MEMORANDUM

TO: The 45th President and 115th Congress

FROM: Joe Antos, Andrew Biggs, Alex Brill, and Alan Viard[1]

DATE: January 1, 2017

SUBJECT: A Balanced Plan for Fiscal Stability and Economic Growth

Introduction

Our plan seeks to achieve long-term fiscal stability and promote economic growth by aligning federal spending and revenue and pursuing market-based policy reforms. The plan limits the national debt to approximately two-thirds of annual GDP in 2040.

The plan emphasizes cuts in the major entitlement programs—Social Security, Medicare, Medicaid, and health insurance subsidies—but still ensures those less fortunate are protected. The plan increases revenue above its recent historical average share of GDP while switching to a consumption tax that allows additional revenue to be raised without hampering economic growth.

Top Three Policy Recommendations

Make Health Care Programs More Efficient

Incentives, rather than controls, would be used to promote greater efficiency while allowing patients and their health care providers to make the best individual decisions within a responsible budget framework. All subsidies would be reformulated to provide greater support to those with greater financial need or higher health risks.

Medicare would be converted to a premium support plan, providing a subsidy to beneficiaries who would choose from among competing health plans. Those selecting more expensive plans (including traditional Medicare) would be responsible for any premium amount above the subsidy.

Federal matching payments for Medicaid would be replaced with block grants, enabling states to manage their Medicaid programs more efficiently and eliminating the incentive to draw more federal funds without

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necessarily providing more or better services. The tax exclusion for employer-provided health insurance would be replaced by a refundable health insurance tax credit providing a fixed dollar subsidy. Subsidies for lower-income individuals who buy insurance through the exchanges would be converted to a block grant to underwrite state-level subsidy programs for private insurance.

Better Target Social Security

The current Social Security benefit formula would be replaced with a flat dollar benefit for all retirees, disabled persons, and survivors, regardless of their earnings history or labor force attachment. The benefit would initially be set at the elderly poverty threshold, but would thereafter be indexed to wage growth. To supplement this flat benefit, workers would be automatically enrolled in employer-sponsored retirement plans with a default contribution of 3 percent of earnings, split evenly between the worker and employer.

The early retirement age would gradually increase from 62 to 65 and the 12.4 percent Social Security payroll tax would be eliminated for all workers age 62 and older. "Experience rating" would be instituted for the employer share of the disability insurance (DI) payroll tax, which would give employers the incentive to provide accommodations to workers with disabilities in order to keep them on the job.

Switch to a Growth-Friendly Consumption Tax

The individual and corporate income taxes and the estate and gift tax would be replaced by the Bradford X Tax, a progressive consumption tax. The X tax consists of a flat-rate, firm-level tax on business cash flow and a graduated-rate household-level tax on wages and fringe benefits.

For married couples, the first $80,000 of taxable earnings would be taxed at 15 percent, the next $160,000 of earnings would be taxed at 25 percent, and earnings above $240,000 would be taxed at 35 percent (bracket ranges would be half as large for unmarried taxpayers). Households would be allowed a nonrefundable credit of $1,000 for each adult and $500 for each dependent. There would be no standard deduction or personal exemptions. An earned income tax credit and credits for charitable contributions, health insurance, mortgage interest payments (on mortgages of up to $250,000), and deductions for child care costs and large employee business expenses would be permitted.

Business firms' cash flow would be taxed at a flat rate of 37 percent. Firms would immediately expense (rather than depreciate over a period of years) all investment, including equipment, structures, land, and inventories. Business tax preferences, except a reformed and permanent research tax credit, would be abolished.

Conclusion

The health care proposal caps federal subsidies for insurance, promotes effective competition and innovation in the health sector, reduces regulatory burden, and develops better consumer information. Subsidies in all federal health programs would be made more progressive, helping those who most need the help. Such policies will provide strong incentives for the private sector to develop new ways to deliver care that improve efficiency and lower the cost per unit of service. Spending reductions are substantial, requiring beneficiaries to shoulder more of the cost of their health care. However, health system improvements are expected to maintain quality of care and access to essential services.

The Social Security proposal protects low earners, is more conducive to saving and longer work lives, and better aligns the work and retirement conditions that will prevail in the coming decades. That will make Social Security solvent and sustainable while reducing program outlays to better accommodate rising costs for other priorities.

The tax proposal increases saving and promotes long-run economic growth by removing the marginal tax penalty on new saving and investment. Because no household-level tax is collected on interest, dividends, capital gains, or other income from savings, there is no household-level penalty on saving. And there is no net business-level tax on a marginal new investment because the tax savings that firms receive from immediately deducting investment costs fully offsets the present value of the taxes on the investment's subsequent cash flows.

Fiscally sound policy will require greater self-reliance, but does not require us to turn our backs on the elderly and the less fortunate. Our proposal narrows the fiscal imbalance, limits the size of government and adopts a more growth-friendly tax code. Although these policies will require difficult choices, they will ensure a vibrant economy and fiscal stability, now and in the future.