# Putting Budgets in Their Place:

## *How Redesigning Government Will Change Spending and Taxes*

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**Overview**

The redesign of American government proposed here requires major changes in spending and taxation at all levels of government—local, state, and federal.

The bottom line would not change much. If all of the reforms proposed here had taken effect in FY 2013, the results would have be as follows:

- Spending: Spending would have fallen, from $6,109 billion to $5,939 billion;
- Revenue: Own-source total revenue (i.e., not provided by another level of government) would also have declined, from $5,611 billion to $5,458 billion;
- Taxes: Taxes would have fallen substantially, from $4,718 billion to $4,222 billion;
- Fees: Utility fees would have risen substantially, from $266 billion to $618 billion;
- Deficit: The combined deficit would have shrunk a bit, from $499 billion to $481 billion.

Although the overall budgetary picture would not change much, the many policy changes proposed here —involving the creation of new programs, the elimination of existing ones, and the reform of user fees and taxation—would nonetheless result in dramatic changes in government budgets *within* government budgets at every level.

The major budget changes proposed on the "spending side" would take place in the areas of economic security, welfare, health care, childcare, education, and roads. (Two other sets of changes—(1) reform of the tax system, and (2) off-budget financing of health insurance—are discussed separately.)

The five major budget changes proposed on the "revenue" side involve: (1) greatly reducing local property taxes; (2) significantly lowering local and state governments' sales and income tax collections, and slightly cutting federal income

tax collections, at the same time as adopting the revenue-neutral policy (going forward) of broadening the tax base and lowering tax rates; (3) replacing the current federal individual income tax with one that is fairer, simpler, and less onerous, and that also offsets the higher revenue loss due to delivering the proposed new Earning Supplement through the income tax system with approximately the same revenue gains arising from ending all tax subsidies for particular forms of income, consumption or investment; (4) lowering corporate income taxes; (5) raising taxes on alcohol and tobacco; and (6) ending tax subsidies for utilities—particularly roads, but also transit and the postal service—and requiring that users pay 100% of the true cost of the utility services they use.

Finally, two major policy changes would occur "off-budget." They involve (1) increasing the federal minimum wage, and (2) financing Health Insurance Purchasing Accounts for all Americans from birth through age 65, at which age Medicare eligibility typically begins.

The following sections cover:

- Proposed spending reforms
- Proposed tax and other revenue reforms
- Proposed "off-budget" reforms

At the end, several appendices provide additional detail.

## Proposed Spending Reforms

### Economic Security and Welfare

In this broad area, five major changes in policy—and, thus, in budgets—would occur.

(1) ***Creation of a national Transitional Jobs Program****:* Increase federal spending by $125 billion.

The federal Bureau of Labor Statistics (BLS) estimated in 2013 that the following number of U.S. adults were "officially" unemployed:

- Approximately 6 million for 15 weeks or more;[1]
- Approximately 2.8 million for 5-14 weeks;[2] and
- Approximately 2.7 million for less than 5 weeks.[3]

In addition, BLS estimated there were roughly 850,000 "discouraged" workers.[4] Another group of approximately 7.9 million were employed part-time for "economic reasons."[5]

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[1] Bureau of Labor Statistics, "Number Unemployed for 15 Weeks or More," Persons 16 and over, ID #: LNS13008516, http://data.bls.gov/pdq/SurveyOutputServlet, data extracted June 20, 2016, 12:30 PM Central

[2] Bureau of Labor Statistics, "Number Unemployed for 5-14 Weeks," Persons 16 and older, ID #: LNS13008756, http://data.bls.gov/pdq/SurveyOutputServlet, data extracted June 20, 2016, 12:30 PM Central

[3] Bureau of Labor Statistics, "Number Unemployed for Less than 5 Weeks, "Persons 16 and older, ID #: LNS13008396, http://data.bls.gov/pdq/SurveyOutputServlet, data extracted June 20, 2016, 12:30 PM Central

Assuming that (A) 50%, 30%, and 20%, respectively, of the 15 week+, 5-14 week, and less-than-5 week groups of unemployed would decide to work full-time in a Transitional Jobs; (B) 20% of "discouraged workers" would do so; (C) 20% of those working part-time for "economic reasons" would wish to work half-time in a Transitional Job; (D) the average yearly cost of a full-time Transitional job (including wages, payroll taxes, and administration) was $22,080 (equal to the product of $10/hour x 40 hours/week x 48 weeks/year multiplied by 115% to cover taxes and administration); and (E) the average yearly cost of a part-time Transitional Job was thus $11,040; then the cost of providing the unemployed and underemployed jobseekers in question with wage-paying Transitional Jobs would be $122.9 billion.

The estimate is rounded up here to $125.0 billion in additional federal spending. The net cost to the federal government might be less, since most of the $125.0 billion would be taxable earnings. Even if the TJ workers made too little to pay income taxes, all of their earnings would be subject to federal FICA and Medicare payroll taxes. However, the net cost might be somewhat greater, to the extent that the additional tax revenue that the IRS collects is offset by greater Earning Supplement payments (based on the new program described in the next paragraph).

(2) ***Replacement of the EITC and Child Tax Credit with a single, unified Earning Supplement.*** Reduce federal costs by $79.1 billion, and reduce federal revenue by $1,030.2 billion gross and $978.7 billion net.

For both budgetary and administrative reasons, it makes the most sense—at least for the immediate future—to deliver this Earnings Supplement as a refundable income tax credit, via the federal individual income tax, and thus not treat it as a direct federal expenditure but as a reduction in federal revenue.[6]

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[4] Bureau of Labor Statistics, "Number Not in Labor Force, Searched for Work and Available, Discouraged Reasons for Not Currently Looking, Want a Job Now," Persons 16 and older, ID #: LNU05026645, http://data.bls.gov/pdq/SurveyOutputServlet, data extracted June 20, 2016, 12:30 PM Central

[5] Bureau of Labor Statistics, "Number Employed Part Time for Economic Reasons," Persons 16 and older, ID #: LNS12032194, http://data.bls.gov/pdq/SurveyOutputServlet, data extracted June 20, 2016, 12:30 PM Central

[6] While much of the current EITC and Child Tax credit are treated as federal expenditures ($57.5 billion in the case of the EITC, $21.6 billion in the case of the CTC), a substantial portion of the cost of the current EITC and much of the cost of Child Tax Credit currently offset individuals' tax liabilities, thus reducing federal revenue. The pattern has therefore already been set to structure the new Earning Supplement as a reduction in revenue. Moreover, since the EITC does not extend to many middle-income and almost all high-income filers (and the CTC also phases out as income reaches higher levels), but the proposed Earnings Supplement is not means-tested and thus is available to all workers, a much higher share of the Earnings Supplement will offset tax liability and reduce federal revenue. The only "innovation" here is to measure and count the *full* amount of the Earning Supplement as a reduction in federal revenue.

Additionally, since the earnings reported on federal tax filers' 1040 forms are the basis for the Earnings Supplement, it is appropriate to use the tax-filing process to make the final calculation of the amount in question.

Finally, since the Earning Supplement is treated as fully taxable income, it simplifies the tax-filing process for filers to use a single 1040 to both calculate the final Earnings Supplement and a few lines later add it to other taxable income for purposes of determining tax liability.

As the subsequent discussion of tax reform makes clear, this reduction in federal revenue is offset by a series of policies that increase federal revenue. Thus, treating the entire Earning Supplement as a revenue offset will not mean collecting less in total federal revenue.

Unlike the means-tested EITC and partially means-tested Child Tax Credit, the new Earning Supplement would go to every American worker. It would be adjusted upwards for 1, 2, and 3 or more dependent children. It would be treated as fully taxable income.

In 2013, approximately 163.4 million individuals reported $5,936.7 trillion in OASDI (Social Security) taxable earnings.[7] Some were younger than 18 or older than 69. Assuming that (A) the approximately 154.9 million workers between ages 18-69 *potentially* qualified for an Earning Supplement; (B) 95% of them claimed an Earnings Supplement; and (C) the average Earning Supplement was $7,000 (less for workers with no children, more for workers two or more children) the federal revenue loss attributable to the Earning Supplement would be $1,030.2 billion (i.e., $1.0 trillion) per year.

It is reasonable to assume that, since the Earning Supplement is taxable income (as part of this proposal's overall recommendation for tax reform), at least 5% of Earning Supplement payments would be "recaptured" as federal tax revenue. The net revenue loss attributable to the Earning Supplement, therefore, would be $978.7 billion. (To the extent that a larger Earnings Supplement induces more individuals to work on balance, it may also generate additional offsetting income tax revenue as well as additional FICA and Medicare payroll tax revenue.)

The impact of the Earnings Supplement on the reduction in federal revenue would of course be the difference between the *new* estimate of net revenue lost, $978.7 billion, and the *existing* amount of revenue lost because of tax filers' EITC and CTC claims.

The total cost of the new Earnings Supplement to the federal government as a whole would be further reduced by the avoidance of the $79.1 billion cost of the refundable portion of the existing ETIC and CTC.

Many states (and a few localities) now "piggy-back" on the federal EITC. They would be free to either discontinue this policy, or choose to continue to "piggy-back" on the new Earning Supplement at a lower, constant, or higher cost. No prediction of what states and localities might do, or estimate of what those decisions would cost, is provided.

(3) ***Expansion of disability benefits****:* Increase federal spending by $59.0 billion.

In 2013, federal SSDI (Social Security Disability Insurance) benefits and administration cost $142.8 billion. Federal SSI (Supplemental Security Income) benefits cost $53.8 billion. The total was therefore $196.6 billion.

The proposal here is to increase the sum by 30%, thus spending $255.6 billion—an additional $59.0 billion—on disability benefits and administration. In

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[7] Social Security Administration, "Annual Statistical Supplement to the Social Security Bulletin, 2015," Table 4.B1—Number of workers with taxable earnings, amount of earnings, and Social Security numbers issued, selected years 1937–2014," and Table 4.B10—Number of workers with Social Security (OASDI) taxable earnings, amount taxable, and contributions, by state or other area and type of earnings, 2013, and Table 4.B5—Number of workers, by sex and age, selected years 1937–2013, https://www.ssa.gov/policy/docs/statcomps/supplement/2015/supplement15.pdf, extracted July 1, 2016, at 11 AM Central.

addition, either the means-testing of SSI would be eliminated, or (as assumed here) the program would simply be folded into SSDI under a policy in which (A) every adult who qualifies for disability benefits would receive a payment above the poverty line, (B) SSDI recipients would receive a larger amount to reflect their work-based contribution to the SSDI component of Social Security, and (D) all applicants and recipients would have ample opportunities and clear incentives to work instead of seeking or receiving disability benefits.

Like all other income, SSDI benefits would be fully subject to taxation. However, the proposed reduction in local property taxes, together with reforms in the federal individual income tax itself, would reduce the overall tax burden of SSDI recipients as a whole

The proposed 30% increase in spending is a placeholder for a more in-depth analysis of the federal cost of ensuring that all adults with disabilities receive a minimum benefit that significantly exceeds the poverty line. It is beyond the scope of this proposal to prepare such an analysis, particularly since countervailing behavior will impact the fiscal outcome in response to two competing incentives: (1) the incentive to obtain disability status because the minimum benefit is higher vs. (2) the conflicting incentive to leave or avoid disability status because wage-paying Transitional Jobs are available, at a higher minimum wage, and with a larger Earning Supplement.

(4) ***Expansion of Social Security benefits****:* Increase federal spending by $46.9 billion.

In 2013, federal Social Security retirement benefits and administration cost $670.6 billion. The proposal here is to increase the amount by 7%, thus spending $717.5 billion—an additional $46.9 billion—on Social Security.

This increase is also a placeholder, pending a more in-depth analysis of the federal cost of ensuring that all retired seniors (i.e., the overwhelming majority who qualify for Social Security retirement benefits) receive a minimum benefit that significantly exceeds the poverty line.

This proposal makes no assumption about how the increase in Social Security payments would be financed. In the long term, the proposed increase in employment and raise in wages would generate additional Social Security payroll tax revenue even if no other changes took place. If such additional revenue is insufficient to finance the added cost, it may be necessary to make changes in the program's structure itself. Various experts have proposed (A) changing the inflation formula, (B) increasing the "normal retirement" age, (C) modifying the formula for non-inflation-based increases in benefits that now occur from age 62 to "normal retirement" and then on to age 70, and/or (D) increasing the payroll tax rate above 6.0% percent for employees, employers, or both.

This proposal does assume that, going forward, all Social Security income would be fully subject to taxation, but the proposed (A) reduction in local property taxes, together with (B) reforms in the federal individual income tax, would reduce the overall tax burden of Social Security recipients as a whole.

It is also an expectation of this proposal that the proposed reform of the health insurance system will drive down the relentless (albeit recently improved) increase in health care costs, and that Medicare enrollees will be a major beneficiary.

(5) ***Elimination of "poverty-requiring" welfare programs*****:** Decrease local, state, and federal spending by $626.1 billion.

A central feature of this proposal—in conjunction with the creation of broad-based economic security programs and equal opportunity in health and education—is the elimination of all means-tested welfare programs.

Thus, the following programs would be eliminated:

- Temporary Assistance to Need Families (TANF): Decrease of $17.1 billion in federal spending;
- Food Stamps (officially known as Supplemental Nutrition and Assistance Program, or SNAP): Decrease of $82.6 in federal spending;
- Low Income Home Energy Assistance Program (LIHEAP): Decrease of $3.5 billion in federal spending;
- Housing and "community development" programs: Decrease of over $100 billion in local, state, and federal spending.
- WIC: Decrease of $25.9 billion in federal spending.
- Medicaid: Decrease of $426.6 billion in local, state, and federal spending.

A number of welfare programs that are *not* (or at least need not be) means-tested would continue, e.g., (A) child welfare programs, including foster care and permanency; (B) refugee assistance; (C) child support collection; and (D) Indian Health Services.

Even with a comprehensive economic security system in place—one that provides easily accessible Transitional Jobs, a higher minimum wage, a larger Earnings Supplement, and higher minimum disability and Social Security payments—there will remain a need for such programs to protect abused and vulnerable children, make sure absent parents meet their support obligations, and meet our obligations to refugees and Native Americans.

The "poverty-requiring" components of the welfare system, however, can disappear.

**Education**

The proposed budget would result in major changes in the areas of childcare, K12 education, and college education.

(1) ***Creation of universal access to childcare***: Increase federal spending by $99.4 billion.

In 2013, the federal government spent $5.1 billion on childcare. This included $2.2 billion in federal "Payments to States for the Child Care and

Development Block Grant" and $2.9 billion for federal "Child Care Entitlement to States."

The need for childcare is far greater. According to the U.S. Census Bureau, in 2013 the United States had 19.9 million children under 5 years old.[8] If we assume that 70% of these children were ages 0, 1, and 2, plus half of the 3 year olds not attending 3-year old kindergarten, then roughly 13.9 million American kids would *potentially* be in need of child care. Many parents of course will of course wish to take care of their own children at home, or make arrangements with grandparents, relatives, or trusted friends.

But if we assume that (A) parents will seek childcare for 75% of these younger children, and (B) the average cost is $10,000 per year, then the amount that should be budgeted for childcare is $104.5 billion.

Compared to the 2013 level of $5.1 billion, this is a $99.4 billion increase. Since most governmental funding for childcare is already federal, and because of the magnitude of the proposed increase, is would be most appropriate for the federal government to bear the cost.

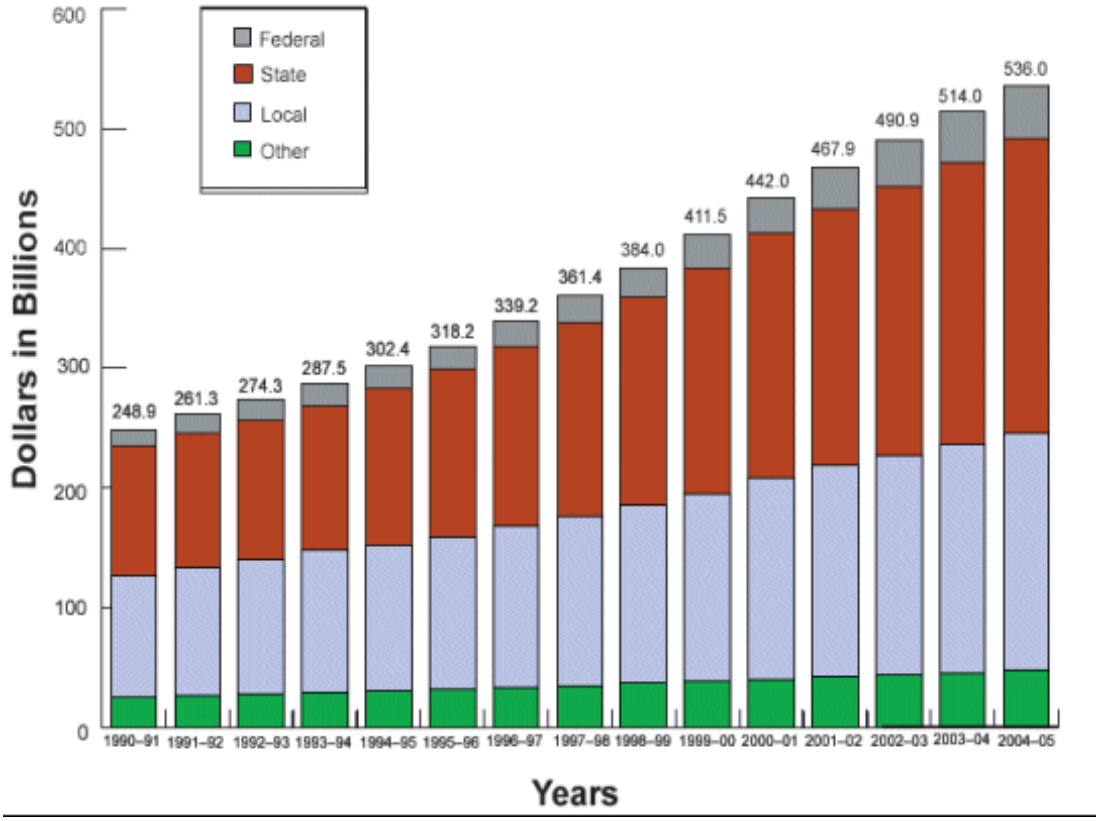
(2) ***Equal K12 education spending, financed by the states***: Keep overall spending at the same level, but move full responsibility for financing K12 education to state governments**.**

In 2013, the Census Bureau reports, American government spent $612.2 billion on K12 education. Of that, local government spent $563.4 billion, with the balance attributed to state governments ($6.4 billion) or the federal government ($42.4 billion).

Unfortunately, this allocation is highly misleading. A huge share of K12 education spending—varying from state to state, but in some states the *largest* expenditure—really came from *state* school aid payments. Altogether in 2013, local governments received $469.3 million from their state governments in what the Census Bureau defines as "Intergovernmental Revenue." The lion's share consisted of payments to local school boards from their respective states. The following chart illustrates—in red—how, for many years in the U.S. as a whole, the portion of K12 education funded by state governments has constituted the larger share:[9]

[8] U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplement, 2013. "Age and Sex Composition in the United States: 2013," Table 1. Population by Age and Sex: 2013, Internet release date: March 2016, https://www.census.gov/population/age/data/2013comp.html

[9] U.S. Department of Education, "Total U.S. Expenditures for Elementary and Secondary Education," from *10 Facts About K-12 Education Funding*, http://www2.ed.gov/about/overview/fed/10facts/index.html




According to the U.S. Department of Education, during the 2004-2005 school year, local governments funded 37.1% of K12 education, while state governments spent 45.6%.[10]

This proposal calls for the full cost of K12 education to be taken over by state governments. The prior discussion about the already high level of state support for K12 schools makes clear that changing from what state governments now pay for K12 schools to the states' assumption of 100% financing is not as big a jump as some may think. Nonetheless, it is a very large increase in state fiscal responsibility. The overall reform of American government proposed here, however, largely offsets the proposed increase in state spending for K12 schools by dramatically reducing state spending on college education (which the federal government would more than make up) and ending state funding for Medicaid (as part of the larger policy of eliminating means-testing welfare programs).

What, then, would full state financing of K12 education cost? In the 2012-2013 school year, the U.S. Department of Education reports that student membership in public schools the United States was 49.8 million, and the average per-pupil expenditure was $10,763.[11] The Department estimated that 5.4 million PreK-12 students attended private school in 2013-2014.[12]

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[10] *Id.*.

[11] U.S. Department of Education, National Center for Education Statistics, *Revenues and Expenditures for Public Elementary and Secondary Education: School Year 2012-2013 (Fiscal Year 2013): First Look: January 2016,*

If we assume that (A) all of these students received a Child Care and Education Account; (B) the account's value for the 49.8 million *public* school students continued to average $10,763 per year; (C) the school expenditure for 5.4 million *private* students was $7,500 per year (reflecting the fact that some private schools do not provide costly special education services to the same extent, and do not provide other services that public schools are required to incur); and (D) 20% of private school students forego the assistance in question because their schools decide they do not wish to comply (as is their right) with the rigorous standards that appropriately attach to the expenditure of taxpayers' funds; then the cost to state governments of providing all 54.5 million participating students with funding for K12 education would be $571.1 billion.

Note that the above per-pupil account values are averages. The payment formula needs to be constructed so that a base amount *lower than the average* is paid on behalf of each student, with *upward adjustments* made for students who have a disability and thus require special education services (as required by the Individuals with Disabilities Education Act, or IDEA), or need help in mastering English as a second language, or both.

In addition, this proposal includes a substantial sum—here assumed to be $41.0 billion—to provide additional support to schools, whether public or private, that accept responsibility for teaching a higher than average share of low-income (and, thus in most parts of the U.S., minority) students. This will assist them in meeting the more difficult challenge of educating students whose economic circumstances make it harder to learn. Compared to today, the economic security policies proposed here mean that students will be far less likely to grow up in households that have an unemployed parent or have incomes below the poverty line. Nonetheless, a significant number of students will still live in low-income homes and low-income communities, which will make their successful education a greater challenge. The additional $41.0 billion would assist schools that are willing to educate such students. The additional funding is also meant to give an incentive to schools, that now do not enroll a significant number of low-income students (whether intentionally or inadvertently), to increase their outreach to and enrollment of such students.

In total, state K12 spending would be $612.1 billion. A residual expense of $0.5 billion would remain at the federal level for the sole purpose of gathering and disseminating data, recommending best practices, and convening education experts to help improve outcomes.

Thus, compared to the 2013 baseline of K12 spending, $612.2 billion, this proposal calls for spending essentially the same amount, $612.6 billion. Reform would not lie in spending a different amount, but in dramatically: (1) altering which government is responsible for financing K12 education; (2) equalizing K12 education funding on a per pupil basis, so that the accident of birth or residence

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NCES 2015-301, Table 4, "Student membership and current expenditures per pupil for public elementary and secondary education, by function, subfunction, and state or jurisdiction: Fiscal year 2013," p.12, http://nces.ed.gov/pubs2015/2015301.pdf

[12] U.S. Department of Education, National Center for Education Statistics, *The Condition of Education*, "Private School Enrollment," May 2016, http://nces.ed.gov/programs/coe/indicator_cgc.asp.

does not determine how much money is spent on a child's education; (3) assisting schools that agree to educate higher-than-average proportions of low-income students; (4) vesting power in parents to decide—regardless of where their children happen to reside—where to send their children to school; and (5) increasing the accountability of all schools that receive taxpayers' dollars to meet rigorous, statewide standards of safety, teacher and staff certification, and annual academic achievement gains for the overwhelming majority of its students, according to regional or state K12 school inspection and certification agencies.

(3) ***Tuition-free college education, financed by the federal government:*** Decrease state spending by $137.1 billion, and increase federal spending by $190.0 billion, thus increasing overall funding for higher education by $52.9 billion.

In 2013, local support for college education stood at $39.0 billion. Given the large costs of K12 education that this proposal removes from local property tax levies and other local tax sources, this expenditure—often associated with supporting local community and technical colleges—can remain.

State spending in 2013 on college education was far greater: $222.1 billion. Much of this derived from fees appropriately paid students for dormitory rooms, food, and other services, as well as from federal research grants. Nonetheless, large share was due to student tuition payments and state tax support.

Given two of the important policies proposed here—(1) sharply reducing and in time eliminating tuition for most college students who qualify to attend college, and (2) assigning to state governments 100% of the responsibility for funding K12 schools—two further policy changes logically follow.

First: reduce state financing of college education. The proposal here is to decrease state spending from $221.1 billion to $85.0 billion.

Second: expand federal financing of college education, but by a much greater amount. The proposal here is to take federal spending on college education from nearly zero (if the Census Bureau's data can be believed) to $190 billion.

This shift expands the *overall* level of funding for higher education by $52.9 billion.

It is beyond the scope of this proposal to estimate how large a drop in college tuition this would allow. The goal is to start by providing all high school graduates (or the equivalent) who qualify for college—and continue to do so—an amount, to be included in their Child Care and Education Accounts, of $15,000 per year to defray the cost of college tuition. To the extent this amount is insufficient to make college fully "tuition-free" in the case of the average college, it can be hoped that over time the $15,000 can be rapidly increased to achieve the necessary amount.

## Road and Other Utility Financing

The final major "on-budget" change that this proposal makes is to eliminate taxpayer subsidies for utilities, particularly for roads (i.e., the entire network of local, state, and federally-supported roads) but also for transit as well as other

government services that are typically labeled as utilities (e.g., water, sewer, electric, and postal service).

Two guiding principles drive the proposed changes in spending and revenue:

First, to the extent new spending is needed, it should overwhelmingly focus on repair and maintenance of *existing* utilities.

American does not need more roads. We need to fix the roads and bridges we already have.

Only in the rarest cases does a country like ours—with a slowly growing population, and with abundant opportunity to build new homes, stores, offices, and factories on land already well-served by the existing road grid—need to widen a highway, much less build a new one. Furthermore, shifting from the current policy of massive subsidies for roads to 100% user fee financing, which would include peak-hour pricing, will reduce demand for the adequately sized road grid we have in place.

Indeed, rather than widen or build new roads, the U.S. should proceed to tear down large segments of the interstate system that run through the heart of our cities, creating beautiful boulevards or new street grids in their place. The experience of several cities in doing this—San Francisco's tearing down of the Embarcadero Freeway, New York City's demolition of the southern part of Manhattan's West Side Highway, and Milwaukee's removal of the Park Freeway stub—have done no harm to traffic patterns. Instead, the result has been to create park-like roadways that are both beautiful and efficient (San Francisco and NYC); restore the local street grid (San Francisco, NYC, and Milwaukee); open up dazzling waterfront vistas (San Francisco and NYC); and add hundreds of millions of dollars in taxable property (San Francisco, NYC, and Milwaukee).

The same policy applies to water and sewer systems. The residents of Flint and other U.S. communities do not need new capacity, i.e., the ability to handle larger volumes of water and sewage. What they need is to repair and properly maintain the water and sewer systems they have, so that residents do not get sick when they have a glass of water, cook, or shower, and so that their disposal of sewage effluent does not foul their communities' rivers, lakes, or groundwater.

The only piece of American infrastructure that does need expansion is transit—subways, light rail, trollies, and buses. After decades of massive subsidies to roads and meager subsidies for transit, America's once extensive transit system has shriveled (with rare exception) into a pathetic shadow of its former self. To paraphrase Donald Trump, we must make American transit great again.

This does *not*, however, mean increasing subsidies. Rather, as we remove all subsidies from the road system and instead require users to pay 100% of its cost, we can on a parallel track (if the expression can be forgiven) remove all subsidies from the transit system and require users to pay its full cost. This should include the cost of expanding the transit system where, based on utility principles, there is reason to believe that fares and advertising will be sufficient to pay off the debt incurred in financing the transit expansion

Second, tax subsidies for all utilities should end, and users should bear 100% of the cost. It is beyond the scope of this proposal to delve into the details of utility financing, but several overarching principles are worth mentioning:

•The costs that users pay should truly correspond to 100% of the cost. This means, in the case of roads, the full cost of all repair and maintenance (and any construction and demolition); the full cost of sweeping, plowing, lighting; the full cost of highway policing, as well as a substantial portion of the cost of local policing (since much of local policing involves enforcement of traffic regulations); and the remission of taxes, or payments in lieu of taxes (PILOT), for land that is removed from the tax base to allow for the road.

•User fees should vary by factors that significantly affect cost. This means, in the case of roads, charging trucks a higher fee per mile based on weight, since heavier trucks do substantially more damage to roads. In the case of water and sewage, this means charging higher fees to users whose water and/or effluent requires higher costs to pump or treat. Not only is this approach essential in order to fairly allocate costs to users, but it also contributes to conservation of resources and reduction of pollution. "Heavy" or "dirty" users of roads, water, and sewage systems who must pay more will find ways to become more efficient, including driving less (reducing air pollution) and discharging less—and less harmful—sewage effluent (less water pollution).

•Finally, user fees should vary based on peak loads. This is particularly relevant to roads, where time-of-day pricing has long been understood as a vehicle for reducing traffic congestion during the morning and evening rush hours. The same approach applies to transit systems. The goal is not only to make the ride (whether in one's own car or a transit vehicle) more pleasant and shorter, but also to avoid the pressure to add capacity that is really not necessary.

The main impact of this policy change occurs at the local level.

(1) ***Road maintenance spending and financing:*** Increase <u>overall</u> spending on roads by 28%, or $44.6 billion, from $162.3 billion to $207.0 billon, to catch up on road repair and maintenance (+20%) and include in the road budget the currently-excluded cost of road policing (+8%).[13]

Restructure spending to allocate 95% of all spending to repair and maintenance, 5% for demolition).

Place local governments in charge of road repair and maintenance, except for state and federal highways (or roads on state and federal property).

At the same time, finance the entire $207.0 billion cost with user fees, treating local, state, and federal agencies as road utilities that would collect fees from drivers based on the principles outlined above.

Currently, property taxes and other taxes subsidize a large share of the cost of roads, with user fees and *ersatz* user fees (like the gas tax or motor vehicle license fees) covering far less than the full cost.

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[13] The Census Bureau's definition of road spending, which is labeled as "highways," does not include policing. "Highways: 'Construction, maintenance, and operation of highways, streets, and related structures, including toll highways, bridges, tunnels, ferries, street lighting and snow and ice removal. However, highway policing and traffic control are classed under Police protection.'" http://www.census.gov/govs/local/definitions.html

Current true user fees do not add up to much. In 2013, localities collected only $6.6 billion and states collect only $8.5 billion in road fees. If gas taxes are counted as user fees (though not directly based on road usage, but rather on the number of gallons of gas purchased regardless of use of the road grid), then it is necessary to add most of the taxes collected on motor fuel sales for "highways" and airports, which in 2013 involved $1.3 billion at the local level, $40.1 billion at the state level, and $49.3 at the federal level. By the same logic, we should count motor vehicle license fees, which came in at $1.9 billion at the local level and $23.2 billion at the state level. If we count all of this (less an arbitrary deduction of 5% to account for motor vehicle fuels for airports), then the sum of true user fees, gas taxes, and motor vehicle license fees is $127.3 billion.

This sum of true user fees, motor fuel sale taxes (less an assumed 5% for airport uses), and motor vehicle license fees, i.e., $126.4 billion, represents 78% of the $162.3 billion that American governments spent in 2013 on roads. In other words, property taxes and other taxes subsidized $35.9 billion, or 22%, of the cost of the road system. If the tax subsidy that policing involves is included, then the tax subsidy for the road system approximates a quarter of the total cost.

Compared to the $207.0 billion we *should* be spending on roads (a 20% increase to pay for repair and maintenance, plus at least 10% of the cost of local policing and 25% of the cost of state policing), the tax subsidy for roads would rise to 39%. The $127.3 collected in true user fees, gas taxes (as calculated above), and license fees would drop to 61% of such a right-sized road budget.

The tax subsidy would reach 42%--and the sum of existing user fees, gas taxes, and license fees drop further to 58%--if the subsidy were expanded to include a hypothetical $10 billion in higher taxes for local property owners that roads do not pay for on the many, long, ribbons of urban and rural land that roads currently withdraw from the tax base.

The calculation of precisely what costs should be incorporated into the "cost base" of a road utility will necessarily have to be left to the policies and rulings of state public utility commissions. The commissions may of course differ in their conclusions. The important point here is that, whatever the cost "base" of a road utility is finally determined to be, it will (A) involve higher costs than now, because of the need to spend substantially more to repair and maintain the road grid, as well as the logic of allocating road policing costs and possibly a property tax responsibility to the road utility; yet (B) result in a dramatic reduction in property tax subsidies and other tax subsidies for the road grid; because (C) of the decision to rely entirely on user fees to pay for the costs of the road grid.

The following table summarizes the changes proposed here for spending and financing roads:

| | Government Spending and Revenue Under Current Policies | | | | | Proposed Government Spending and Revenue | | | |
|---|---|---|---|---|---|---|---|---|---|
| | FY 2013: Billions of Dollars | | | | | FY 2013: Billions of Dollars | | | |
| | **Local** | **State** | **Federal** | **Intergovernmental Transfers from the Federal Government** | **Total** | **Local** | **State** | **Federal** | **Total** |
| **Spending** | | | | | | | | | |
| Roads: | $ 64.7 | $ 94.0 | $ 47.9 | $ (44.3) | $ 162.3 | **$ 134.5** | **$ 62.1** | **$ 10.3** | **$ 207.0** |
| *Maintenance* | | | | | | *$ 127.81* | *$ 59.0* | *$ 9.8* | *$ 196.6* |
| *Demolition* | | | | | | *$ 6.73* | *$ 3.1* | *$ 0.5* | *$ 10.3* |
| **Revenue** | | | | | | | | | |
| User Fees | $ 6.6 | $ 8.5 | | | $ 15.2 | $ 134.5 | $ 62.1 | $ 10.3 | $ 207.0 |
| Motor Vehicle Taxes (assuming 5% for airports)* | $ 1.3 | $ 38.1 | $ 46.8 | | $ 86.18 | $ 1.3 | $ 40.1 | $ 49.3 | $ 90.7 |
| Motor Vehicle License Fees ** | $ 1.9 | $ 23.2 | | | $ 25.1 | $ 0.4 | $ 4.6 | | |
| **Total** | $ 9.8 | $ 69.8 | $ 46.8 | | $ 126.4 | | | | |
| **Subsidy from Property Taxes and Other Taxes *** | | | | | **$ 35.9** | $ - | $ - | $ - | $ - |

*Under the proposed reform, motor vehicle fuel sales would continue to be taxed, but the resulting revenue would be treated the same as other sales and included in the state's sales tax revenue (except for the taxes used for aiports).
**Under the proposed reform, motor vehicle license fees would be reduced by 80%, with the remaining funds used only to cover the cost of issuing and supervising licenses.
***Since it is difficult to know which portion of local and state government road spending was financed with their own revenues vs. fund transfers from the federal government, no estimate of tax subsidies at the local or state level is provided. Only the overall tax subsidy is estimated (less the subsidy for road policing).

(2) ***Transit spending and financing****:* Increase transit spending overall by $48.9 billion, and shift full financing of transit to user fees on a utility basis.

Currently, American governments at all levels spend $65.1 billion on transit. For the reasons expressed at the beginning of this section, this proposal calls for an 75% increase in transit funding to $114.0 billion. Of that, $75 billion would be at the local level, $20 billion at the state level, and $19 billion at the federal level.

Just as users should pay for roads and other utilities, users should pay for transit. A combination of growing demand for transit, and its greater affordability, will make it fairly easy for users to be able to afford the resulting fares.

Two components of this overall proposal will make transit more affordable. First, the large gains in disposable income for many Americans (particularly lower-income and middle-class Americans)--due to the proposed reforms of the nation's economic security system (already discussed), the tax reforms already mentioned (i.e., greatly lower property taxes), and additional tax reforms still to be discussed (i.e., in the proposal on reforming the federal individual income tax)--will make it much easier for the majority of Americans to afford transit fares.

Second, the elimination of the current massive taxpayer subsidy for roads, in favor of requiring users to pay the full cost of the roads they use on an as-you-drive basis, will not only increase the disposable income of many renters and property owners but also encourage them to use transit options to get around. This will enable transit systems to hold down fares—even as they expand—because such a high portion of transit system costs is fixed. When the number of users of a train, subway, light rail, trolley, or bus increases, the transit utility experiences an immediate gain in revenue. Its costs, however, may not rise at all, or will increase slowly. Regardless of whether 100 or 500 people ride a train or subway car, and regardless of whether 25 or 50 people take the bus, the cost per mile is pretty much the same.

In 2013, of the $65.1 billion that all governments spent on transit, utility financing resulted in $11.6 billion in local revenue and $3.5 billion in state revenue, for a total of $15.1 billion. Thus, the taxpayer subsidy for transit was $50.1 billion, or 77% of the total $65.1 billion cost. The $15.1 billion in user fees and (presumably) advertisement revenue picked up only 23% of the $65.1 billion cost.

The proposal here is to eliminate the use of taxes to subsidize both roads and transit. For transit, this means—if this proposal had been in effect in 2013—both a big increase in transit spending from $65.1 billion to $114 billion *and* the generation of $114 billion in revenue through user fees, advertisements, and other non-tax sources.

(3) ***Other utilities****:* There continue to be, scattered across our governmental system, a variety of utilities—most notably, for water, sewage, and postal services—where taxpayers in some jurisdictions (and, of course, the U.S. Postal Service for the whole country) receive significant tax subsidies for their operations.

This proposal calls for elimination of all such tax subsidies, and the adoption of the universal principle that users of utilities should pay for 100% of their true costs.

## Proposed Tax and Other Revenue Reforms

(1) ***Property tax reform: lower collections, broader base, lower rates:*** Decrease local property taxes by $235.4 billion.

In 2013, local governments collected $442.4 billion in property taxes. This proposal would reduce local property tax collections by 53%, resulting in lower collections of $207.0 billion.

The reduction is attributable to eliminating local responsibility for financing K12 education, and ending the use of property taxes (and other taxes) to subsidize roads and other utilities.

The budget numbers do not necessarily reflect the additional but desirable tax reform of the *structure* of the property tax. Today, local and state governments exempt—or treat unequally—all kinds of real property. This proposal would require that *all* property be taxed, at full market value, but at lower rates. The goal is to treat all property owners the same, not to alter how much revenue is raised. Under the new structure, the amount collected would still be $207.0 billion.

Since some of the special treatment for certain types of property is embedded in state constitutions, the process of ending discriminatory tax treatment in favor of—and thus, implicitly, against—different kinds of real property will take a long time. It should nonetheless be set out as a goal, as part of the larger necessary strategy of eliminating government interference in the market.

If various classes of individuals who own particular types of property need help, they should be helped based on broad principles of economic security. Creating complex property tax exemptions, which often do nothing or little for low-income individuals and skew their benefits towards high-income groups, is both unjust and a drag on the efficiency of the market in real estate.

(2) ***Sales and income tax reform:*** Reduce state sales tax revenue by $63.5 billion; and lower local, state and federal income tax revenue by, respectively $5.0 billion, $115.0 billion, and $25 billion—a total of $145.0 billion.

In 2013, states collected $254.2 billion in sales taxes. This proposal would reduce local property tax collections by 25%, resulting in lower collections of $190.7 billion. The sales tax is the second largest source of general state revenue, but it is a flat regressive tax. Cutting sales tax revenue provides an opportunity reduce the tax burden on all residents of a state.

In 2013, localities, states, and the federal government, respectively, collected $28.9 billion, $309.5 billion and $1,316.4 billion, in individual income taxes. This proposal would trim income tax collections by 17% for localities, 37% for states, and 2% for the federal government. The resulting revenue "take" would be $23.9 billion at the local level; $194.5 billion at the state level; and $1,291.4 billion at the federal level.

A host of factors feed into the ability of American government to provide the kind of essential government services described in this proposal—and, in particular, to greatly strengthen the nation's system of economic security and equal opportunity in health and education—and simultaneously lower local, state, and federal taxes as proposed here. The major factors include:

- *For local governments:* Shifting the cost of K12 education to state governments, and eliminating local tax subsidies for roads, transit, and other utilities;
- *For state governments:* Offsetting the increase in K12 education costs with (1) the elimination of all expenses for means-tested welfare programs (including the very costly state share of Medicaid): (2) a great reduction in state expenditures for college education (which increased federal spending more than offsets, on the way to making college tuition-free); and (3) the elimination of any state tax subsidies for roads, transit, and other utilities;
- *For the federal government:* Offsetting the increase in spending for Transitional Jobs, childcare, and K12 education with (1) very large spending cuts due to ending means-tested welfare programs (including TANF, Food Stamps, and Medicaid); (2) a substantial reduction in road spending, as well as changing the financing for roads from taxation to user fees; and (3) moving "off budget"—in a proposal still to be discussed—the mechanism for financing the Health Insurance Purchasing Accounts of Americans from birth until Medicare eligibility at age 65.

The proposed new revenue collection numbers are not dependent on proposed reforms in tax policy itself.

For all types of taxation (property, sales, and income) and at all levels of government, however, it would be desirable to reform tax policy in order make taxation fairer, simpler, and less damaging to the operation of an effective market. Specifically, as many economists have argued and as President Ronald Reagan accomplished to a limited extent in 1986, we should "broaden the base" of what is taxed and "lower the rates" of taxation that then apply.

To repeat the *leitmotif* heard elsewhere in this proposed redesign of the place of government, the way to help low-income, middle-class, or older individuals

who might be particularly burdened by a tax on a particular type of cost (e.g., rent, mortgage payment, food, utility bill, medical care, etc.) is to increase their income in the manner described in this proposal's comprehensive reform of economic security so that they have sufficient money to pay the full cost *and* the normal tax. Attempting to assist them by manipulating the tax system to create a tax break for the cost in question is the wrong approach for at least three reasons.

First, such tax breaks add complexity to the tax system. They therefore increase the opportunities for fraud and error; add paperwork; and add time and expense.

Second, such tax breaks frequently hand out help to individuals who need no help at all. For example, if we exempt food from the sales tax, we give not only a modest tax break to middle-class families who eat hamburgers and French fries, but a bigger tax break to wealthy people who dine on caviar, filet mignon, and oysters Rockefeller.

Third, such tax breaks often have harmful unintended consequences. For instance, economists generally agree that the primary impact of the mortgage interest deduction is *not* to increase home ownership (since some nations that do not provide such a deduction have comparable rates of home ownership), but rather to induce people who would buy homes anyway to purchase bigger homes that typically consume more energy and contribute more to climate change.

The solution is to make all property, sales, and income taxable, but at a lower rate, thus generating the same revenue as before while making each of the three major tax systems simpler, fairer, and less harmful to the market.

Since the federal individual income tax is America's biggest tax; it is a useful tool for delivering the national Earning Supplement proposed here; its structure currently completes some penalties for getting married; and making it fair requires a few additional policy measures beyond "broaden the base" and "lower the rates," the next section discussed it further and in greater detail.

(3) ***Federal individual income tax reform:*** While this proposal calls for a very modest reduction of $25 billion in federal individual income tax collections, this 2% cut in federal tax collections is the least important proposal regarding the federal individual income tax. The main event is a complete overhaul of the tax itself. The triple aim of the reform is to (A) enable the tax to deliver a national Earning Supplement, (B) eliminate any marriage penalty, and (C) make it much fairer, simpler, and less burdensome.

The proposed model would alter the current federal income tax as follows:

(1) **Treat each adult member of the filing unit separately, except--if a couple that is "married and filing jointly" both request--combining the married couple's refund or payment at the end of the tax-filing process.**

If a couple is married and files jointly, each would separately report her or his income, Earning Supplement, exemption, taxable income, tax rate, and tax liability.

The couple could decide any how best—for them—to allocate jointly owned income, which of them (if they are both earners) claims any dependent children in

claiming their respective Earnings Supplements, and which of them claims dependent children for purposes of claiming the children's Personal Exemptions.

(2) **Treat <u>all</u> income as taxable...no exclusions, in whole or part.**

All earnings, interest, dividends, capital gains, and other forms of income would be fully subject to taxation. This includes all government benefits that individuals receive as cash, i.e., SSI benefits, SSDI benefits, Social Security payments, Unemployment Insurance benefits, Worker's Compensation benefits, Railroad Retirement benefits, etc. No income would be excluded from taxation. No income would be partially included.

(3) **Provide all adult workers with an Earnings Supplement that encourages work, ensures full-time workers end up well above the poverty line, and has no marriage penalty.**

The new Earning Supplements (replacing the current EITC and Child Tax Credit, and described below) would also be fully treated as taxable income.

The Earning Supplement would be calculated as follows:

- For individuals without dependent children: 50% of earnings, not to exceed $5,000 per year (regardless of whether the individual's filing status);
- For the custodial parent or guardian of a dependent child:
  - --For one child: 70% of earnings, not to exceed $7,000;
  - --For two children, and for more than two children if filing singly or married but filing separately: 90% not to exceed $9,000;
  - --If three children *and* married and filing jointly: 110% of earnings, not to exceed $11,000;
  - --If four or more children *and* married and filing jointly, 130% of earnings, not to exceed $13,000.

In the case of a married couple, the worker would the higher earnings would claim the Earnings Supplement (thus, guaranteeing that the family receives the highest possible amount). The reason for basing the Earning Supplement on *individual* earnings rather than on *family* earnings, and for giving a married couple the ability to claim up to 4+ dependent children, is to reverse the EITC's unintended marriage penalty (despite significant improvements made in this area during the last several decades) and achieve marriage neutrality (indeed, in some cases, a marriage reward).

The IRS would be required to deliver up to 80% of the Earning Supplement to workers on a periodic "as you earn" basis. Since virtually all workers will receive the maximum amount, the risk of overpayment—and, thus, any obligation to repay—will be minimal. The 20% balance of the Earning Supplement would be incorporated into any refund the filer is owed.

**(4) Provide all filers with a large Personal Exemption for themselves, a spouse (if married/filing jointly), and each dependent child**.

The proposed Personal Exemption is $5,000 per person. All other exemptions, exclusions, deductions, and credits would be eliminated.

**(5) Apply to taxable income (i.e., all income, including any Earning Supplement, *minus* the Personal Exemption) a progressive tax rate.**

One approach would be to begin by applying a 10% tax rate to taxable income, and then increase the rate by 0.025% (i.e., a quarter of a percent) for each

additional $1,000 increment of taxable income that exceeds $10,000 of taxable income, until capping the tax rate at a maximum of 35%.

This approach, which modern computing technology and on-line tax submission makes possible, avoids the major pitfall of tax brackets, i.e., the incentive to lie or fudge in order to keep all taxable income below the next—significantly higher—tax rate bracket.

The primary benefit of this tax reform model is its fairness and its simplicity. Everyone with income pays taxes; no one with income can "get away with murder" by paying nothing or far less than a fair share. Of equal importance, everyone with the *same* filing status and the *same* income from the *same* sources would have the *same* taxable income and also pay the *same* final tax. Finally, for most Americans, the federal income tax would be easy to understand. It would take many people under an hour to complete.

The following illustrates what IRS Form 1040 would look like for an average American family with earning near the 2013 median income level of $51,939.[14]

| | | |
|---|---|---|
| **Filer** | *Enter 1* | 1 |
| **Spouse Filing Jointly** | *Enter 1* | 1 |
| **1st Dependent Child** | *Enter 1* | 1 |
| **2nd Dependent Child** | *Enter 1* | 1 |

| | | *If married and jointly:* | | |
|---|---|---|---|---|
| | | **Filer** | **Spouse** | **Combined** |
| **Income** | | | | |
| | Wages, salaries, tips, etc. | $30,000 | $21,750 | $51,750 |
| | Interest | $0 | $150 | $150 |
| | Dividends | $0 | $40 | $40 |
| | Capital Gains (or losses) | $0 | $0 | $0 |
| | Pensions and annuities | $0 | $0 | $0 |
| | Business and farm income (or loss) | $0 | $0 | $0 |
| | Rental real estate, royalties, etc. | $0 | $0 | $0 |
| | Unemployment compensation | $0 | $0 | $0 |
| | Social Security & SSI benefits | $0 | $0 | $0 |
| | Earning Supplement | $5,000 | $9,000 | $14,000 |
| **Total Income** | | $35,000 | $30,940 | $65,940 |
| **Exemptions** | Persons | 1 | 3 | 4 |
| | Personal Exemption per Person | $ 500 | $ 500 | $ 500 |
| | ***Total: Personal Exemptions*** | $ 500 | $ 1,500 | $ 2,000 |
| **Taxable Income** | ***Total Income - Personal Exemptions*** (If a negative number, insert 0) | $34,500 | $29,440 | $63,940 |
| **Tax Rate** | 10% +0.025% for each $1,000 that Taxable Income > $10,000, capped at 35% | 22.9% | 19.0% | |
| **Tax** | | $ 7,901 | $ 5,594 | $ 13,494 |

Several features of the proposed reform of the federal individual income tax are fundamental, and cannot be changed without damaging its intent and outcome.

- For this tax reform to work, all income must be treated equally.

[14] https://en.wikipedia.org/wiki/Household_income_in_the_United_States

•In order to ensure that full-time work always yields an income well above the poverty line, the Earning Supplement must be large.

•To avoid imposing a higher marginal tax rate on lower-income filers than on higher-income filers, the Earning Supplement must be "flat," i.e., after its phase-in should not be phased-out.

•To avoid a marriage penalty, it helps to base the Earning Supplement on individual earnings, not family earnings.

•To treat equally all filers with the same income, it is necessary not only to treat all income equally, but also to eliminate tax breaks, i.e., exemptions, allowances, deductions or credits that aim to favor certain types of consumption or investment.

•To generate sufficient, as well as to achieve fairness, the tax rate should be progressive: as taxable income rises, the tax rate should gradually rise up to a cap.

Most of the formulaic details of the proposed tax model, however, can be modified—toggled down or up, within limits—in order to ensure that the federal individual income tax a whole achieves its revenue goal, in Fiscal Year 2013, of $1,316.4 billion (and whatever the goal is set at in other years). For example:

•The exemption amount (set her at $500 per person) could be lowered or raised;

•The exemption amount could be *different* for dependent children, e.g., lower;

•The starting point of taxable income at which the tax rate begins to progressively rise (set here at $10,000 of taxable income) could be lowered or raised;

•The base tax rate (here: 10%) could be lowered or raised;

•The size of the income increments at which the rate steps up (here: $1,000 increments) could be lowered or raised;

•The increase in the tax rate for each additional income increment (here, an additional 0.025%, or quarter of a percent) could be lowered or raised; and

•The maximum tax rate (here: 35%) could be lowered or raised.

By putting together various combinations of these formulaic changes, it should be possible to recalibrate the tax as a whole so as to yield the targeted revenue level.

(4) ***Lower federal corporate taxes:*** Decrease the federal corporate tax levy by $54.7 billion, and simplify the tax.

This proposal calls for lowering the federal corporate income tax. In 2013, it raised $273.5 billion. The proposed 20% reduction would reduce it to $218.8 billion.

It is assumed that similar 20% reductions in local and state corporate income taxes would follow suit. Local corporate taxes raises $8.0 billion; that would decline to $6.4 billion. States' corporate taxes generate $45.0 billion; that would fall to $36.0 billion.

There are several reasons for lowering corporate income taxes. At the margin, lower corporate taxation may increase the competitiveness of American

firms, as well as encourage new investment to choose the U.S. as a place to build or expand.

More importantly, the proposed reform of the federal *individual* income tax will require a significant number of high-income Americans to pay higher taxes. This increase, to use Lincoln's favorite expression, is fitting and proper. Many wealthy Americans have profited for far too long from an unfair tax system that in some cases lets them escape taxation entirely, and in other cases allows them to pay far less than a fair share. To offset this impact, it may be appropriate to lower the federal tax burden on corporations, so that they are better positioned to distribute higher dividends to shareholders or confer more compensation to (presumably deserving) managers.

The most important rationale for lowering the corporate income tax is provide a kind of offset to any cost increases that corporations incur due to the proposed approach (still to be presented) for financing American residents' Health Insurance Purchasing Account from birth through Medicare eligibility at 65.

The proposed new policy for providing health insurance to the pre-Medicare will set in motion powerful market forces—choice, competition, and incentives—that are likely to lower significantly the *overall* growth in corporate costs for health insurance. For *some* U.S. companies, however, there will be a hike in their health care spending. Firms that provide no insurance or skimpy insurance to their employees; or that try to stick government employers or other private businesses with their employee health care costs (e.g., by requiring or giving cash incentives to their workers to use the "other guy's" health care plan); or that are simply lucky in the risk pool they employ; could see higher health care costs.

To offset this potential risk, cutting corporate taxation is a helpful tool. It also sends a message that the purpose of fundamentally restructuring the U.S. health insurance system is not to saddle firms with higher costs, but to lower their overall expenses and thus responsibly help them to make profits.

(5) ***Raising taxes on alcohol and tobacco:*** Increase <u>local</u>, <u>state</u>, and <u>federal</u> taxes on alcohol and tobacco by 50%.

Heavy users of alcohol and users of tobacco, as a group, impose significant extra costs on other taxpayers. Their "habits"—in many cases, sadly, their addictions—raise our costs for policing, fire protection, and especially health care. While it is necessary to tax positive assets and activities (i.e., property, sales, and income) in order to generate the levels of revenue we need to pay for government's necessary services, it makes sense to constrain our reliance on these taxes by raising more revenue from activities that frequently contribute to negative outcomes, i.e., alcohol and tobacco sales.

In 2013, taxes on alcohol resulted in $0.6, $6.1, and $9.3 billion in, respectively, local, state, and federal taxes. The proposal here is to increase these amounts by 50% to $0.8 billion, $9.1 billion, and $14.0 billion. (The results do not appear to be exactly 50% higher because of rounding.)

In 2013, taxes on tobacco produced $0.4 billion, $17.9 billion, and $15.1 billion in, respectively, local, state, and federal taxes. The proposal here raises those

amounts to $0.6 billion, $26.8 billion, and $22.7 billion. (Rounding again makes some of the results look a bit off.)

(6) ***End subsidies for utilities:*** End tax subsidies for utilities—roads, transit, and all other utilities, including the postal service—and require that users pay 100% of the true cost of the utility services they use.

In the "spending side" discussion on roads and other utilities, this policy has been fully explained. The only thing to add here is to summarize the revenue impact.

In 2013, total local and state utility revenue was $265.7 billion. This proposal, based on the actual costs of the utilities in question, ends the use of taxes to subsidize them, and results in utility revenue that totals $618.1 billion. Thus, utility revenue more than doubles, increasing by $352.5 billon.

The following table provides a utility-by-utility breakdown:

| | Local | State | Federal | Local | State | Federal |
|---|---|---|---|---|---|---|
| Sewerage | $ 50.1 | $ 0.6 | $ - | $ 53.0 | $ 0.7 | $ - |
| Solid waste management | $ 16.4 | $ 0.4 | $ - | $ 22.1 | $ 2.4 | $ - |
| Water | $ 58.5 | $ 0.3 | $ - | $ 64.6 | $ 0.4 | $ 7.7 |
| Electric | $ 67.4 | $ 9.8 | $ - | $ 75.6 | $ 10.6 | $ 2.2 |
| Gas | $ 6.7 | $ 0.0 | $ - | Gas fees included in electric | | |
| Highways | $ 6.6 | $ 8.5 | $ - | $ 134.5 | $ 62.1 | $ 10.3 |
| Transit | $ 11.6 | $ 3.5 | $ - | $ 75.0 | $ 20.0 | $ 19.0 |
| Air transportation (airports) | $ 19.1 | $ 1.5 | $ - | $ 19.3 | $ 1.8 | $ 21.5 |
| Port facilites (sea and inland) | $ 3.3 | $ 1.3 | $ - | $ 3.9 | $ 1.6 | $ 9.8 |
| **Total** | **$ 239.7** | **$ 25.9** | **$ -** | **$ 448.0** | **$ 99.6** | **$ 70.5** |

Not included is the U.S. Postal Service. According to one account, the subsidy to USPS is $18 billion every year.[15] One may dispute the methodology and arrive at a different number, but it is hard to counter the assertion that taxpayers in various ways subsidize the Post Office.

Just as Americans need water, sewerage, electricity, gas, telecommunication, roads, and transit, we need the U.S. Postal Service to deliver the mail and packages. All of these utilities are vital parts of America's infrastructure. In the case of several of these utilities, we need to spend a lot more on them.

But just as we should end taxpayer subsidies for water, sewerage, electricity, gas, telecommunication, roads, and transit, we should end the subsidies received by the U.S. Postal Service.

It is beyond the scope of this proposal to suggest how postal costs and revenues should be brought into line, i.e., whether the direction should be to curtail service, raise rates, increase efficiency, some mix or something else. But the end result should be clear. Users should pay 100% of the true cost of the services provided.

[15] Chris Matthews, "American taxpayers give an $18 billion gift to the post office every year," *Fortune*, May 27, 2015, http://fortune.com/2015/03/27/us-postal-service/

**Off-Budget Reforms**

Finally, two major policy changes would occur "off-budget."

(1) ***Raising the minimum*** wage: The first off-budget reform is straightforward. This proposal recommends increasing the federal minimum wage from $7.25 per hour to at least $10.00 per hour. Optimally, it should be increased to at least $12.00 per hour.

Increasing the minimum wage is an essential component of the overall work-based strategy, advocated throughout this proposal, for dramatically reducing poverty. Together with four other policies— (A) creating a national Transitional Jobs program (whose jobs pay the minimum wage); (B) replacing the EITC and Child Tax credit with a larger, restructured Earning Supplement; (C) providing parents with the option to enroll their children in quality childcare programs; and (D) boosting the income of impoverished adults who rely on disability benefits or who have retired on Social Security—a substantial rise in the minimum wage will lead to cutting the U.S. poverty rate by 50% or more.[16]

This is not the place for presenting or analyzing the historic, never-ending debate about whether raising the minimum wage does more harm than good. It obviously does both. It squeezes out, at the margin, some jobs. It also raises not only the minimum level of earnings for the majority of low-wage workers who remain employed, but pushes up wages above the new minimum. The nature and magnitude of these impacts, as well as the wage "tipping point" at which the negative outweighs the positive, is the subject of countless op-eds, monographs, and other analysis—some of it thoughtful, much of it biased and rhetorical.

Here, it is appropriate only to make two points. First, the Transitional Jobs program proposed here will function as a "safety trampoline" for jobseekers who have trouble landing jobs, or laid-off workers who lose jobs, because of a hike in the minimum wage. Second, one fairly new positive side effect of raising the minimum wage is the reduction in Earning Supplement costs it implies. That is, to the extent the minimum wage increases earnings, policymakers can then set the maximum Earnings Supplement at a somewhat smaller amount—and thus reduce the overall cost of Earnings Supplement—and still produce the policymakers' desired combination of earnings + Earnings Supplement that lifts total earnings-based income well above the poverty line.

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[16] See Community Advocates Public Policy Institute, "Working Our Way Out Of Poverty," http://ppi.communityadvocates.net/policy_projects/working_our_way_out_of_poverty/, and Kye Lippold, Urban Institute, "Reducing Poverty in the United States: Results of a Microsimulation Analysis of the Community Advocates Public Policy Institute Policy Package," March 25, 2015, http://www.urban.org/research/publication/reducing-poverty-united-states

(2) ***Financing Health Insurance Purchasing Accounts*:** To create a workable "off-budget" system of Health Insurance Purchasing Accounts for America's pre-Medicare population, thereby allowing them to buy excellent health insurance coverage in an intensely competitive marketplace whose incentives interact to hold down costs and improve both quality and outcomes, we need to answer to questions:

First. What would be the aggregate cost?

Second. How would the program be financed?

*Estimating the Cost:* In 2013, the Census Bureau reported that 267,828,000 residents of the United States were less than 65 years of age.[17] For various reasons, not all 267.8 million would set up a Health Insurance Purchasing Account. Their reasons for not doing so may include: incarceration; personal or religious objection to health insurance; lack of awareness about how to enroll in a national health insurance program; or eligibility for and enrollment in *other* health insurance programs, such as Medicare, VA coverage, or Tricare (military) coverage. Let us assume that 98% do set up the kind of Health Insurance Purchasing Account outlined in this redesign of government, which means (after rounding) that 262.7 million individuals would have an account.

The annual cost in 2016 for a 21-year old to buy an ACA Platinum level health insurance plan, covering 90% of ACA-defined Essential Health Benefits on an actuarial basis, was $4,360.[18] Since this is a 2016 premium, spending the same amount in 2013 would have purchased what might be called a Platinum-Plus benefit package, covering *more* than 90% of the cost of Essential Health Benefits.[19]

The cost of health care—thus: the premiums for health insurance—varies considerably, of course, by age. Actuaries prepare actuarial tables that show this variation.[20] Based on an actuarial table, the $4,360 premium for a 21-year old would range, according to one set of actuarial assumptions, from $2,768 for individuals under age 20 to $12,871 for a 64-year old. See Appendix E.

Thus, one way to estimate the cost of providing Health Insurance Purchasing Accounts to 262.7 million Americans under age 65 is to multiply the (A) number of covered persons in each age cohort, times (B) the actuarially adjusted cost, for that age cohort, of an ACA Premium-Plus plan. Doing so, the cost would be $1,491.5 billion. See Appendix E.

Another way to tackle the cost question would be to add up the amount currently being spent by the two biggest types of existing health insurance plans that cover most of the population in question—i.e., Medicaid (including SCHIP) and

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[17] U.S. Census Bureau, Current Population Survey, *Annual Social and Economic Supplement, 2013*, "Age and Sex Composition in the United States: 2013," Table 1. Population by Age and Sex: 2013, Internet release date: March 2016, https://www.census.gov/population/age/data/2013comp.html

[18] Cost of ACA Platinum Plan for a 21-year old in2016 from Jonathan Wu, "Cost of Health Insurance (2016), http://www.valuepenguin.com/average-cost-of-health-insurance, extracted May 13, 2016 at 9 AM Central.T

[19] For a summary of what the Affordable Care Act includes under "Essential Health Benefits," see the following page on the HealthCare.gov website: https://www.healthcare.gov/coverage/what-marketplace-plans-cover/.

[20] Jonathan Wu, ValuePenguin, "How Age Affects Health Insurance Costs," Average Health Insurance Costs by Age, http://www.valuepenguin.com/average-cost-of-health-insurance, extracted May 13, 2016 at 9 AM Central

private insurance—for the kinds of health care benefits in question. According to the U.S. Department of Health and Human Services (DHHS) account of national health expenditures in 2013, Medicaid (including SCHIP) and private health insurance spent $1,166.2 billion on the following categories of health care:

- Physician and Clinical: $307.2 billion
- Hospital: $509.5 billion
- Prescription Drugs: $137.8 billion
- Other $211.7 billion

If Nursing Care Facilities and Continuing Care Retirement Facilities are added, the additional $60.2 billion raises the total to $1,226.3 billion.[21]

In short, it seems reasonable to conclude that the aggregate cost of funding Health Insurance Accounts for roughly 260 million Americans prior to Medicare eligibility, at a level where the dollar amount would be sufficient to buy an excellent health insurance plan, would be in the range of $1,200 to $1,500 billion.

*Financing the Program:* According to the DHHS estimates of national health expenditures, private buyers (mostly businesses) are today by far the *biggest* payer for health insurance coverage of the pre-Medicare population. Government is a significantly *smaller* payer. In 2013, private insurance paid for 72% ($840.7 billion) of the $1,1662 billion that we spent in the U.S. spent for medical care, hospital services, prescription drugs, and other health-related services as part of the nation's pre-Medicare health insurance structure. Government programs, principally Medicaid and its junior partner SCHP, paid for 28% ($325.5 billion).

Adding the total of $1,166.2 billion to the $516.4 billion that the Medicare insurance program paid, mostly for 65-and-older seniors, the health insurance system as a whole in 2013 spent $1,682.6 billion. Private insurance still accounted for 50% of the cost of the major health insurance programs even with Medicare added to the denominator.

Please note that this analysis only deals with insurance-funded spending (thus, out-of-pocket spending is excluded), and only addresses health care (thus, dental care and nursing care/continuing care retirement facilities are excluded). It also excludes the relatively (only) smaller health care systems, such as the VA system and the military system, that do not fit the classic "insurance" model, although they certainly could be viewed as a form of insurance.

The point of this introduction to financing Health Insurance Purchasing Accounts is to underscore a central point.

The health insurance structure we have created in the U.S. (or, perhaps more accurately, allowed to cobble itself together) is *already* off-budget for the most part. The single biggest slice of America's health insurance pie—the $840.7 billion that individuals and (especially) businesses pay for—does not appear on the government's budget books.

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[21] U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services, "National Health Expenditures by type of service and source of funds, CY 1960-2014," https://www.cms.gov/research-statistics-data-and-systems/statistics-trends-and-reports/nationalhealthexpenddata/nationalhealthaccountshistorical.html

The challenge, therefore, is how to transform a health insurance system that is *already* off-budget for the most part into a system that remains off-budget but works far, far better?

The Health Insurance Purchasing Account structure provides a simple mechanism for covering everyone (except for Medicare enrollees, or those who choose to rely on the VA or military system). It would provide excellent health care benefits. Its incentives—(1) for individuals to choose the lowest-cost, high-quality health insurance plan because they must pay the full extra amount (on an after-tax basis) if they select a more expensive plan; and (2) thus for health care plans, and the providers they work with, to drive down their premiums and costs by improving quality and outcomes—are the right incentives. How, then, to get the money into the accounts?

The proposal here is to use a variation of the Worker's Compensation program as the guiding model. Worker's Comp is a social insurance program. It was indeed the first American social insurance program, pioneered in Wisconsin and adopted by all states by 1948. [22] In the great majority of U.S. states, however, Worker's Comp is not financed by a tax on employers to pay into a government fund, but by a mandate on employers to purchase a qualifying Worker's Compensation policy.

The variation here is as follows:

•*No Individual Mandate:* Individuals would <u>not</u> be mandated to purchase health insurance;

•*Presumptive Enrollment, with Opt-Out:* All U.S. residents would, as explained elsewhere, have an Individual Progress Portfolio (IPP) that includes a Health Insurance Purchasing Account. There would be no sign-up fee. It is assumed that virtually all Americans would use their IPPs and Health Insurance Purchasing Accounts to obtain 12 continuous months of health insurance

However, they could opt-out (or, in the case of dependent children, the parent(s)/guardian(s) could opt-out on behalf of their children) if both of the following conditions were clearly met:

(1) They agree in writing (which could be done online) to "suspend" (not terminate) the account for a year and instead obtain Essential Health Benefits at the same Platinum-Plus level through an employer; *and*

(2) Their employer has submitted, in a timely fashion, a written commitment to the entity that oversees the IPP system to provide the individual in question with 12 continuous months of Essential Health Benefits at the Platinum-Plus level through its own qualifying health insurance arrangement (i.e., either self-insurance, or purchase of an insurance policy);

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[22] "The first comprehensive workers' compensation law was finally passed shortly thereafter in Wisconsin in 1911. Nine other states passed regulations that year, followed by thirty-six others before the decade was out. The final state to pass workers' compensation legislation was Mississippi in 1948." Gregory P. Guyton, "A Brief History of Worker's Compensation," *Iowa Orthopaedic Journal*, Iowa Orthop J. 1999; 19: 106–110, http://www.ncbi.nlm.nih.gov/pmc/articles/PMC1888620/

•*Employer "Pay or Play" Requirement:* While there would be no individual mandate, there would be—as in the Worker's Compensation program—an employer mandate. Employers would have two ways to fulfill the requirement:

(1) Each employer (including self-employed individuals) who is "engaged in commerce" could pay into the Health Insurance Purchasing Account fund a charge equal to 17% of the total "Medicare" earnings paid to its U.S. resident employees; or

(2) If the employer elects not to pay the charge, the employer would instead be required, with respect to all of its U.S. resident employees (including part-time employees), all U.S. resident non-working spouses, and all U.S. resident dependent children not eligible for Medicare, with Essential Health Benefits at the Platinum-Plus level through the employer's qualifying own health insurance arrangement (either self-insurance, or purchase of an insurance policy).

In 2013, Medicare Part A (HI) taxable earnings were $7,335,869,000,000, i.e., $7,335.9 billion.[23] If all employers decided to comply with the requirement by paying the 17% charge, it would have generated $1,250.5 billion.

This is within the revenue target range. It is, of course, near the bottom of the target range. It is reasonable to hope, however, that a 17%-of-earnings charge will be sufficient, given continuing growth in U.S. wages (which allows 17% to generate more dollars) and the new pressures that the Health Insurance Purchasing Account mechanism will bring to bear on health insurance premiums (which reduces the number of dollars that must be raised). While it would be imprudent to imagine that the percent might fall (much less sharply) over time, it is not simply speculation to believe that it could be stable and not rise much.

## Appendices

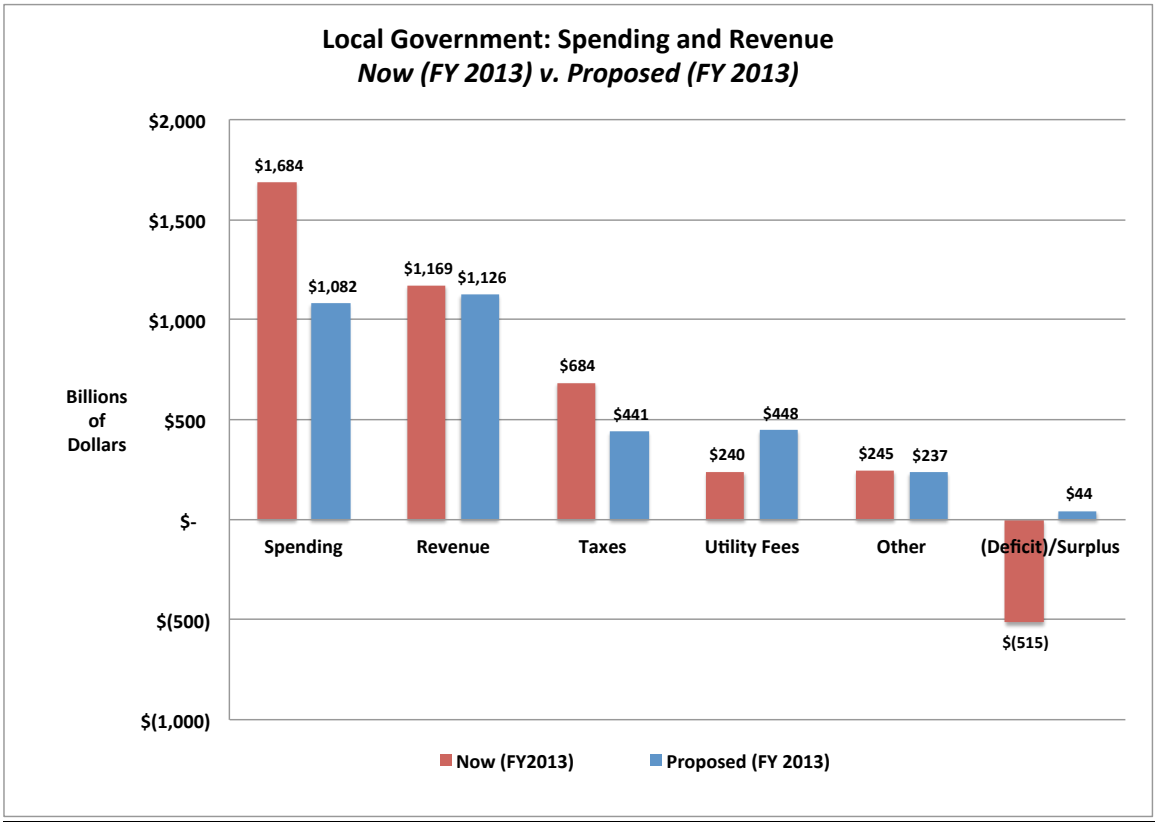
Several appendices provide further information.

[23] Social Security Administration, "Annual Statistical Supplement to the Social Security Bulletin, 2015," Table 4.B12—Number of workers with Medicare Part A (HI) taxable earnings, amount taxable, and contributions, by state or other area and type of earnings, 2013, https://www.ssa.gov/policy/docs/statcomps/supplement/2015/supplement15.pdf, extracted July 1, 2016, at 12 PM Central.

Appendix A:

Local Government Spending and Revenue: Current v. Proposed: FY 2013

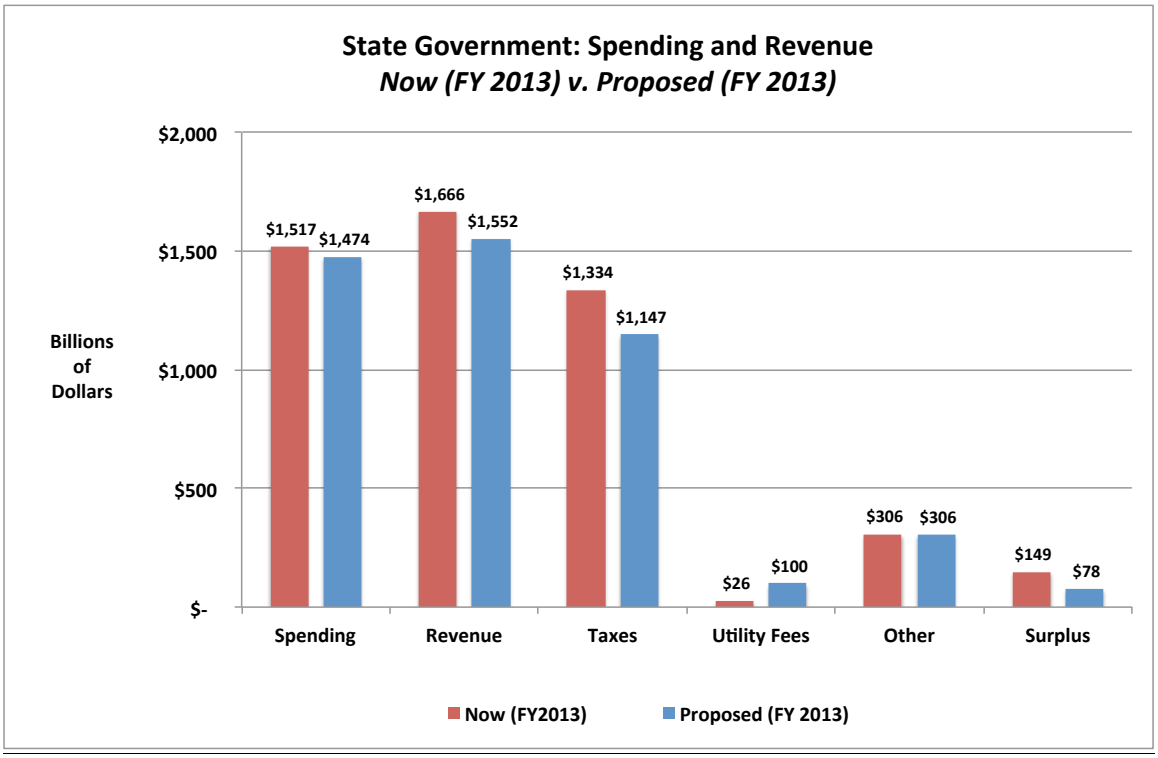
| | Local Government Now (FY2013) | Local Government Proposed (FY 2013) | Change |
|---|---|---|---|
| **Spending** | $ 1,684 | $ 1,082 | $ (602) |
| **Revenue** | $ 1,169 | $ 1,126 | $ (43) |
| **Taxes** | $ 684 | $ 441 | $ (243) |
| **Utility Fees** | $ 240 | $ 448 | $ 208 |
| **Other** | $ 245 | $ 237 | $ (8) |
| **(Deficit)/Surplus** | $ (515) | $ 44 | $ 558 |



Appendix B:

State Spending and Revenue: Current v. Proposed: FY 2013

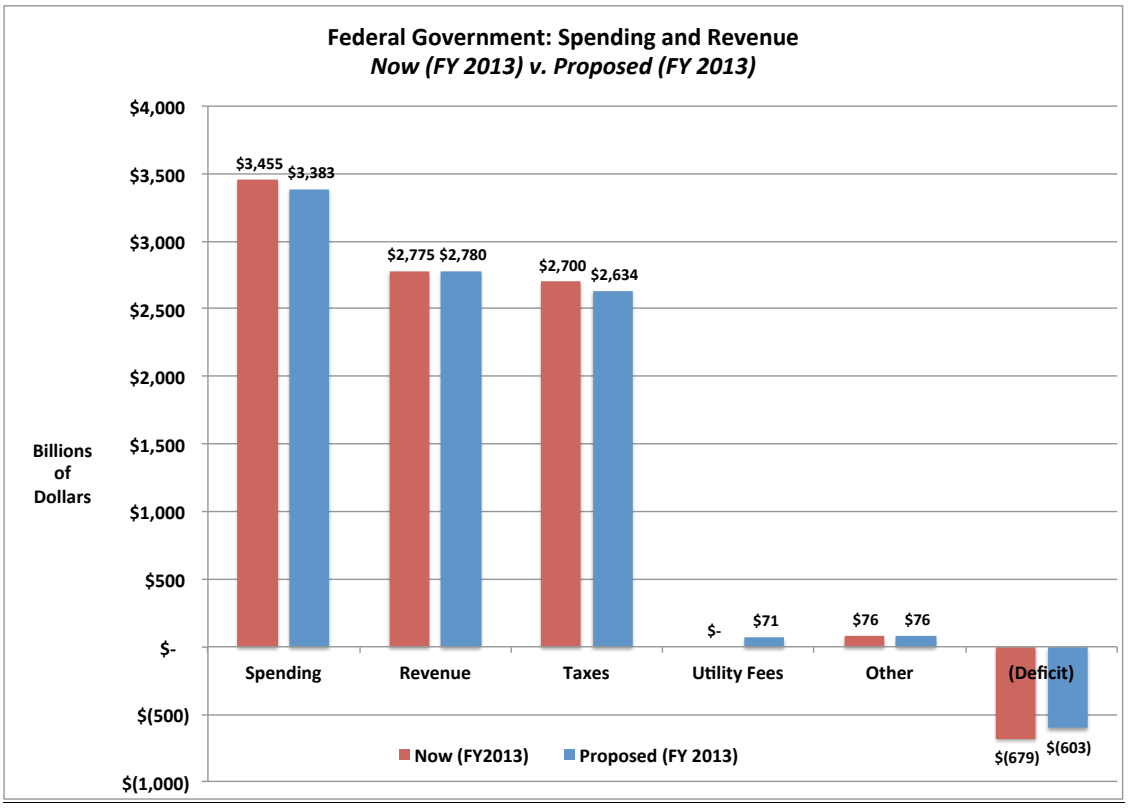
| | State Government Now (FY2013) | State Government Proposed (FY 2013) | Change |
|---|---|---|---|
| **Spending** | $ 1,517 | $ 1,474 | $ (43) |
| **Revenue** | $ 1,666 | $ 1,552 | $ (114) |
| **Taxes** | $ 1,334 | $ 1,147 | $ (187) |
| **Utility Fees** | $ 26 | $ 100 | $ 74 |
| **Other** | $ 306 | $ 306 | $ (1) |
| **Surplus** | $ 149 | $ 78 | $ (71) |



Appendix C:

Federal Spending and Revenue: Current v. Proposed: FY 2013

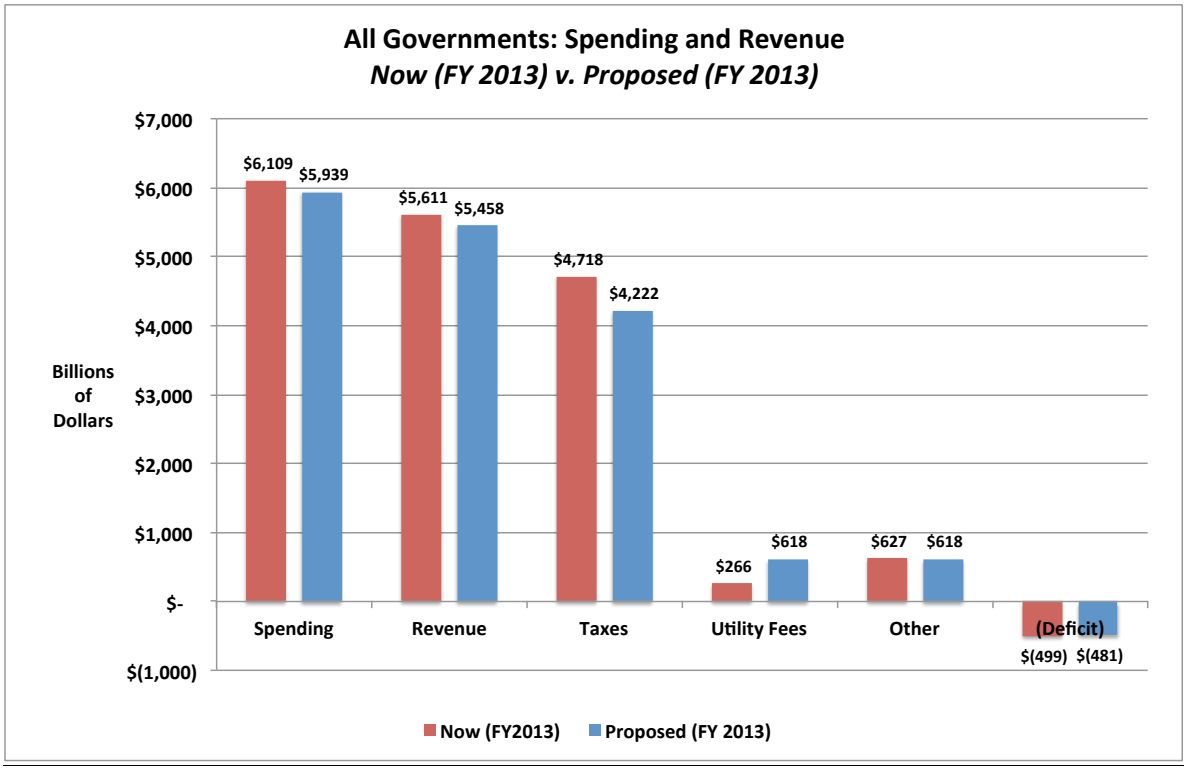
| | Federal Government Now (FY2013) | Federal Government Proposed (FY 2013) | Change |
|---|---|---|---|
| **Spending** | $ 3,455 | $ 3,383 | $ (72) |
| **Revenue** | $ 2,775 | $ 2,780 | $ 5 |
| **Taxes** | $ 2,700 | $ 2,634 | $ (66) |
| **Utility Fees** | $ - | $ 71 | $ 71 |
| **Other** | $ 76 | $ 76 | $ - |
| **(Deficit)** | $ (679) | $ (603) | $ 76 |



Appendix D:

All Governments' Spending and Revenue: Current v. Proposed: FY 2013

| | All Governments Now (FY2013) | All Governments Proposed (FY 2013) | Change |
|---|---|---|---|
| **Spending** | $ 6,109 | $ 5,939 | $ (170) |
| **Revenue** | $ 5,611 | $ 5,458 | $ (152) |
| **Taxes** | $ 4,718 | $ 4,222 | $ (496) |
| **Utility Fees** | $ 266 | $ 618 | $ 352 |
| **Other** | $ 627 | $ 618 | $ (9) |
| **(Deficit)** | $ (499) | $ (481) | $ 18 |



# Appendix E:

## Cost of Health Insurance Purchasing Accounts: 2013 *

| Age | Preum Multiple | Annual Premium *Platinum Plan* | Covered Person (thousands) | Annual Cost (thousands) |
|---|---|---|---|---|
| Under 20 | 0.635 | $ 2,769 | 80,422 | $ 222,656,349 |
| 20 | 0.635 | $ 2,769 | 4,342 | $ 12,021,261 |
| 21 | 1 | $ 4,360 | 4,342 | $ 18,931,120 |
| 22 | 1 | $ 4,360 | 4,342 | $ 18,931,120 |
| 23 | 1 | $ 4,360 | 4,342 | $ 18,931,120 |
| 24 | 1 | $ 4,360 | 4,342 | $ 18,931,120 |
| 25 | 1.004 | $ 4,377 | 4,143 | $ 18,135,734 |
| 26 | 1.004 | $ 4,377 | 4,143 | $ 18,135,734 |
| 27 | 1.048 | $ 4,569 | 4,143 | $ 18,930,527 |
| 28 | 1.087 | $ 4,739 | 4,143 | $ 19,635,003 |
| 29 | 1.119 | $ 4,879 | 4,143 | $ 20,213,034 |
| 30 | 1.135 | $ 4,949 | 4,049 | $ 20,036,881 |
| 31 | 1.159 | $ 5,053 | 4,049 | $ 20,460,569 |
| 32 | 1.183 | $ 5,158 | 4,049 | $ 20,884,256 |
| 33 | 1.198 | $ 5,223 | 4,049 | $ 21,149,061 |
| 34 | 1.214 | $ 5,293 | 4,049 | $ 21,431,519 |
| 35 | 1.222 | $ 5,328 | 3,767 | $ 20,070,275 |
| 36 | 1.23 | $ 5,363 | 3,767 | $ 20,201,668 |
| 37 | 1.238 | $ 5,398 | 3,767 | $ 20,333,061 |
| 38 | 1.246 | $ 5,433 | 3,767 | $ 20,464,454 |
| 39 | 1.262 | $ 5,502 | 3,767 | $ 20,727,239 |
| 40 | 1.278 | $ 5,572 | 4,049 | $ 22,561,352 |
| 41 | 1.302 | $ 5,677 | 4,049 | $ 22,985,039 |
| 42 | 1.325 | $ 5,777 | 4,049 | $ 23,391,073 |
| 43 | 1.357 | $ 5,917 | 4,049 | $ 23,955,989 |
| 44 | 1.397 | $ 6,091 | 4,049 | $ 24,662,135 |
| 45 | 1.444 | $ 6,296 | 4,128 | $ 25,989,228 |
| 46 | 1.5 | $ 6,540 | 4,128 | $ 26,997,120 |
| 47 | 1.563 | $ 6,815 | 4,128 | $ 28,130,999 |
| 48 | 1.635 | $ 7,129 | 4,128 | $ 29,426,861 |
| 49 | 1.706 | $ 7,438 | 4,128 | $ 30,704,724 |
| 50 | 1.786 | $ 7,787 | 4,388 | $ 34,169,180 |
| 51 | 1.865 | $ 8,131 | 4,388 | $ 35,680,583 |
| 52 | 1.952 | $ 8,511 | 4,388 | $ 37,345,039 |
| 53 | 2.04 | $ 8,894 | 4,388 | $ 39,028,627 |
| 54 | 2.135 | $ 9,309 | 4,388 | $ 40,846,137 |
| 55 | 2.23 | $ 9,723 | 4,092 | $ 39,785,698 |
| 56 | 2.333 | $ 10,172 | 4,092 | $ 41,623,333 |
| 57 | 2.437 | $ 10,625 | 4,092 | $ 43,478,809 |
| 58 | 2.548 | $ 11,109 | 4,092 | $ 45,459,174 |
| 59 | 2.603 | $ 11,349 | 4,092 | $ 46,440,435 |
| 60 | 2.714 | $ 11,833 | 3,452 | $ 40,847,654 |
| 61 | 2.81 | $ 12,252 | 3,500 | $ 42,880,600 |
| 62 | 2.873 | $ 12,526 | 3,500 | $ 43,841,980 |
| 63 | 2.952 | $ 12,871 | 3,500 | $ 45,047,520 |
| 64 | 2.952 | $ 12,871 | 3,500 | $ 45,047,520 |
| | | | 262,664 | $ 1,491,537,915 |

* Assumes:
(1) 2013 population data from U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplement, 2013. "Age and Sex Composition in the United States: 2013," Table 1, https://www.census.gov/population/age/data/2013comp.html. Within 5-year age bands, numbers for each age are assumed to be identical.
(2) Actuarial adjustments from Jonathan Wu, ValuePenguin, "How Age Affects Health Insurance Costs," Average Health Insurance Costs by Age, http://www.valuepenguin.com/average-cost-of-health-insurance, extracted May 13, 2016 at 9 AM Central
(3) Cost of ACA Platinum Plan for a 21-year old in 2016 from Jonathan Wu, "Cost of Health Insurance (2016), http://www.valuepenguin.com/average-cost-of-health-insurance, extracted May 13, 2016 at 9 AM Central