A “Modest” Proposal To Balance The Federal Budget

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ABSTRACT

The total debt of the United States (US) federal government now exceeds annual Gross Domestic Product (GDP). This level has historically proved problematic in other countries. The primary driver of the debt is a federal budget deficit that now exceeds \$1 trillion per year. Despite forecasts of dire consequences, the deficit and debt have not been controlled, as efforts to make meaningful reductions—including plans developed by the bipartisan Bowles-Simpson and Domenici-Rivlin groups—have so far fallen prey to infighting in the political process. This paper examines one approach to eliminate the annual deficit, balance the federal budget, and reduce the federal debt. This approach increases tax revenues with a flat income tax applied to a broader tax base plus a consumption tax. Health and welfare spending is reformed using the Boortz-Linder Prebate and the Bismarck social-insurance health care plan to provide a more comprehensive safety net. Defense spending is reduced by making greater use of reserve forces following the model of Sweden, Switzerland, and Israel, by reducing overseas deployments, and by reforming procurement. Many unnecessary or counterproductive activities are cancelled, transferred to the states, or privatized. Social security is placed on a sound footing for the future. These proposals are based in large part upon programs and procedures that have produced positive results in other countries. This approach is offered not as the only or best solution, but rather to indicate that solution is possible and to lead to further discussion.

Keywords: Balanced Budget; Bowles-Simpson; Bismarck Social Insurance; Boortz-Linder Prebate; Budget; Consumption Tax; Debt; Deficit; Domenici-Rivlin; Flat Tax; Gross Domestic Product (GDP); Income Tax; Military Spending; Overseas Deployments; Privatization; Procurement; Reserve Forces; Safety Net; Social Security; United States; Welfare Spending

(T)he best economic stimulus is fiscally responsible, long-term deficit reduction that sends a clear signal to the private sector about Washington’s commitment to economic stability.

– Michael Bloomberg, Mayor of New York, 8 November 2011

Our national debt is our biggest national security threat.

– Admiral Mike Mullen, Chairman of the Joint Chiefs of Staff, 23 June 2010

INTRODUCTION

In September 2012 the total debt of the United States (US) federal government topped \$16 trillion, roughly equal to the US Gross Domestic Product (GDP), the value of all goods and services produced in the US in one year. Of this total, roughly \$4.74 trillion is inter-government and \$11.27 trillion is owed to outsiders. About \$5.4 trillion is owed to foreign investors, with about \$1.1 trillion each to Chinese and Japanese entities. The 2012 budget prepared by the Obama administration showed the debt increasing past \$26 trillion by 2022. Economist Mark Zandi of Moody’s Analytics described reaching the 100% mark as an indication of “the grave need to address our long-term fiscal problems.” (Woolf, 9 Jan 2012). The debt has grown to such level primarily because of continued annual budget deficits. Off-budget items affect the debt as well, but the budget deficit is the largest single factor.

There is some confusion in the general public about differentiating between deficits and the debt. They two are different, but are related as follows:

Debt at beginning of year
 + Deficit for this year, if applicable
 - Surplus for this year, if applicable
 +/- Off-budget items
 = Debt at end of year

Conceptually, it may be helpful to think in accounting terms that the debt is comparable to accumulated retained earnings on the balance sheet while the annual surplus or deficit is comparable to one year's net income or loss on the income statement. Another related misconception is the tendency, particularly among politicians, to commingle annual amounts with totals for multiple years. For example, it is a common political gambit to speak a \$1 trillion dollar deficit on the one hand and then promote a proposed solution with a claimed impact of \$500 billion, when the claimed impact actually represents 10 years of impact at \$50 billion per year. Obviously and misleadingly, the \$500 billion number implies a much more significant impact on the deficit than the proper annual amount of \$50 billion. A more truthful presentation would compare one year of impact to one year's deficit, or ten years of impact to ten years of projected deficits. But that more truthful presentation would obviously weaken the case for the proponent, who therefore engages in this sleight of hand. To avoid the latter issue, all amounts throughout this paper are expressed in terms of single year impact, unless specifically stated otherwise.

Figure 1 shows the growth in the federal debt compared to GDP for the period from 1940 to estimates for 2017 (source OMB, 2012).

Figure 1 – Growth Of The Federal Debt 1940-2017

Total debt began to increase significantly in the mid 1970s, and continued to increase thereafter, but remained significantly lower than GDP until about 2008. Debt held by the public excludes certain borrowings from other governmental agencies or funds, such as the Social Security trust fund.

Figure 2 shows how revenues and expenditures, and the resulting surpluses and deficits, have contributed to the growth of the debt since 1940 (source OMB, 2012). Consistent with the growth of the debt in the comparable time frame, Figure 2 shows that throughout most of the period 1976-present, spending has exceeded 20% of GDP while revenues have been less than 20% of GDP.

Figure 2 – Federal Revenues/Expenditures As A Percent Of GDP 1940-2017

Although each major political party is quick to blame the other, it should be noted that deficits are not a partisan issue. Deficits have been the rule with either Democrats or Republicans in power, in virtually any combination, as shown in Table 1, with dollar amounts in billions (OMB, 2012):

Table 1 – Debt And Deficit By Party Controlling Congress And Presidency

Period	Party controlling (D=Democrat/R=Republican)			Average annual budget deficit (surplus)	Average annual increase (decrease) in debt	Increase (decrease) in debt	Ending debt
	Presidency	Senate	House				
1789-1980	Various	Various	Various	\$9	\$5	\$994	\$994
1981-86	R	R	D	172	270	1,352	2,346
1987-92	R	D	D	206	401	2,005	4,351
1993-94	D	D	D	229	170	569	4,920
1995-2000	D	R	R	(23)	47	849	5,769
2001-02	R	D	R	15	446	991	6,760
2003-06	R	R	R	339	548	2,190	8,950
2007-08	R	D	D	936	1,463	2,926	11,876
2009-10	D	D	D	1,297	1,444	2,888	14,764
2011-12	D	D	R	1,114	1,392	2,784	17,548

Note: For purposes of this table, party elected in year 1 and taking power in year 2 is deemed to be responsible for budgets in fiscal years (FY) 3 and 4. For example, results for 2001-02 reflect outcome of 2000 election, deficits for FY 2002 and FY 2003, and cumulative debts at the ends of FY 2003. Alternative interpretations yield results that vary slightly, but do not alter the conclusion materially. Annual budget deficits differ from annual change in the debt due to certain “off budget” items.

The budget deficit has exceeded \$1 trillion per year since 2008, and is expected to continue for the foreseeable future to exceed the amount of any annual deficit prior to 2008. Table 2 shows the projected debt and deficit numbers from President Obama’s 2013 budget proposal (OMB, 2012, Historical Tables, Table 1-1 and Table 7-1, amounts in billions of dollars):

Table 2 – Projected Deficit And Debt Amounts

Year	Receipts	Outlays	Surplus (Deficit)	Total Debt	Debt Held by Public
2012	2,469	3,796	(1,327)	16,351	11,578
2013	2,902	3,803	(901)	17,548	12,637
2014	3,216	3,883	(667)	18,500	13,445
2015	3,450	4,060	(610)	19,427	14,197
2016	3,680	4,329	(649)	20,391	14,980
2017	3,919	4,532	(613)	21,325	15,713

The 2012 budget included revenues of \$2.6 trillion, defense expenditures of \$0.8 trillion, other discretionary expenditures of \$0.5 trillion, mandatory expenditures of \$2.3 trillion, and interest expense of \$0.2

trillion, resulting in total expenditures of \$3.8 trillion and a deficit of \$1.2 trillion (OMB, 2012). The magnitude of those amounts clearly means:

- The proposal to increase personal income taxes on those making more than \$250,000, expected to produce \$80 billion per year, would have minimal effect on the deficit.
- Complete elimination of military spending would not be sufficient to eliminate the deficit, or even reduce it to pre-2008 levels.
- Elimination of all discretionary spending, both military and non-military, would eliminate the deficit, but barely so.

Therefore it is reasonable to conclude that elimination or significant reduction of the deficit will require increased revenues, reforms to entitlement programs to reduce mandatory spending, and reductions wherever possible in military and other discretionary spending. To this point, neither major political party—Democrats nor Republicans—has truly faced the problem. There has been more infighting than accomplishment (Smith and Cowan, 2011). Some minor compromise measures have been implemented, but nothing of sufficient scale to effect a material reduction of either deficit or debt. Republicans have opposed tax increases and cuts to military spending. Democrats have opposed cuts to welfare and entitlement spending. During the past two years, several different attempts have been made to find ways to reduce the large deficit and growing debt.

- The Bowles-Simpson Commission, appointed by President Obama, whose report was slated to be submitted to Congress for an up-or-down vote if 77% of its members had supported it (61% did support it, including majorities of both Republicans and Democrats on the commission)
- The Rivlin-Domenici Committee, formed to develop an independent bipartisan plan
- President Obama's own budget proposal
- An alternative Republican proposal developed by Representative Paul Ryan

It should be noted that:

- Three of the four proposals actually reduce the top marginal tax rates for both individuals and corporations to enhance economic growth by increasing US competitiveness, making up revenues by broadening the tax base through reduction or elimination of deductions and exemptions.
- The Domenici-Rivlin plan accomplishes the maximum reduction in the debt to GDP ratio, primarily because it includes a consumption tax for the specific purpose of debt reduction.
- The Bowles-Simpson plan proposes the largest reduction in defense spending, while the Ryan plan proposes the largest reduction in domestic discretionary spending

Table 3 summarizes the principal points of those four proposals (dollar amounts in billions).

Table 3 – Principal Provisions Of Various Deficit Reduction Proposals

Proposal/Author	Bowles-Simpson	Domenici-Rivlin	President Obama	Congressman Paul Ryan
Origin	Bipartisan, commissioned by President Obama	Bipartisan Policy Center	Democrat	Republican
Debt to GDP in 2022	62%	59%	77% per budget	70%
Domestic discretionary savings	\$680B over 12 years	\$440B over 12 years	\$770B over 12 years	\$2,000B over 12 years
Defense savings	\$1,100B over 12 years	\$580B over 12 years	\$400B over 12 years	\$78B over 12 years
Other mandatory	Unspecified	Unspecified	\$360B over 12 years	\$715B over 12 years
Individual tax rates	12%-22%-28%	15%-27%	Up to 39.6%	Top annual rate 25%
Corporate tax rates	28%	27%	Unspecified	25%
Other	Approved by 61% of commission, including majorities of both D and R.	Includes consumption tax.	Only proposal that does not reduce tax rates.	

Comparing the US to other developed countries provides useful perspective for evaluating alternative approaches. Figure 3 (source OECD 2012) reflects total national, state/provincial, and local taxes and spending for the developed countries:

Figure 3 – Government Revenues And Expenditures For OECD Countries

Including federal, state, and local levels, US government expenditures are slightly below average for OECD. US government revenues are substantially less than OECD average, resulting in deficits and debt.

OBJECTIVES

The analysis described in this paper has been performed with the following goals/objectives in mind:

- Reduce annual deficit by 80-100%
- Reduce accumulated debt from 100% to 60% of GDP in 10 years
- Make US more competitive in world markets to increase jobs and growth
- Maintain or improve welfare safety net
- Maintain strongest defense in world, tailored to threat scenario
- Provide for future solvency of social security

METHODOLOGY AND ASSUMPTIONS

This analysis has utilized the following methodology:

- Start from President Obama's proposed budget deficit of \$901 billion for 2013
- Use projections of economic growth, GDP, other activity from President's Budget for 2013
- Use historical tax data from IRS databases
- Calculate the components of taxable income by applying the GDP growth rates proposed in President Obama's 2013 budget to historical baseline data
- Calculate impact of tax changes by applying proposed rates and tax structure to projected levels of taxable income and other components of the tax base
- Use the 2013 projected amounts in President Obama's budget for 2012 as the baseline
- Where spending cuts have been proposed by other analysts, generally accept their calculations.

Significant assumptions include:

- GDP will grow as projected in the president's budget for 2013

- Various components of taxable income will continue in proportion to GDP as they have been for the period 2005-2009.
- Interest rates on federal debt, compared to the projection in the president's budget for 2013, will be equal to the projected level in 2013, 0.25% higher than the projected level in 2014, 0.5% higher than the projected level for 2015, 0.75% higher than the projected level in 2016, and 1.0% higher than the projected level in 2016 and subsequently.
- Businesses and consumers will not modify their economic decisions from current projections as a result of changes in government tax and spending policies, although the expectation is that several modifications will in fact occur and that the net effect of such modifications will be decidedly positive.

Table 17 (at end) summarizes the key historic data used as the basis for the analysis and calculations.

TAXES/REVENUES

In evaluating various proposals to increase revenues, it is helpful to look first at how other countries generate tax revenues. Both Bowles-Simpson and Domenici-Rivlin noted a need to implement a tax structure that improves US competitiveness in the global economy. They cited this need as the primary reason for the approach they adopted—reducing tax rates, elimination or reduction of deductions, and generally broadening the tax base.

The Organisation for Economic Co-operation and Development (OECD) maintains tax databases for its member countries (which are essentially the developed countries of the world). Table 4 shows the sources of tax revenues for the developed countries as a whole, compared to the current US tax revenue sources, which can provide useful guidance regarding possible restructuring of tax structures to increase productivity (OECD, 2012, and GPO, 2012, Historical Tables, Table 2-1):

Table 4 – Comparative Tax Revenue Sources For US And OECD Countries

Source	Tax Structures for the OECD Countries as a Whole						US 2009
	1965	1975	1985	1995	2005	2009	
Personal income tax	26%	30%	30%	26%	24%	25%	48%
Corporate income tax	9%	8%	8%	8%	10%	8%	11%
Social security and other payroll taxes	19%	23%	23%	26%	26%	27%	33%
National property taxes	8%	6%	5%	5%	6%	5%	-
General consumption taxes	12%	13%	16%	19%	20%	20%	-
Specific consumption/ excise taxes	24%	18%	16%	13%	11%	11%	2%
Other taxes	2%	2%	2%	3%	3%	3%	6%
Total	100%	100%	100%	100%	100%	100%	100%

The US tax structure is far more reliant on the individual income tax and somewhat more reliant on the corporate income tax and (highly regressive) social security tax than OECD as a whole. Unlike the rest of OECD, the US has no general consumption tax and relies far less on specific consumption and excise taxes than OECD as a whole.

In addition to the differences in tax sources, there are differences in comparing tax rate structures within each tax. Table 5 compares the top individual, corporate, and combined dividend (combination of corporate tax rate plus individual tax rate on after tax income returned as dividends) tax rates (including national, state, and local) for the US to the comparable average for all OECD countries, including a comparison of top marginal tax rates to total tax bite (total taxes divided by GDP) for both US and OECD (OECD, 2012):

Table 5 – Comparative Tax Structures For US And OECD Countries

Description	1995		2000		2005		2010	
	US	OECD	US	OECD	US	OECD	US	OECD
Personal/Individual taxes								
- Top marginal rate	43.0%	49.0%	46.7%	46.5%	41.4%	43.1%	41.9%	41.7%
- Lowest marginal rate	N/A	N/A	15.0%	13.8%	10.0%	13.9%	10.0%	13.7%
- Ratio	N/A	N/A	3.1	3.4	4.1	3.1	4.2	3.0
Corporate taxes								
- Top marginal rate	39.6%	36.6%	39.3%	32.8%	39.3%	28.2%	39.1%	25.4%
Combined dividend tax (CIT + PIT)								
- Top marginal rate	67.4%	53.3%	67.3%	49.0%	52.0%	43.2%	52.2%	41.4%
Total overall tax bite	27.8%	34.5%	29.5%	35.2%	27.1%	34.9%	24.8%	33.8%
Ratio of top rate to total tax bite								
- For individuals	1.55	1.42	1.58	1.32	1.53	1.23	1.69	1.23
- For corporations	1.42	1.06	1.33	0.93	1.44	0.81	1.58	0.75
- For dividends	2.42	1.54	2.28	1.39	1.92	1.24	2.10	1.22

This comparison strongly suggests that US taxes are substantially more progressive than for OECD as a whole, and more detailed analysis reveals the following points, some of them perhaps surprising:

- OECD top personal tax rates are slightly lower on average than the top US personal tax rates.
- OECD individual tax structures are generally less progressive than in the US, with the ratio of highest to lowest tax bracket approximately 4.2 to 1 in the US versus 3.0 to 1 for OECD.
- Both US and OECD individual tax rates have been trending lower since 2000, with the US structure becoming more progressive and OECD less progressive, as measured by the ratio of top rate to lowest rate.
- US corporate tax rates are substantially higher than the OECD average (and are currently highest in OECD), primarily because OECD corporate tax rates have fallen significantly since 1995 while US corporate rates have remained steady.
- The US combined dividend tax (the measure of the corporate tax bite plus individual tax bite on corporate earnings paid out as dividends) has been falling since 1995 but is substantially higher than the OECD average, currently ranking third highest in OECD.

Any discussion of “fair share” should thus consider that the US currently has a highly progressive tax system, the most progressive in the developed world. In 2008, the percentage of total income, percentage of tax liability, and effective tax rates for the quintiles of individual taxpayers were as shown in Table 6 (Mencarow, 2011, quoting Gaver, 2010):

Table 6 – Shares Of Individual Income And Tax Liability By Quintile For 2008

Quintile	Number (thousands)	Income (millions)	Taxes paid (millions)	% Income	% Taxes	Effective Tax Rate	Ratio of % Taxes to % Income
All	139,960	8,426,625	1,031,512	100.0%	100.0%	12.2%	
Top 1%	1,400	1,685,472	392,149	20.0%	38.0%	23.3%	1.90
Top 5%	6,998	2,926,701	605,718	34.7%	58.7%	20.7%	1.69
Top 10%	13,996	3,856,462	721,421	45.8%	69.9%	18.7%	1.53
Top 25%	34,990	5,678,179	890,614	67.4%	86.3%	15.7%	1.28
Top 50%	69,980	7,352,111	1,003,639	87.2%	97.3%	13.7%	1.12
Bottom 50%	69,980	1,074,514	27,873	12.8%	2.7%	2.6%	0.21

Interestingly Gaver (2010) also notes that the ratio of taxes to income was lower for the top quintile during the Clinton administration than during the George W. Bush administration, despite the “Bush tax cuts.”

Another perspective is provided by OECD (2008), which compared the concentration of household taxes to the concentration of income, using two approaches—one based on the Gini coefficient and the other based on the percentage share of income and taxes for the top 10% or incomes, with results comparing the US to selected countries and to OECD as a whole in Table 7 (note, results for countries omitted to save space are consistent with those presented). In the Gini comparison columns, a higher coefficient for taxes means that taxes are imposed more unequally on higher incomes, a higher coefficient for market income means that income is distributed more unequally in favor of higher incomes, and a larger ratio means that taxes are imposed more unequally than income is distributed. The percent share for the richest decile simply compares the share of taxes paid by the top decile (10%) to the share of income for the top decile. In both analyses, a ratio greater than 1.00 means that taxes are imposed at greater than a pro rata rate on higher income, or in other words a more progressive tax structure.

Table 7 – “Fair Share” Calculation For Us Compared To OECD Countries

Country	Concentration of household taxes and market income			Percentage share of richest decile		
	Concentration coefficient for household taxes	Gini coefficient of market income	Ratio of concentration coefficients to Gini coefficients	Share of taxes of richest decile	Share of market income of richest decile	Ratio of share of taxes to share of income for richest decile
Australia	0.53	0.46	1.16	36.8	28.6	1.29
Canada	0.49	0.44	1.13	35.8	29.3	1.22
France	0.37	0.48	0.77	28.0	25.5	1.10
Germany	0.47	0.51	0.92	31.2	29.2	1.07
Italy	0.55	0.56	0.98	42.2	35.8	1.18
Japan	0.38	0.44	0.85	28.5	28.1	1.01
Sweden	0.34	0.43	0.78	26.7	26.6	1.00
Switzerland	0.22	0.35	0.63	20.9	23.5	0.89
UK	0.53	0.46	1.16	38.6	32.3	1.20
US	0.59	0.46	1.28	45.1	33.5	1.35
OECD Average	0.43	0.45	0.96	31.6	28.4	1.11

By both measures, the US has a more progressive tax structure than OECD as a whole, and more progressive than any other OECD member country. OECD (2008) concluded that the US had the most progressive tax system in the world. It should be noted that based upon either the Gini measure or the share of market income measure, there is no strong correlation between more progressive tax structures and more even distribution of income. This may be because, as OECD further notes, while most countries rely more on cash transfers than taxes to redistribute income, the US stands out as attempting to achieve greater redistribution through the tax system than through cash transfers (OECD, 2008).

Some analysts have suggested that tax structures make other countries more attractive to investors than the US. It is certainly well documented that US individuals and companies (Mitt Romney, GE, Google, and Facebook) are investing and conducting business in foreign locations to reduce their tax bills. Bowles-Simpson and Domenici-Rivlin noted this, and restructured US tax rates as discussed above to try to make the US more competitive again.

One driver behind the data for other OECD countries is the recent trend—particularly among developing nations seeking to increase both the growth of their economies and the efficiency of their taxation regimes—to abolish complex and loophole-filled progressive income tax systems and replace them with flatter and simpler taxes applied to broader tax bases. Particularly intriguing are the former communist countries, which have adopted this approach to promote growth in creating market economies from scratch—Estonia, Latvia, Lithuania, Russia, Slovakia, Serbia, Ukraine, Romania, and Georgia (Boortz, 2008, pp. 48-49).

This proposal incorporates a tax system that would adopt some of the taxation principles identified in other countries, as noted above, and would carry them further in an effort to increase US competitiveness in the worldwide economy. This 15-15-15 Plan includes the following elements:

- 15% payroll tax, which would work like current social security (7.5% paid by employee, 7.5% paid by employer), but with the regressive income cap removed, and proceeds would go to the social security fund.

- 15% flat tax on all business earnings regardless of form of entity – corporation (with deduction for dividends paid), partnership, LLC, farm, rental – and on all investment income – dividends, interest, capital gains
- 15% consumption tax – like “Fair Tax” or value-added tax (VAT) or general sales tax (GST).

This approach eliminates the personal income tax and the dreaded April 15 deadline. Unlike the “Fair Tax” proposal, the IRS would not be dismantled, but its role would shift significantly. All compliance work could be performed at the business entity level, reducing the number of taxable units from 140 million to 35 million, thereby facilitating more efficient audit coverage and increasing compliance. The IRS could also administer the Prebate (discussed below).

The payroll tax would work essentially like social security today, with the elimination of the wage and salary cap that makes the social security tax perhaps the most regressive in the entire US tax system. It would fund a comprehensive social security system, into which unemployment and disability income would be combined, as is done in France and other European countries. . Numerous studies have indicated that raising or eliminating the salary cap would significantly lengthen the time before the social security fund becomes insolvent. Social security is discussed in greater detail below.

The consumption tax effectively replaces the individual income tax, along the lines of the “Fair Tax” proposed by some more conservative groups.

The third leg is a flat rate 15% income tax on all business and investment activities—corporations, partnerships, limited liability companies, dividends (which would be deductible by the paying corporation), interest, capital gains, and rental and farm income. Because there is no personal income tax other than the payroll tax, this provision catches all non-payroll forms of income.

The consumption tax, combined with the flat business income tax, would reduce or eliminate current tax disincentives that chase investment overseas. A consumption tax can imposed on all imports, which effectively affords some tariff protection, and can be rebated on all exports, allowing other countries to “subsidize” exports. Rebates of consumption taxes (but not other taxes) are perfectly legal under international tax and tariff agreements to which the US is a party. Because the US is the only developed country that does not have a national consumption tax, its ability to tax imports is reduced and it is the only developed country that cannot rebate embedded taxes on exports, placing US companies at a significant disadvantage in the global economy. Principal beneficiaries would be the middle class, whose job prospects are enhanced. As will be shown below, the middle class also benefit because the medical benefits (as in Europe) and the Prebate (which Europe does not have) also accrue to the middle class.

Revenues from this tax structure have been based upon historic tax return data regarding salaries and wages and business income, projected into the future by applying the historic percentage of GDP to the GDP projections contained in President Obama’s 2013 Budget (OMB, 2012). Estimation of revenues from the consumption tax requires some assumption regarding size of the tax base, and this has been a hotly debated topic. The proposed tax follows the “Fair Tax” approach of applying to all retail sales, and if the tax is structured alternatively as a value added tax (VAT), the same ultimate tax base would be proposed. Bachman, et al (2006) estimated that such a tax would apply to 81% of GDP. Gale (2006) noted correctly that most European VAT structures capture significantly less of GDP in the tax base (around 40%) and calculated a consumption tax base of 70% of GDP. Dale (1998), in response to Gale (1998), noted that Gale had failed to include in his tax base all transactions that “Fair Tax” would include, and calculated that the base would be 84% of GDP. Tuerck (2007) calculated a base equal to 81% of GDP. All differences appear to result from relatively minor disagreements over what should/should not be included in the consumption tax base. A base equal to 75% of GDP has been assumed in these calculations.

Flat tax and consumption tax schemes are frequently criticized as providing windfalls for higher incomes and penalizing lower incomes. First, for the effect on lower incomes, the Boortz-Linder Prebate (Prebate) makes this approach more progressive. The Prebate is essentially Milton Friedman’s (1962) negative income tax adapted to a consumption tax environment. The Prebate is an amount paid to every family/taxable unit every month, determined as follows:

- For each taxable unit (individual, family), determine the poverty level of income
- Provide a credit equal to 30% of that amount (to offset 15% payroll/business profit tax plus 15% consumption tax)
- Prebate the amount with a monthly check/EFT

Table 8 shows the Prebate calculation in accordance with the above formula:

Table 8 – Calculation Of Prebate Amounts For Specific Family Situations

One adult household				Two adult household			
Family Size	Annual Consumption Allowance	Annual Prebate	Monthly Payment	Family Size	Annual Consumption Allowance	Annual Prebate	Monthly Payment
Single person	11640	3492	291	Couple	23279	6984	582
+ 1 child	15659	4698	392	+ 1 child	27299	8190	683
+ 2	19679	5904	492	+ 2	31319	9396	783
+ 3	23699	7110	593	+ 3	35338	10601	883
+ 4	27718	8315	693	+ 4	39358	11807	984
+ 5	31738	9521	793	+ 5	43378	13013	1084
+ 6	34683	10405	867	+ 6	47397	14219	1185
+ 7	39777	11933	994	+ 7	51417	15425	1285

Table 9 calculates the total annual cost of the Prebate for 2013, based upon the on number of 1040 returns filed per IRS and demographic data per BLS.

Table 9 – Estimated Annual Cost Of Prebate

	Households (thousands)	Annual Prebate	Annual Cost (thousands)		Households (thousands)	Annual Prebate	Annual Cost (thousands)
Single person	30,837	3,492	107,682,804	Couple	25,810	6,984	180,257,040
and 1 child	13,136	4,698	61,712,928	and 1 child	11,866	8,190	97,182,540
and 2 children	6,863	5,904	40,519,152	and 2 children	13,406	9,396	125,962,776
and 3 children	3,339	7,110	23,740,290	and 3 children	5,964	10,601	63,224,364
and 4 children	1,488	8,315	12,372,720	and 4 children	2,075	11,807	24,499,525
and 5 children	505	9,521	4,808,105	and 5 children	620	13,013	8,068,060
and 6 children	305	10,405	3,173,525	and 6 children	310	14,219	4,407,890
and 7 children	104	11,933	1,241,032	and 7 children	109	15,425	1,681,325
Subtotals			255,250,556				505,283,520
Total							760,534,076

Second, we will look at the impact on upper incomes. Recently there have been a number of highly-publicized cases of high-income individuals paying effective tax rates as low as 14%--for example, Mitt Romney 13.9% (Romney 2012)—and multiple analyses indicate that effective taxes on higher incomes average in the 20-25% range. Under this plan those individuals would pay a 15% payroll tax on income taken as salaries (those who own their businesses would pay both the employer and employee portions), or a 15% tax on business profits and investment gains, plus a 15% tax on their consumption. This makes their effective rates 22.5% if their consumption equals 50% of total income, 24.0% if they consume 60%, and 25.5% if they consume 70%, roughly comparable to or higher than current effective tax rates. Note that under this approach, the top incomes also receive medical benefits (as in Europe) and the Prebate, but those amounts are clearly immaterial with incomes at \$1 million or more.

One additional tax is proposed. Our dependence on oil causes economic, foreign policy, and environmental problems that have been well documented. A measure that would provide disincentive to use oil and other fossil fuels, as well as to raise revenues, would be useful. There are two basic approaches, the “cap and trade” plan or a carbon tax. This paper proposes imposing a carbon tax—an additional motor fuel tax of \$2/gallon, phased in 25 cents per year for 8 years. To mitigate the impact on lower incomes, this approach would provide an allowance of 10,000 miles per driver/vehicle per year, at the CAFE mileage standard, and include a monthly allowance in the

Prebate. If the CAFE standard were 25 mpg, for example, then the allowance would be 400 gallons per year, and the tax on that amount would be included in the Prebate. At current usage of 13 million barrels of gasoline per day, or about 550,000 gallons per day, such a tax when fully implemented would provide approximately \$399 billion per year in additional revenues. The usage allowance of 10,000 miles per vehicle/driver per year would cost approximately \$138 billion per year, for net revenue increase of \$261 billion when fully implemented. This would be phased in over 8 years, so if started in 2013 would not be fully implemented until 2020. Such a carbon tax could, and arguably should, be extended to other carbon fuel sources, but only the impact upon gasoline has been considered in this paper. Alternatively, a “cap and trade” scheme could be adopted.

Table 10 summarizes the impacts of these tax changes. Because some of them would be phased in, the single year impact when fully phased in is presented (in 2013 dollars) along with the phase-in results over 1, 5, and 10 years. Note that the cumulative totals may differ from 1, 5, or 10 times the proposed annual impact because phasing in would reduce the long-term impact while growth and inflation would increase it.

Table 10 – Impact Of Proposed Tax Changes

Tax (Amounts in \$ Billions)	Per President Obama's 2013 Budget	Proposed Approach for 2013	Annual Impact (2013 dollars)	Estimated Cumulative Impact		
				1 year	5 years	10 years
Individual income tax	1,294	0	-1,294	-1,294	-7,588	-18,304
Business/corporate/investment income tax	365	758	393	393	2,182	5,236
Payroll taxes	990	1,008	18	13	124	206
Consumption tax	0	1,985	1,985	1,838	10,272	23,455
Less Prebate	0	-839	-839	-839	-4,509	-9,874
Additional carbon tax on gasoline usage	0	261	261	33	489	1,636
Other taxes	253	253	0	0	0	0
Total taxes	2,902	3,426	524	144	970	2,415

HEALTH, EDUCATION, AND WELFARE SPENDING

The Patient Protection and Affordable Care Act (PPACA, or ACA, or Obamacare) had the following as its enumerated objectives:

- Provide universal health insurance
- Reduce the cost of health care
- Relieve the health care burden on US employers

It would appear to fail on all counts. It is now estimated that some 30 million people will be left without insurance through 2022 (Burke 2012, Elmendorf 2012). The Congressional Budget Office (CBO) has expressed skepticism about the ability of ACA to reduce or restrain costs without serious degradation of quality or availability (Elmendorf, 18 Nov 2009, p. 17), numerous analyses subsequent to passage appear to suggest that the negative impact on the federal budget will be greater than anticipated, and the incremental costs to states and the private sector appear to exceed the benefit to the federal government (Elmendorf, 19 Dec 2009, p. 20). With the penalty provisions for employers who fail to provide insurance coverage for employees, or who provided coverage that does not meet mandatory standards, the widespread perception in the business community is that ACA will make health care more expensive, not less, for businesses. This has led many businesses to seek exemptions, and many others to consider dropping health care coverage altogether. Taken together, these points would suggest consideration of another alternative.

One item cited in support of a change to US health care is the 2000 World Health Organization (WHO) study of world health care systems where the US health care system ranked 37th (WHO, 2000). In reviewing the results of that study, several factors must be considered (WHO, 2000):

- The WHO study evaluated not only quality but also cost and equality of access, and the factors were weighted roughly 20% quality, 40% cost, and 40% access. The US actually placed first in one of the two component measures that approximated quality, and 10th in quality and access combined.
- The two systems commonly touted as models for the US to apply, Canada (single payer) and UK (single provider), ranked 30th and 18th, respectively; particularly considering the heavy factor weightings given to access and cost, these represent very poor results versus the US.
- The methodology contained apparent bias in favor of smaller systems, as Andorra, San Marino, Malta, and Singapore placed in the top ten and Monaco was 13th. The US actually ranked first among countries with over 125 million in population, second (behind Japan, a Bismarck universal insurance system) among countries with over 85 million populations, and fourth (behind France, which ranked first overall, and Germany, both Bismarck universal insurance systems) among countries with over 65 million population.

In subsequent studies, systems utilizing the Bismarck universal insurance approach to health care tend pretty consistently to lead the pack, and have consistently outperformed UK and Canada in numerous studies with various metrics (Matthews, 2010). The approach to health care recommended herein is a version of the Bismarck approach, with three basic elements:

- Universal private health insurance
- Taxpayer funding for basic health insurance for all persons
- Freedom to supplement above the base, on either an individual or group (employer provided or otherwise) basis

In this system, government would function very much like an employer in the current US model, purchasing a basic health insurance policy for everyone, funded with consumption taxes. Everyone would then be able to supplement as wanted, and employers can supplement as an employee benefit. It is a model somewhat like Medicare. This approach breaks the US connection of health care to employment. With basic insurance paid by consumption taxes, the cost to an employer to provide supplemental insurance decreases considerably, further aiding global competitiveness. The market for health insurance above the baseline plan can be freer than the current US health insurance market, with many more options than are currently available. In France, for example, the vast majority of individuals do take advantage of this free market to supplement and the majority of businesses offer supplemental plans. In particular, this approach can restore the use of Health Spending Accounts (HSAs), which have been severely constrained under ACA/Obamacare. This is an important change because many analyses have indicated that the consumer control achieved with HSAs can have a major impact on controlling costs.

As for the cost of such a system, start by assuming an annual cost of \$2,700/person for the basic plan, which approximates the current French experience. For a population of 315 million people, that results in a cost of roughly \$850 billion. Assuming additionally that administrative costs are 10% (Medicare currently experiences 5-7% administrative costs, for comparison), results in a total cost of \$935 billion. This cost can be financed as follows:

- With this system, Medicaid becomes redundant and can be eliminated, saving \$350 billion at the federal level (OMB, 2012) and another \$125 billion at the state level (Urban Institute, 21 December 2011).
- The basic plan subsidizes 50 million people on Medicare to the extent of \$2,700 each per year, or \$135 billion in total, generating that amount of annual Medicare savings.
- With the impact of the Prefund, many people will no longer qualify for benefits under the current “means-tested” social welfare programs, and costs will drop significantly as a result. These programs could be eliminated in their entirety at the federal level, saving \$337 billion (OMB, 2012), and with the burden of Medicaid lifted from the states, these programs with their resulting reduced costs could be transferred to the states, with the idea that states could adopt or reject individual programs, or experiment with new approaches.

The net cost of this health care plan is thus approximately \$100 billion at the federal level. This approach to health care and welfare spending is conceptually based on the federalism principle—the federal government provides a baseline safety net, and states are free to supplement as they see fit.

To see how this would work in practice, let us consider the impact on specific individuals. Table 11 shows the current interaction of taxes and welfare payments for a family of three as they progress from \$15,000 to \$55,000 in annual earned income (author's calculations, based upon data for Texas, plus state taxes assumed at a flat rate of 5%):

Table 11 – “Welfare Trap” Impact Of Welfare And Taxes On Families

Earned Income	\$5,000	\$15,000	\$25,000	\$35,000	\$45,000	\$55,000
FICA	(383)	(1,148)	(1,913)	(2,678)	(3,443)	(4,208)
Federal income tax	0	0	(570)	(2,100)	(3,531)	(4,987)
State income tax	(250)	(750)	(1,250)	(1,750)	(2,250)	(2,750)
EITC	2,000	5,028	3,218	1,108	0	0
Food stamps	6,312	4,733	1,443	0	0	0
Medicaid/SCHIP	15,000	15,000	15,000	6,000	6,000	0
Section 8 housing	7,500	4,500	1,500	0	0	0
TANF	4,740	4,740	0	0	0	0
Net economic benefit	40,302	48,251	44,341	38,258	45,219	47,263

This “welfare trap” or “poverty trap” phenomenon, whereby increased taxes and lost welfare benefits essentially offset additional earned income dollar-for-dollar, amounts to an effective tax rate of 100% and serves as a considerable disincentive for persons with low incomes to seek jobs (or better-paying jobs for those who have jobs). Thies (2009) found results very similar to the above for a family of three in Virginia, as noted in Mankiw (2009). Clearly any “means tested” welfare program must inherently contain points of diminishing returns. As Mankiw notes, when multiple income-related programs are piled on top of one another, the implicit marginal tax rate can exceed 100 percent. The math simply cannot work otherwise. That makes the current welfare/tax combination extremely regressive in the lower income range.

Table 12 shows how this “welfare trap” effect would essentially be eliminated with the Prebate and Bismarck health care. This table assumes that the “means tested” welfare programs would be transferred to the states, as discussed above, and has assumed that the state being portrayed has continued food stamps but has eliminated or raised the threshold for other programs. Food stamps are retained because it is assumed that 1) the more conservative states will continue fewer programs, 2) the more rural states tend to be more conservative, and 3) farmers generally support food stamps because higher demand increases crop prices.

Table 12 – Status Of Family Of Three On Welfare With Proposed Taxes And Prebate

Earned Income	\$5,000	\$15,000	\$25,000	\$35,000	\$45,000	\$55,000
Prebate	7,500	7,500	7,500	7,500	7,500	7,500
Health care benefit	10,800	10,800	10,800	10,800	10,800	10,800
Payroll tax	(375)	(1,125)	(1,875)	(2,625)	(3,375)	(4,125)
Consumption tax	(3,095)	(4,344)	(5,592)	(6,841)	(8,090)	(9,339)
State tax	(250)	(750)	(1,250)	(1,750)	(2,250)	(2,750)
Subtotal	19,580	27,081	34,583	42,084	49,585	57,086
Assume state continues food stamps	6,312	4,733	1,443	0	0	0
Total	25,892	31,814	36,026	42,084	49,585	57,086

Two particular things which should be noted in this calculation are that 1) with nothing more than a single minimum-wage job, the hypothetical family of three is above the poverty line (and while not included here to save space, analyses of other individual and family situations reveal this to be true in every case), and 2) the disincentives to seek work, or a better job, have been almost entirely removed. Our hypothetical family of three is somewhat better off under the current system up to \$25,000 earned income; but at \$35,000 and above, clearly better off with the Prefund/Bismarck health care combination. This turns what may be described as a handout today into a “hand up.” At \$55,000, the illustrated family is roughly \$10,000 better off than today, and would incur taxes above that point at essentially a marginal tax rate of 30% (15% payroll/business profits plus 15% consumption), obviously making the middle class better off as well.

Another feature for consideration is adoption of the Swedish “no fault” medical malpractice system. This operates somewhat like US workers’ compensation now; damaged parties get faster compensation through a review board, without the jackpot damage awards given by some US juries and courts.

REFORM OF MANDATORY PROGRAMS

Above and beyond the changes to the health and welfare programs discussed above, there are also some efficiency improvements that can be made to mandatory programs such as Medicare which will remain. Edwards (2005) has identified the following changes to Medicare with estimated annual impact in 2015 totaling \$77 billion:

- Increase Medicare Part B premiums to cover 50% of program costs - \$59 billion
- Increase and conform deductibles for Medicare Parts A and B and medigap policies - \$18 billion

DEFENSE SPENDING

Defense spending currently comprises almost 20% of total federal spending, and roughly half of discretionary spending. Clearly, some cuts in defense will be required to achieve a balanced budget. The goal should be to cut in areas that minimize the negative impact on national security. The following changes are proposed as fulfilling that requirement:

- Military personnel cost approximately \$125 billion per year. The way to have a strong military force without excessive cost is to keep a substantial portion of that military force at a lowered state of readiness (Luttwak, 1985, p. 211-212). This principle is applied quite successfully by nations such as Israel, Sweden, and Switzerland, who maintain large and capable military forces for a reduced cost by relying heavily on reserve components. The US could employ this principle to maintain a much larger and more capable force that would be available in time of war for a reduced cost in time of peace. Reservists serve part-time and are typically paid for approximately 60 days per year, or one-sixth as much as conventional soldiers, sailors, airmen, and Marines. They also incur lower operating costs per capita. Analysis of detailed budget line item data for the period 2013-15 indicate that payroll cost for roughly 1.45 million active duty military personnel is approximately \$83,000 per capita, while the corresponding cost for roughly 850,000 reservists is approximately \$25,000 per capita. In terms of personnel costs, converting about 450,000 active duty slots (costing about \$37 billion annually) to 950,000 reserve slots (costing about \$23 billion annually) would save \$14 billion annually (approximately 11% of current personnel costs), while raising potential end strength from 2.3 million (1.45 million active and 850,000 reserves) to 2.8 million (1 million active and 1.8 million reserves). An added benefit would be that the smaller standing army would provide less temptation to political leaders to become ensnared in every dispute worldwide.
- Operation and maintenance (O&M) costs approach \$300 billion per year. One way to reduce the need for a peacetime standing army is to bring home most if not all the 250,000 troops currently deployed overseas at roughly 1,000 bases in Germany, Japan, and other locations. If some presence is still desired, active duty troops on site could be replaced by much cheaper reserve troops who would be activated and deployed only in an emergency. In 2004 Defense Secretary Rumsfeld estimated that closing 200 to 300 of those bases could save \$12 billion annually (Vine, 2011). Considering inflation, it is reasonable to conclude that closing substantially all of those bases should generate an O&M cost savings roughly comparable to the 11% personnel cost savings, or approximately \$30 billion per year given current operation and maintenance expenditure levels.
- Annual expenditure on new weapons systems approximates \$200 billion per year, including approximately \$125 billion procurement and \$75 billion research and development. Various analysts have proposed procurement cuts ranging from \$10 billion (Edwards, 2005) to \$50 billion per year. One generally accepted problem is that defense procurement tends to be weighted unreasonably heavily toward costly state-of-the-art systems, when in many cases a cheaper solution would serve as well. For example, the Navy is using *Arleigh Burke* class Aegis destroyers on pirate patrol in the Indian Ocean when much cheaper *Knox* or *Perry* class frigates (or versions of European frigates or Coast Guard cutters) could do the job as well or better. Even worse, in many cases the expensive systems have failed to meet specifications, even after costly modifications. A solution would be to implement the high/low procurement procedures

employed by former Chief of Naval Operations Elmo Zumwalt. This could include more state of the art (first rate) procurement for active forces and more second rate items for reserves and foreign sales. Another way to cut procurement costs would be to combine procurement of many items with NATO and other treaty partners to reduce costs for all parties. The target for procurement savings could be slightly higher than the personnel and O&M savings, or 15% per year for a reduction of \$30 billion per year.

- Cut another \$20 billion through efficiency savings per year through measures identified by Secretary of Defense Robert Gates (Wilson, 2010).
- A reduction in defense contractors by 15% would save another \$7 billion per year (Coburn 2011).
- Get rid of top-heavy management structure (Luttwak 1985) with unspecified savings.

Assuming all of these changes are phased in over time, the impact on defense spending for the first year, first five years, and first ten years can be estimated as shown in Table 13:

Table 13 – Proposed Changes To Defense Spending

Step (amounts in billions of dollars)	Annual (2013 dollars)	Savings (\$ Billions)		
		1 st year	5 years	10 years
Convert 450,000 active duty slots to 950,000 reserve slots	15	5	70	180
Bring troops home from overseas	30	0	80	280
Reduce procurement and research and development costs by converting to high/low mix strategy and make other procurement changes, eliminating least promising technologies, and cooperating more closely with NATO and other allies	30	6	82	207
Reduce size of nuclear arsenal	5	1	10	60
Implement efficiency savings identified by Secretary of Defense Gates (2010)	20	5	60	140
Reduce defense contractors by 15%	7	3	30	67
Totals	107	23	360	994

NON-DEFENSE DISCRETIONARY SPENDING

A number of groups have taken differing looks at possible cuts to non-defense federal spending. Where savings have been calculated by the sources for a one-year period, the costs over 5 and 10 year periods have been inflated at a rate of 3% per year. Where the sources calculated savings based on a 10-year period, the savings for 1 and 5 years have been estimated as 6% and 45%, respectively, of the 10-year amount, to reflect phasing in and inflation/growth. These savings are summarized in Table 14:

Table 14 – Proposed Changes To Non-Defense Discretionary Spending

Source	Description	Estimated Savings (\$Billions)		
		1 year	5 years	10 years
	General Government			
C, D	Three-year freeze on federal salaries	8	64	144
C, R	Reduce federal headcount 15% through attrition	13	102	229
C, R	Reduce number of and spending for federal contractors by 15%	13	104	233
C, R	Reduce federal vehicle fleet by 20%	0	2	6
C, R	Reduce Senate and House of Representatives budgets by 15%	0	2	4
C	Eliminate the Office of National Drug Control Policy	0	2	5
	Department of Agriculture			
C, D, E	Reduce USDA conservation programs by 60%	3	20	48
C, D, E	Reduce USDA price support payments by eliminating the 75% that go to large corporate farmers	3	20	48
C, E	Cut funding for Forest Service in half	2	15	33
	Department of Commerce			
C	Transfer and consolidate programs at NOAA, Census Bureau	2	13	27
	Department of Education			
C, G	Consolidate programs	25	130	280

Source	Description	Estimated Savings (\$Billions)		
		1 year	5 years	10 years
C	Eliminate mandatory Pell Grants and reform and tighten remaining grant programs	7	54	128
	Department of Energy			
C,E	Eliminate the Office of Energy Efficiency and Renewable Energy	2	12	26
C, E	Consolidate the Advance Research Projects Agency-Energy into the Office of Science	1	5	11
C, E	Consolidate the Office of Environmental Management within the National Nuclear Security Administration	2	15	34
C, E	Reform and reduce the Office of Electricity Delivery and Energy Reliability	1	7	15
	Department of Health and Human Services			
C, E	Consolidate the SAMHSA activities into four core programs and consolidate the agency with the CDCP	0	2	4
	Department of Homeland Security/Transportation Safety Administration			
A, C, E	Eliminate 15 programs and reduce the costs of 10 additional programs	3	12	24
	Department of Housing and Urban Development	0	0	0
A, C	Eliminate 12 programs and reduce the cost of 7 other programs	5	40	86
	Department of the Interior			
C, E	Eliminate 5 programs and reduce the cost of 12 additional programs	6	13	26
	Department of Justice			
A, C, E, G	Eliminate or consolidate certain programs and end duplication	3	15	35
	Department of Labor and Pensions			
C, D	Replace Federal Employee Retirement System (FERS) with defined contribution plan for new employees, and equalize employer-employee payments for existing FERS participants	12	88	196
C, D	Set Pension Benefit Guarantee Corporation premiums at a level to fund liabilities fully	1	7	16
	Department of State and Foreign Affairs			
B	Reduce the overhead cost of foreign diplomatic operations	1	6	13
A, C	Reduce the amount of voluntary contributions the UN by \$2 billion per year	2	10	22
C	End foreign aid to countries with over \$10 billion in unpaid debt to the US	1	8	18
A, C, E	Reform and consolidate various foreign aid programs	2	18	40
C, E	Reduce foreign economic aid funding	3	20	42
C	Reduce funding to the World Bank	0	1	3
C, P	Reduce foreign military financing	2	12	27
	Department of Transportation			
C, G	Eliminate duplicative and/or low-priority spending, repeal or reform unnecessary mandates, and give states more flexibility	0	0	192
	Department of the Treasury			
C	Eliminate the Community Development Financial Institutions Fund, Office of Technical Assistance, Tropical Forest Conservation Act, and Heavily Indebted Poor Countries Initiative and Trust Fund	1	4	10
	Department of Veterans Affairs			
C, P	Require the Department of Defense and Department of Veterans Affairs to co-purchase drugs, achieving savings	0	3	7
C	Change co-pay requirements for veterans using VA medical facilities	0	3	6
	Environmental Protection Agency			
C, G	Eliminate or consolidate 8 duplicative or counterproductive programs, plus reform and reduce spending for 6 other programs	2	15	34
	Miscellaneous			
C	Auction off more of the electronic spectrum	2	10	20
	Totals	128	854	2,092

Key to Sources: A=Cato (2008), B=Bowles-Simpson (2010), C=Coburn (2011), D=Domenici-Rivlin (2010), E=Edwards (2005), G=GAO (2011), P=People's Budget (2011), Ross Perot (1992-93); sources are noted if they proposed the same or similar cuts to specific activities.

PRIVATIZATION

The federal government is engaged in a number of activities that could easily be privatized and supported by user charges. They have been privatized successfully in one or more foreign countries.

- The interstate highway system could be operated as a system of national toll roads. Estimates are that it could generate a profit of \$25-50 billion a year, after operating expenses and the \$40 billion in annual capital expenditures currently budgeted.
- The postal service has been privatized successfully in many locations, including New Zealand where it is combined with a bank.
- The air traffic control system needs substantial modernization which has not been forthcoming as rapidly as needed. Canada has avoided this problem by privatizing its system.
- Many European countries have privatized their formerly nationalized rail systems, and operated them more efficiently in that mode. Privatizing Amtrak could accomplish the same for the US.
- The Tennessee Valley Authority and the western power and water authorities currently provide service at below market prices which encourages overconsumption. If privatized they could charge market rates, fostering conservation, and could also be vehicles for alternative energy projects on a major scale.
- The Bureau of Reclamation and the civilian operations of the Army Corps of Engineers provide services for which they could charge market value to users if privatized.

Table 15 shows the annual savings that could be realized if these activities were privatized here and supported wholly by user charges:

Table 15 – Budget Impact Of Proposed Privatization Possibilities

Activity (source of cost data)	Where Currently Privatized Successfully	Annual Budget Cost/Subsidy (\$Billions)
Interstate highway system (national toll road system) (OMB, 2012)	Europe	40.5
Postal service (Edwards, 2005)	New Zealand	- 4.7
Air traffic control system (Edwards, 2005)	Canada, UK	2.8
Amtrak (Edwards, 2005)	Europe	1.3
TVA (OMB, 2012)	UK, Brazil, Argentina, Australia	0.0
Western Power and Water Authorities (Edwards, 2005)	UK, Brazil, Argentina, Australia	0.2
Army Corps of Engineers civilian projects (Edwards, 2005)	UK, Brazil, Argentina, Australia	4.9
Bureau of Reclamation (Edwards, 2005)	UK, Brazil, Argentina, Australia	1.2
Net Annual Savings		46.2

Over ten years, these savings of \$46 billion per year, plus the cumulative \$2.1 trillion savings on discretionary programs outlined above, produce total cumulative savings of over \$2.5 trillion in discretionary programs. In addition to saving budgetary expenditures in future years, privatization of these activities would allow more effective management processes to be implemented. Additional functions that could be supported by user fees instead of taxes could also be privatized.

One possibility would be to transfer the assets associated with these activities to the social security fund in payment of debts owed. These activities could then be set up to earn a 5% annual return on investment (ROI), to be paid to social security trust fund to help amortize future social security costs. In this model, future investment in facilities and other assets would come from earnings and social security contributions, not from the general budget

SOCIAL SECURITY

Although the Social Security Trust Fund (Fund) is not technically insolvent at the present time, there are legitimate worries about its future. It has been estimated that social security payments would exceed tax revenues by 2017, and that the social security fund would be depleted by 2042. In fact, the point where payments exceed revenues has been reached, bringing about expectations that the fund will not last until the 2042 date. The shortfall between 2016 and 2083 has been estimated to be as much as \$7.7 trillion (John, 2010) Former President Bill

Clinton's 2000 budget noted that the Fund "balances are available to finance future benefit payments and other Trust Fund expenditures—but only in a bookkeeping sense... They do not consist of real economic assets that can be drawn down in the future to fund benefits" (Cato, 2005, p. 49). President Clinton himself has observed that the only ways to keep Social Security solvent are to 1) raise taxes, 2) cut benefits, or 3) get a higher rate of return through private investment. Henry Aaron of the Brookings Institute testified before Congress in 1999, "Increased funding to raise pension reserves is possible only with some combination of additional tax revenues, reduced benefits, or increased investment returns from investing in higher yield assets: (Cato, 2005, p. 50). The following changes are estimated to be sufficient to make the Trust Fund secure for at least the next 100 years, and in all likelihood forever:

- Remove the wage/salary cap on taxes, as noted above in the discussion of the payroll tax. This step has been estimated variously to lengthen the life of the trust fund by 30 to 70 years.
- Like most of Europe, combine old age, survivors, disability, and unemployment compensation into a single omnibus social security program. The payroll tax funding already described produces roughly \$20 billion per year more in revenue than the current combined federal revenues for all those purposes, which will then extend the life of social security. Adding these other programs reduces slightly the long-term effect of the tax increase above, but it is reasonable to assume that the net impact of the two steps together would add 20 to 30 years to the life of the trust fund.
- Raise the standard retirement age by one month per year until it reaches age 70. Over a period of 48 years, this would phase in a significant cost reduction, consistent with rising life expectancies. For people who seek early retirement, keep the same early retirement ages, with benefits actuarially adjusted in a manner similar to the current procedure.
- Reduce inflationary costs by adopting a slower rate of inflationary growth on the upper end of social security benefit payments; this leaves the most needy still getting inflation protection at current rates, but gradually reduces cost by reducing payments to those best able to absorb them. This would narrow the gap between the highest and lowest social security benefits payments, with the eventual result that all recipients would receive the same amount, thus eliminating the regressive nature of the present benefits structure. CBO data indicate that indexing the entire benefit stream would save roughly \$30 billion by 2020, and the author estimates that this approach should have an impact equal to some significant portion of that number.
- Restore the non-taxability of all social security benefit payments. This would help the neediest who seek work to augment social security, as well as reduce the impact of those on the upper end whose inflationary increases have been curtailed by the previous step.
- Adopt Swedish partial privatization to create "super 401k" to provide all with an investment stream of income; this will further offset the slowdown in inflationary increases to upper level social security payments. Under this approach, an employee would contribute an extra 2.5% of salaries and wages, matched by employer, to fund which would then invest in safe private sector investments. The privatized federal functions discussed previously could be one target for such investments, to provide a stable base with a guaranteed 5% ROI. A reasonable approach would be that for each individual, the first \$50,000 in his/her account would go to these privatized government corporations, the second \$50,000 would go to a predesignated and very secure private sector investment fund, and any amounts above that could be directed to one of a number of private investment funds. This retirement account would be property of the individual. Withdrawal of proceeds would be nontaxable, so long as certain statutory provisions were observed. Upon death of an individual, the balance could be transferred to heirs.
- Recognize statutorily that each individual does have a property right in at least the privatized portion of his/her social security account. Further recognize the same statutory right in the trust fund portion of the account, reversing the holding in *Flemming v. Nestor* (1960).

With the privatized "super 401k" in place, each employee would take home 90% of his/her wages/salary in each paycheck, with 5% going to a retirement account which he/she would own. Excluding the benefit from the private retirement account, the economic benefit calculations shown in Table 12 above should be revised as follows: With \$5,000 earned income the resulting economic benefit is \$25,767; with \$15,000 earned income the benefit is \$31,439; with \$25,000 earned income the economic benefit is \$35,401; with \$35,000 earned income the economic benefit is \$42,209; with 45,000 earned income the economic benefit is \$48,460; and with \$55,000 earned income the economic benefit is \$55,711.

SUMMARY

The projected one-year impact of these proposed changes are summarized in Table 16.

Table 16 - Summary Of Impact Of Proposals

	Annual Impact (\$ Billions)
Start with President Obama's Budget Deficit for 2013 as baseline	(901)
Increased revenues from 15-15-15 plan, net of Prebate, plus gasoline tax	325
Net cost of Bismarck universal health care	(100)
Reform of mandatory programs	77
Defense savings	107
Non-defense discretionary savings	340
Net interest savings	30
Resulting budget surplus (deficit)	(122)

It is expected that normal growth will eliminate the remaining deficit. Because the various steps are planned to be phased in over time, the full impact does not occur in the first year, and changes should be estimated over ten years. Table 18 summarizes the resulting budgets for the period 2013-2022, in the format of Tables S-1 and S-2 of President Obama's 2013 Budget for comparison. Highlights include:

- Debt in 2022
 - 61.8% of GDP (55.4% held by general public)
- Annual budget as a percent of GDP
 - Revenues – 21.1% (taxes 19.3% of GDP)
 - Expenditures – 20.6%
- Composition of tax revenues (no individual income tax)
 - 30.2% payroll tax
 - 31.8% consumption tax
 - 22.7% business/investment income tax
 - 7.1% excise taxes
 - 8.2% other

Comparing the results of this analysis to the stated goals reveals the following:

- Reduce annual deficit by 80-100%
 - \$901 billion to \$122 billion, with growth and additional measures balancing budget over time
- Reduce accumulated debt from 100% to 60% of GDP in 10 years
 - 61.8% in 2022 (55.4% held by general public)
- Make US more competitive in world markets to increase jobs and growth
 - Top corporate/business tax rates reduced below OECD average, consumption tax incorporated tariff on imports/rebate on exports, and employers relieved of significant health care costs.
- Maintain or improve welfare safety net
 - Prebate and universal health care provide more comprehensive safety net or floor, with a single minimum wage job sufficient to put every individual and family above the poverty threshold.
- Maintain strongest defense in world, tailored to threat scenario
 - Resulting force more responsive to defending against actual threats
- Provide for future solvency of social security
 - Revenues increased by eliminating the regressive wage/salary cap, future costs reduced by raising retirement age gradually and reducing inflation adjustments for wealthier retirees, ROI improved from privatized government functions and "Super 401k" created with privatized portion of accounts

OPTIONAL OR ALTERNATIVE ITEMS

The following optional items could be adopted to eliminate any remaining deficit or generate a surplus:

- Raise taxes on alcohol and tobacco to cover 100% of society's cost of treatment for those suffering illness/injury as a result – possible yield \$50 billion per year
- Providing legal guest worker status for more immigrants, reducing current enforcement costs and generating permit fees – possible yield \$1-2 billion, plus reducing enforcement costs \$50-80 billion
- Increasing other excise taxes
- Establishing or raising user fees for more federal services
- Adjusting the tax rate from 15%, higher or lower, as needed.

Alternatively, higher growth rates may take care of this remainder. Although no study of growth rates under this specific approach has been made, it can be inferred from analyses of similar approaches that the impact on growth would be favorable. This proposal includes elements of the Fair Tax and Flat Tax proposals, for which growth impacts have been forecast. With respect to the Fair Tax:

- Kotlikoff and Jokisch (2005) estimated that by 2030, capital stock value would be 30% higher than under current law, interest rates would be 150 basis points lower, and marginal labor productivity would increase by 18.9% and real wages by 10.6%, resulting in overall economic welfare gains of 26.7% for low-income, 10.9% for middle-income, and 4.7% for high-income households.
- Arduin, Laffer & Moore (2005) estimated that investment would be 33% higher in the first year and 41% higher in the tenth year than under current law.
- Long-term increase in GDP has been estimated by Auerbach (1996) at 9.7%, by Boskin (1995) at 10%, by Jorgenson (1996) at 9-13%, by Kotlikoff (1993) at 7-14%, by Arduin, Laffer & Moore (2005) at 24.4%, and by Robbins and Robbins (1994) at 36.3%.
- The Joint Committee on Taxation (1997) summarized results from nine different economic models, all of which estimated that a flat consumption tax would increase investment and economic growth.

Fair Tax advocates conducted all those studies except the last, but all appear to have followed reasonable methodologies and utilized reasonable assumptions, and there have been no studies from a different perspective to refute those results. Because this approach incorporates some Fair Tax concepts, it seems reasonable and consistent with those findings to conclude that the 15-15-15 tax plan could be expected to add something in the range of ½% to 1% to annual growth, above what would otherwise be expected. This potential positive impact has not been considered in any of the projections herein.

Possible alternatives for consideration could include (impacts calculated by the author based upon data from IRS, 2012, Tax Statistics):

- Retain the individual income tax, with or without substantial reductions or eliminations of deductions or modification of taxable income calculations. The impact of this change would vary depending upon what definition of taxable income was used, what exemptions/deductions are retained, and whether the Prebate was adjusted to offset the income tax as well as other taxes. If essentially all current itemized deductions and exemptions were eliminated, and the individual income tax were applied to what is currently defined as Adjusted Gross Income (AGI), the required flat rate for all taxes in the package (payroll, consumption, business, and individual income) to be revenue neutral would drop from 15% to 12.3% (if the Prebate rate is kept at 30%) or 13.2% (if the Prebate rate is increased to offset all three taxes). If the individual income tax were applied to Taxable Income as currently defined, the respective rates would be approximately 13.3% with the Prebate rate at 30% and 14.7% with the Prebate rate increased. Retention of some, but not all, exemptions and deductions would produce a rate somewhere between those two extremes.
- Retain the individual income tax with a more progressive tax structure. If the top marginal rates for individuals were raised to the 27% level generally proposed by Bowles-Simpson and Rivlin-Domenici, and applied to all taxable income above \$200,000, this would generate an additional \$100-200 billion in annual revenues. That revenue could be used to reduce taxes in other areas.

CONCLUSION

This paper outlines one approach to balancing the US federal budget, eliminating the annual budget deficit, and ultimately reducing the outstanding federal debt. The intent is not to state that this is the only way, or even the best way, to get it done, but to show that there are ways that it can be done and to serve as a starting point for further discussion and consideration. It does appear that any solution to the problem must include:

- Increased tax revenues
- Reform of health and welfare programs to reduce cost
- Reductions to military spending
- Reductions to non-military discretionary spending

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Table 17 – Historic Data Used In Projections

Item (amounts in billions, unless otherwise noted)	Source	2005	2006	2007	2008	2009	% OF GDP	% Growth
Gross Domestic Product (GDP)	OMB	12,623	13,377	14,029	14,369	13,939		2.5%
Population (millions)	Census Bureau	293	296	299	301	304		0.9%
Number of family units (millions)	Census Bureau	78	78	79	80	81		0.9%
Salaries and wages	IRS	5,155	5,469	5,842	5,951	5,707	41.2%	2.6%
Corporation taxable income	IRS	1,598	1,473	1,379	1,079	1,382	10.7%	(3.6%)
S Corporation taxable income	IRS	421	457	484	432	449	3.3%	1.6%
Partnership taxable income	IRS	724	871	976	929	874	6.4%	4.9%
Schedule C taxable income	IRS	270	282	280	264	245	2.0%	(2.2%)
Rents, royalties, farming, and other taxable income	IRS	35	24	25	35	25	0.2%	(2.0%)
Dividend income	IRS	166	199	237	219	163	1.4%	(0.5%)
Interest income	IRS	162	223	268	223	168	1.5%	0.8%
Capital gains	IRS	663	771	896	467	231	4.4%	(23.2%)

Sources: IRS is IRS tax database; OMB is President's Budget for 2013

Table 18 – Budget With Proposed Changes 2013-2022

(Dollars in billions)	2013	2014	2015	2016	2017	5-year Total	2018-2022	10-year Total	Obama 10-Year Total
Individual Income Tax	0	0	0	0	0	0	0	0	18304
Consumption tax	1838	1930	2045	2167	2292	10272	13173	23455	0
Less Prebate	(839)	(870)	(902)	(935)	(963)	(4509)	(5365)	(9874)	0
Payroll tax	1345	1412	1496	1585	1677	7515	9647	17162	12667
Less Privatized portion	(336)	(353)	(374)	(396)	(419)	(1878)	(2410)	(4288)	0
Business income tax	577	603	642	680	720	3225	4141	7366	4444
Investment income taxes	181	190	202	214	226	1013	1301	2314	0
Excise, estate, and gift taxes	132	175	214	248	288	1057	1992	3049	1353
Other receipts	154	218	328	384	357	1441	2065	3506	3506
TOTAL RECEIPTS	3052	3308	3651	3947	41778	18136	24553	42689	40274
Defense	689	588	593	605	621	3096	3184	6280	7216
Non-defense discretionary	396	324	321	324	331	1696	1482	3178	5680
Social security	826	874	924	976	1033	4633	6100	10733	10702
Health care	1331	1396	1454	1543	1600	7324	9550	16874	11493
Other mandatory	196	179	179	188	187	929	1020	1949	6957
Net interest	246	343	369	471	560	1989	3593	5582	5889
Other, net	78	(14)	(58)	(78)	(95)	(167)	(812)	(979)	(979)
TOTAL OUTLAYS	3762	3690	3782	4029	4237	19500	24117	43617	46958
SURPLUS (DEFICIT)	(710)	(382)	(131)	(82)	(59)	(1364)	436	(928)	(6684)
OBAMA 2013 PROJECTIONS	(901)	(668)	(610)	(649)	(613)	(3441)	(3243)	(6684)	
Total debt	16710	14982	15256	15471	15650		15744		23750
Debt held by the public	12825	13350	13624	13839	14018		14112		19486
GDP	16335	17156	18178	19261	20369		25488		25488
Receipts as % GDP	18.7%	19.3%	20.1%	20.5%	20.5%		20.5%		19.3%
Outlays as % GDP	23.0%	21.5%	20.8%	20.9%	20.8%		20.9%		22.5%
Surplus (Deficit) as % GDP	(4.5%)	(1.9%)	(0.8%)	(0.5%)	(0.1%)		(0.4%)		(3.2%)
Debt as a % of GDP	102.3%	87.3%	83.9%	80.3%	76.8%		61.8%		113.9%
Debt held by public as % GDP	78.5%	77.8%	74.9%	71.8%	68.8%		55.4%		93.5%

NOTES