corporate income tax and replaces it with a Business Consumption

Tax of 8.5 percent on goods and services. BCT calculated using the "subtraction method."

- Businesses determine their tax liability by subtracting their total purchases (e.g. material costs from other businesses) from total sales.

- The BCT is imposed on this net receipts figure (i.e the firm's value added) and paid to the Federal Government each reporting period.

▫ *Treatment of Investments*. Allows immediate expensing of investments.

▫ *Border-Adjustability*. Lifts the BCT on exports leaving the U.S. and imposes it on imports when arriving in the U.S.

TITLE VII: JOB TRAINING REFORMS

▫ *Competition for Job Training Grants*. Requires competitive bidding for all job training grants awarded to private contractors. Gives greater weight to applications that leverage Federal resources with private investment, and prohibits the renewal of grants that fail to help trainees succeed.

▫ *Performance Measures*. Creates one set of performance metrics for all Federal job training programs.

▫ *Transparency*. Requires that both the training outcomes and the spending data for all job training programs are placed on a centralized website for access by the public.

▫ *Encouragement of State Innovation*. Gives each State the option to develop, in conjunction with the Department of Labor, a 3-year plan to improve training outcomes. Allows each State, as long as the approach is successful, to consolidate the funding streams of up to 48 existing Federal job training programs into one integrated and streamlined block grant.

▫ *Accessibility*. Removes barriers separating the Workforce Investment Act sequence of services and enables job counselors to match certain job seekers with needed training in a timely fashion, giving special consideration to displaced workers and workers in danger of being displaced.

▫ *Life-Long Learning Awareness Campaigns*. Requires recipients of job training grants to conduct public awareness campaigns on the need for, and availability of, job training opportunities in the local community. Provides incentives for the Nation's broadcasters to do the same through Public Service Announcements.

▫ *Accountability*. Requires the Government Accountability Office [GAO] to conduct periodic reports on how well the job training programs are working based on the new common metrics, and how much duplication still exists among the programs. Prohibits the act of "cream-skimming" to meet performance goals, and requires both the Department of Labor's Inspector General and the GAO to conduct periodic audits looking for such problems.

TITLE VIII: BUDGET PROCESS REFORM

▫ *Cap on Total Government Spending*. Establishes a binding cap on total spending as a percentage of GDP at the levels projected to result from this legislation.

▫ *Discretionary Caps*. Establishes statutory caps, enforced by sequestration, to freeze non-defense discretionary spending.

▫ *Annual Long-Term Projections*. Requires that, every year, the Office of Management and Budget [OMB] and the Congressional Budget Office project Federal Government spending levels and compare those levels to the government spending limits.

▫ *Excess Spending*. Creates a mechanism to automatically slow the growth in faster-spending entitlement programs, applied every 5 years, if spending is projected to exceed the established limits, and Congress has failed to address the problem during the previous 5 years. Under the mechanism, requires OMB to make across-the-board spending reductions in both mandatory and discretionary programs by a percentage calculated to bring spending under the cap, but applies the reduction only to fast-growing programs, and is limited to no more than 1 percent of a program's spending.

▫ *Congressional Grace Period*. Provides that, after the spending reduction is ordered, it does not go into effect until the next fiscal year, affording the Congress time to act to correct the problem before the automatic spending reductions go into effect.

▫ *Suspension in Times of Low-Growth or War*. Provides that spending reductions would not be required if the nation is at war or suffering an economic downturn.

▫ *Supermajority Requirement for Tax Increase*. Requires a three-fifths vote in the House and Senate to consider legislation that would cause a net increase in Federal revenue.