A ROADMAP FOR AMERICA'S FUTURE

As noted in the introduction, this proposal restructures health care, the Federal health care programs, retirement security, and Federal taxation. 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.

It is important to reiterate that this proposal should not be viewed as a rigid, absolute plan. It is a legislative plan built on a *strategy* for approaching the major components of the challenge America faces, 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 in which the most important aspects of this multifaceted challenge are addressed.

Details of the full legislative proposal are contained in Appendix 1 of this report. Below is a summary and explanation of the major components.

THE STATE OF HEALTH CARE TODAY

The rising health care costs described previously in this report have become the most burdensome financial hardship American families face today. The estimated $2.1 trillion spent by the U.S. in 2007 to provide, administer, and finance health care translates to nearly twice the amount per capita that any other industrialized nation in the world spends. Moreover, the rapid growth of health care costs is eroding paychecks for millions of Americans; and skyrocketing insurance costs are overburdening businesses across the U.S., and leaving 47 million individuals without access to affordable coverage.
Even with public health programs such as Medicare and Medicaid, families and individuals face increasingly limited access to care. 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 more than 18 percent of its budget to health programs, which is second only to national defense (20 percent, including war costs). Overall health care costs are absorbing 15.9 percent of national gross domestic product [GDP]. If the status quo continues, health care costs will consume 20 percent of GDP in 8 years.

The current third-party-payer model that serves as a framework for the financial underpinnings of the U.S. health care system can no longer meet the needs of patients, doctors, hospitals, and governments. It has undermined the doctor-patient relationship and removed the individual patient from the decision-making process. Transforming

America’s fractured and antiquated health care network demands wholesale and fundamental reform.

HEALTH CARE SECURITY

Every American should be able to afford and 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 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. What’s more, people will no longer live in fear of losing their health care if they lose their job. As the marketplace begins to respond to this new patient centered control, the resulting increase in competition will necessitate an improvement in the quality of services and provide more options to meet the diverse needs of Americans.

The Health Care Marketplace

Changing the Tax Treatment of Health Coverage. To correct this problem, 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 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 – $2,500 for individuals and $5,000 for families – to pay for health coverage. The tax credit is available solely for the purchase of health insurance. 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 product 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. 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:

- *Broad Availability.* Individuals without income tax liability are still eligible for the credit. Due to the refundable nature of the tax credit, ownership of health insurance is available to every American, regardless of income level. It is also "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 would 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 care 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 consumers.

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

Increasing Affordable Options Through Interstate Purchasing. Currently, individuals and families can only purchase health insurance in the States in which they live, and insurance companies are prohibited from marketing polices outside their respective States. Thus, consumers are prevented from purchasing coverage from another State that might be better suited to their needs, more affordable, or both.

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." (Government Accountability Office, *Federal Employee Health Benefits Program: Competition and Other Factors Linked to Wide Variation in Health Care Prices*, August 2005)

The arrangement also 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 Securities and Exchange Commission, 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 not only face an insurmountable burden in medical expenses themselves, but that burden is often transferred to taxpayers in the form of uncompensated care expenses from hospitals, or due to the likelihood that these individuals end up on Medicaid after having exhausted their financial resources paying for their medical costs.

This plan strengthens the health care safety net for these individuals. As further explained below, States choosing to let their Medicaid populations participate in the tax credit must spend previously allocated Medicaid funds on a Maintenance of Effort [MOE] program. A State's base MOE amount is equal to the amount the State spent in calendar year 2008 for its State Children's Health Insurance Program and Medicaid for healthy adults and children. The MOE amount increases each year by the same inflation adjustment as the health care tax credit. Each State is to apply these funds to the following:

- *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." As part of offering affordable coverage to high-risk individuals, States may offer direct assistance with health insurance premiums and/or cost-sharing for low-income and/or high-cost families.

- *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. Under this procedure, any uninsured person seeking medical care could be enrolled in an insurance plan, so that he or she no longer continues without coverage.

- *Setting Reasonable Limits on Premiums*. As part of high-risk pool reform, States will define premium standards such that individuals may be deemed high-risk if their health insurance premiums exceed a certain amount. Covering these individuals in high-risk pools dramatically improves the actuarial health and price of existing group health insurance plans, thereby lowering and stabilizing premiums for the vast majority of Americans with average health profiles.

- *Creating Reinsurance Mechanisms*. The establishment of State reinsurance mechanisms will ensure that high-risk pools are adequately funded, and that individuals receiving coverage through high-risk pools are not subject to prohibitively high premiums.

Relief 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 would 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 must own their own health coverage, so too should own their own health records. By establishing a modern market-driven approach to building a National Health Information Network, the 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. Without major reform, Medicaid recipients' access to health care is in jeopardy. The right changes can form a more effective program, and also make the health care safety net stronger and more reliable for the neediest populations.

Allowing States to offer their Medicaid populations the option of using the refundable tax credit to enroll in private insurance, in lieu of traditional Medicaid coverage, will restrain rising health costs and level the playing field for those with Medicaid coverage. The increased number of individuals shopping for health coverage and services will not only restrain prices, but also will increase competition in the marketplace. Additionally, Medicaid recipients – like all other Americans – will be able to purchase more affordable coverage from other States with the refundable tax credit if they find health insurance plans that better suit their needs.

Below are some of the particular benefits of this approach.

Removing 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 providing care or going bankrupt (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.

State Flexibility. States may choose whether to allow their Medicaid populations participate in the tax credit plan, or to continue their current Medicaid Programs. States that select the latter receive their Federal Medical Assistance Percentage [FMAP] funding in the form of a block grant, adjusted for population growth and indexed to inflation by a blended rate of the consumer price index [CPI] and the medical care component of the CPI. This gives States maximum flexibility to adapt their programs to their specific populations. Any State opting to let its Medicaid population to take part in the tax credit must agree to use its previously allocated Medicaid funds to assist the Medicaid population in enrolling and purchasing health insurance plans. As mentioned above, States can use their MOE funds to supplement the tax credit for low-income and high-risk families if they choose to do so.

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 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 New Medicare Program. 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 beneficiaries from prices – and is therefore inefficient in restraining rising costs and proficient at sheltering prices from beneficiaries – into one in which Medicare 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. 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 GDP.

Medicare Payment. For future Medicare beneficiaries who are now 55 or younger (those who first become eligible on or after 1 January 2019), the proposal creates a standard Medicare payment to be used for the purchase of private health coverage. For current beneficiaries, and those older than 55, the plan preserves the existing Medicare Program, as further described below. 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. Additionally, 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.

The standard payment is $9,500 (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 risk-adjusted. They also are partially geographically adjusted, with the geographic adjustment phasing out over time.

Risk Adjustment. Medicare beneficiaries receive the standard amount – $9,500 – 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. Once enrolled in a plan, Medicare beneficiaries may complete initial health exams through their health insurance plan to determine whether they are eligible to receive a higher risk-adjusted payment. The health plan must submit to the Medicare program any necessary results of the exam in order for Medicare to determine an adjusted risk-assessment.

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

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 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.

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. Those with incomes between 100 percent and 150 percent of poverty receive 75 percent of the full deposit.

Retention of Medicare for Those Over 55. Clearly, the transition to this restructured Medicare Program must 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 2019. For those eligible prior to that date (those over 55), 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. Following consultation with the Office of the Chief Actuary of the Centers for Medicaid and Medicare Services, this reform plan has been found to 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." (Cited by the Historian's Office of the Social Security Administration, May 1996). In this regard, Social Security is one critical, if unfinished, piece of the retirement security safety net for seniors – especially those with limited incomes.

That evolution must continue today, because Social Security as currently structured is going bankrupt and cannot fulfill its promises to future retirees. Without reform, future retirees face benefit cuts of up to 22 percent in 2041. 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. By comparison, even through periods of economic downturn, the average rate of return of the stock market has been at least 7 percent. As discussed in a previous section, the current system also unfairly discriminates against minorities and women who work outside the home.

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, the share of future retirees' income promised by Social Security 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 their prosperity to their descendants.

Individuals over 55 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 closely resembles 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 Chief Actuary of the Social Security Administration, the program will be solvent with permanent and growing surpluses by 2066. Finally, it will allow hard-working Americans to accumulate more than $10 trillion in their accounts by 2040, all money which they can pass on to their heirs.

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 Benefits. Individuals who choose to invest in personal accounts will be ensured that their total benefits are at least as large as the benefits would be if they decided to remain in the traditional system. If an individual's personal account is too small to provide a monthly annuity payment equal to this level, the government will make up the difference.

Personal Choice in Retirement Accounts. Beginning in 2011, 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 constantly 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 2041, 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. Benefits 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 who choose 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 over 55, 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 poverty, an improvement from current law. Those in the personal account system will be guaranteed a minimum of at least 150 percent of poverty.

The use of progressive price indexing for lower-income workers (see below) will also allow the benefits of those who most need the safety net 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.

No Change for Survivors and the Disabled. Survivor and disability benefits will continue as under the current system unchanged.

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 2016, employs "progressive price indexing" – a mix of wage indexing and price indexing – for initial Social Security benefits. Individuals who make less than approximately $29,000 per year will continue to receive initial benefits based on wage indexing. Those who make between $29,000 and $113,000 (in 2016) 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 $29,000 and $113,000 will have his initial benefit adjusted upward approximately 50 percent by wage indexing and 50 percent by price indexing. Individuals making more than $113,000 will have their initial benefits adjusted upward by price indexing. These amounts will consistently 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 still be under 70 years of age for nearly all of the 21st 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 noted previously, the Federal tax code is needlessly complex and burdensome, and it discourages economic growth and U.S. competitiveness in the international marketplace. Further, taxpayers and their families face, in the next few years, sharply higher tax rates on income and investment, the reinstitution of the marriage penalty, and higher taxes per child, among numerous other tax increases as a result of the schedule expiration of the 2001 and 2003 tax laws. There is also the Alternative Minimum Tax [AMT], which becomes a more intractable problem every year.

For the longer term, the overall Federal tax burden is projected to reach unprecedented levels as a share of economic resources. The current tax code also puts American businesses and American-made products at a competitive disadvantage against foreign competitors, making it harder to keep jobs in the U.S. and to grow the economy.

As is true with the structure of major Federal entitlement programs, the problems in the Federal tax law cannot be corrected by merely tinkering with an excessively complex and burdensome tax code. What is needed is a restructuring of the tax laws – one that is broad and yet achievable. It is the kind of tax reform called for in this proposal.

This proposal eliminates the 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 in their own businesses and create more jobs in the U.S. Most important, this plan is designed to hold overall Federal tax revenue at roughly 18.5 percent of GDP for the foreseeable future – consistent with the historical average of the past 40 years – rather than allowing the tax burden to rise to unprecedented levels, as is 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 navigating a labyrinth of deductions and credits, a host 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 tax deductions and preferences in the system – which serve to narrow the tax base – are mainly used by a relatively small share 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 lower economic growth.

Individuals react negatively toward the tax code partly because it steers 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 a certain control over their own financial lives.

This reform proposal attempts to solve these problem in a fundamentally American way: by offering individuals a choice. Individuals can choose to pay their Federal taxes under the existing tax code, with all the familiar deductions and schedules, or they could move to a highly simplified income tax system. The simplified plan 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 exemption level. The tax form for this system could 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.

Eliminates 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 must pay another tax on the return from their savings (i.e. interest, capital gains, or dividends). The plan eliminates this 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 Death Tax, another form of double taxation that is particularly harmful to small businesses.

Offers Taxpayers a 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 would choose one of the two tax systems. But individuals are allowed *one* additional changeover between the two tax 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 on the next page for a comparison with current tax brackets.) Taxable income equals earnings minus a standard deduction and personal exemption.

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.

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.

The tables below compare the tax rates in the Simplified Tax with those in the current Federal tax code.

Table 7: Tax Rate Comparison - Single Filers

Current Tax Code		Simplified Tax	
Marginal Rate	Taxable Income	Marginal Rate	Taxable Income
10 percent	$0-$7,825	10 percent	$0-$50,000
15 percent	$7,825-$31,850		
25 percent	$31,850-$77,100	25 percent	$50,000 and over
28 percent	$77,100-$160,850		
33 percent	$160,850-$349,700		
35 percent	$349,700 and over		

Table 8: Tax Rate Comparison - Joint Filers

Current Tax Code		Simplified Tax	
Marginal Rate	Taxable Income	Marginal Rate	Taxable Income
10 percent	$0-$15,650	10 percent	$0-$100,000
15 percent	$15,650-$63,700		
25 percent	$63,700-$128,500	25 percent	$100,000 and over
28 percent	$128,500-$195,850		
33 percent	$195,850-$349,700		
35 percent	$349,700 and over		

Prevents Future Increase in Tax Burdens. This individual tax system – in combination with the business tax described below – is designed to keep Federal revenues at approximately 18.5 percent of GDP for the foreseeable future, roughly equivalent to the historical average.

Gives Taxpayers Greater Certainty. Under current law, the scheduled expiration of the 2001 and 2003 tax relief measures along with a growing expansion of the AMT would 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 gives Americans peace of mind so that they can adequately plan for their financial future.

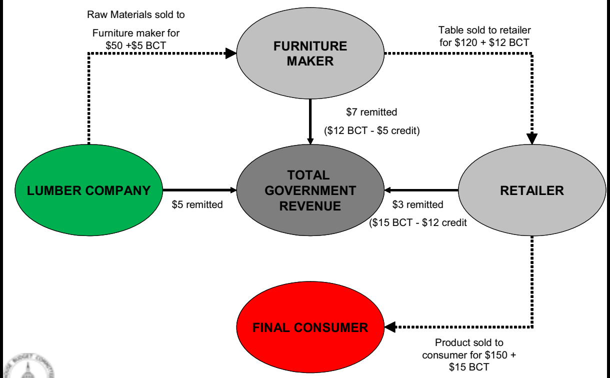
Business Taxation

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, this 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. It operates under what is known as the "credit invoice method," in which businesses apply the BCT to the sales of their products or services and then claim a credit for the BCT paid on purchases of material costs from other businesses shown on purchase invoices. The difference between the BCT collected on sales and credit for the BCT paid on input purchases is then paid to the Federal Government. Thus, this system provides a clear audit trail of the business tax, because the amount is clearly stated on sales and purchase receipts.

The flow chart alongside shows how the BCT would operate for businesses 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.

Figure 13
How the Business Consumption Tax Works



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

Transition to the BCT. The plan incorporates temporary "transition relief" to facilitate the switch from the current income 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 BCT.

Leveling 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 it leaves the U.S. It is instead imposed on foreign imports when it enters the U.S. As a result, 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. (It is important to note that the WTO has ruled that the credit invoice method business tax is border adjustable.)

Encouraging Investment. Under the current corporate income tax, investments are 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).

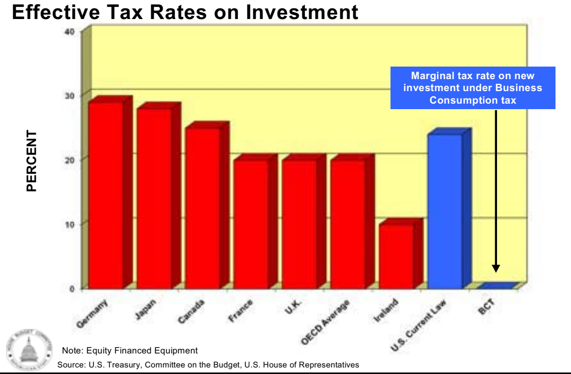
Under the BCT, the cost of an investment is fully deducted immediately – in other words, investments are expensed. That becomes important from a tax perspective because a dollar's worth of tax benefit today is worth more than a tax benefit in the future for any business. Expensing becomes the key element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

Figure 14
Effective Tax Rates on Investment



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 would essentially eliminate the tax distortion on new business investment in the U.S. The result would be a quantum leap in terms of establishing a competitive business tax for the 21st century.

The move would 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 businesses taxes as a whole typically raise more revenues as a share of their overall economy than the U.S.)

Key Benefits

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 would reverse this trend.

- With an enhanced investment climate, international businesses, particularly capital-intensive industries such as manufacturing, would 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 would bring these earnings and profits back to the U.S.

- Greater investment in the U.S. would 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 and productivity and rising living standards. 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.

CONCLUSION

The proposal described above is broad and comprehensive because it must be: piecemeal, incremental "fixes" cannot match the scope and magnitude of America's challenges in health care, Federal entitlement programs, Federal tax policy, and economic competitiveness. It is built on the principle of personal ownership exercised in a free economy, because that has been the source of U.S. prosperity through America's history. It maintains a reliable safety net, because Americans have always shown compassion for those who are less well off. Finally, it enhances America's ability to compete successfully in the international market that is the permanent reality of the 21st century – because this competitiveness is a necessary component of expanding jobs and opportunities for Americans.

Above all, however, the importance of this proposal is that it lays out a plan for meeting these challenges – because it is time to get beyond debating the problem, and to begin aggressively pursuing solutions.