NATIONAL CENTER FOR POLICY ANALYSIS

Blowing Money

(The following document is three pages in length.)

On Tuesday, February 24, the President will address a joint session of Congress. In his State of the Union speech, the president will outline many of the public policy problems we face. He will also introduce strategies to address health care reform, entitlement reform, tax reform, and other economic initiatives. The National Center for Policy Analysis is committed to working with President Obama and Congress to find solutions to these and other public policy problems. To that end, following is a brief outline of many of our solutions to the problems described by the President. These NPCA solutions rely on private alternatives to government regulation and control, solving problems by relying on the strength of the competitive, entrepreneurial private sector.

Health Care Reform

- As a candidate, President Obama said he could save the average American household $2,500 a year through such reforms as coordinated care, preventive care, evidenced-based care, pay-for-performance care, electronic medical records and a slew of similar ideas.
  - In reality (according to CBO), these reforms will only save about 1% of what the President projects, and maybe nothing at all (CBO reports are here and here).
  - In fact, the only way for the President's plan to succeed in reducing health care costs will be for the government to commandeer the health care dollars, and then control costs by ratcheting down payments to providers, limiting access to technology, and rationing care.
- **A better way** to control costs (and simultaneously increase quality) is to allow individuals to control health care dollars.
  - Individuals – not government – are best suited to make decisions about how to spend health care dollars.
  - Individually-controlled dollars will force providers to compete for those dollars, which will decrease prices and increase quality, as it does in other aspects of the economy where individuals control the dollars. This isn't to say individuals won't have to make difficult decisions about purchasing health care, but it is better for individuals and families to make those difficult decisions rather than a government health care bureaucracy.
  - **Health Savings Accounts** allow individuals to make tax-free deposits into special bank accounts that can be used to purchase health insurance. Employers should be encouraged to automatically enroll their employees in a health savings account.
  - **Tax Incentives for Health Insurance** should be the same, whether you work for a large company, a small business, or are self-employed. Instead of disproportionately subsidizing health insurance for those with high incomes – a uniform, refundable tax credit should be provided for individuals and families to purchase private health insurance.
  - **Alternatives to public health care will** provide patients with more choices. Allowing low-income people to use their Medicaid (or S-CHIP) dollars to enroll in private insurance plans will increase choices and reduce costs.

To see the NCPA's Congressional Brief on Health Care, click here.

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Social Security and Medicare

- Social Security is a pay-as-you-go program, which means today's workers pay taxes to support today's senior citizens.
  - The number of Social Security beneficiaries is growing faster than the number of workers supporting them. In 1940, the ratio was 42-to-1 (workers to retirees). Today, the ratio is 3.3-to-1. By 2050 it will be 2-to-1.
  - By 2017, Social Security will spend more in benefits than it collects in taxes. By 2041, the program will have spent everything from the Social Security Trust Fund.
  - In all, the Social Security program faces a $15 trillion unfunded liability (meaning we've promised $15 trillion in benefits that we don't know how to pay for).
  - The President seems serious about reforming entitlement, as he stated during a White House Fiscal Responsibility Summit held on 2/23.
  - **The solution** to shoring up Social Security and providing additional revenue for senior retirement is to allow younger workers to invest a portion of their payroll taxes into retirement accounts that, over time, would grow much faster than the shrinking resources in the Social Security Trust Fund, and eventually replace an increasing portion of retirement benefits.
- The unfunded liabilities of Medicare are far worse than Social Security.
  - Although the demographic pressures are the same for Medicare as Social Security, the problems of soaring health costs are causing severely unsustainable Medicare growth.
  - By 2020, the deficits in Medicare will claim more than 1-in-5 federal income tax dollars (in other words, the federal government will have to stop doing one in every five things it does today to pay for Medicare).
  - In all, the Medicare program faces an unfunded liability of $85.9 trillion – more than 5 times larger than Social Security's unfunded liability, and 5½ times the size of the entire economy.
  - **The solution** to reforming Medicare is to combine the disparate and inefficient parts of Medicare (Part A, B, C & D, as well as individually-purchased Medigap plans) into a single plan with a single premium.
    - Seniors should be able to choose from among competing plans in the private market with different features and options, just like those under 65-years-old do today.
    - Competition among plans will force plans to decrease prices and increase quality.
    - To help fund senior health care needs, Medicare-eligible seniors should be allowed to open and make deposits into health savings accounts to cover out-of-pocket health expenses.

To see the NCPA's Congressional Brief on Social Security, click here.

To see the NCPA's Congressional Brief on Medicare, click here.

Tax Reform

- The President has proposed raising taxes by allowing many of the 2001 & 2003 Bush tax cuts expire.
  - The President hopes to increase federal revenue (and thereby reduce the deficit) by relying on outdated, static revenue forecasts, which suppose higher taxes will increase revenue for the federal government. But those forecasts do not account for the effects of tax changes on individual behavior.
  - Real experience shows that tax policy can encourage or discourage certain behavior (*e.g.*, higher tobacco taxes reduce individual tobacco consumption). For example:
    - Revenues from capital gains doubled when tax rates were cut from 20% to 15%.
    - After the top tax rate for stock dividends was cut from 35% to 15% in 2003, net individual dividend income from Standard & Poor's 500 firms increased 50% over the previous year.

- **A better way** to reform the tax code is to create tax policy that encourages productive behavior. Tax policy should be permanent, predictable, and consistent (which, in and of itself, will bolster economic activity)
  - **Make the 2001/2003 Tax Cuts Permanent**. Lower tax rates encourage work, investment and reduce tax avoidance.
  - **Repeal the Alternative Minimum Tax (AMT)**. Although the AMT was originally aimed at wealthy households with high deductions, the AMT will grow to affect more than one-third of taxpayers by 2017.
  - **Repeal the Estate Tax**. The estate tax generates little revenue for the federal government, but it negatively affects every American by reducing capital formation. This lowers productivity, wages, employment and federal revenue from payroll and income taxes.
  - **Make Dividents Tax Cuts Permanent**. When dividends taxes fall, the cost of capital falls and businesses tend to increase investments in equipment and building. These investments result in job creation and higher incomes.
  - **Make Capital Gains Tax Cuts Permanent**. Keeping capital gains taxes low will relieve federal budget deficits by increasing government revenue and encouraging greater capital investment.

To see the NCPA's Congressional Brief on Tax Reform, click here.

Housing & Mortgage Reform

- At its root, the mortgage crisis was caused by at least three factors:
  1. Individuals borrowed too much money to buy homes that were realistically unaffordable.
  2. Banks loaned too much money to individuals based on flimsy information about income and the ability to repay loans.
  3. Mortgage debt was sliced and diced into securities that are now "toxic" because of banking rules that not only conceal their potential future value, but also drain the banks of sorely-needed capital.
- The President has proposed a bailout plan for homeowners who can't afford to pay their mortgages by
  - Allowing them refinance into government-backed loans (through Fannie Mae & Freddie Mac),
  - Inducing banks to work with borrowers to modify the terms of their loans (bank regulations won't be announced until next week), and
  - Permitting bankruptcy judges to rewrite the terms of mortgages.
- In reality, 92% of home owning mortgage-holders are already paying their bills on time.
- The President's plan provides lopsided benefits for the 8% of homeowners in default, perhaps at the expense of the 92% of homeowners who are paying their bills on time ("spreading the wealth"). This incentivizes bad behavior and discourages good behavior.
- **A better way** to solve the housing/mortgage crisis is to suspend mark to market accounting rules, which would allow realistic values to be put on mortgage-backed securities, thereby restoring some ability for the markets to sort out otherwise "toxic" assets by valuing those assets on the basis of their potential worth in the future, rather than the capricious rules currently required by the government.