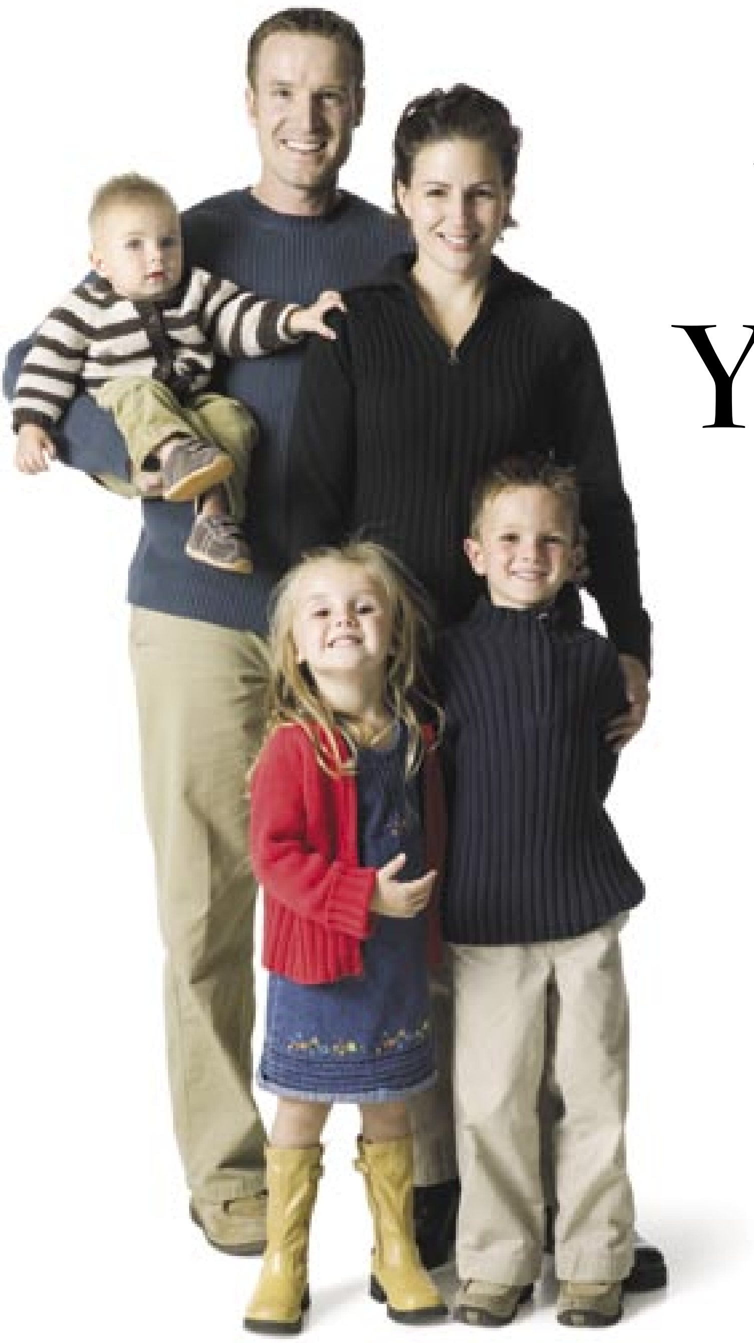
THE INSIDER

Fall 2004

Conservative Solutions For Advancing Liberty



A Future to Call Your Own

How Liberty Can Change the Face of Social Security, Taxes and Health Care

INSIDE:

Welcome to the new *Insider*. Since 1978, in various forms, this magazine has brought together knowledge and news from all parts of the conservative movement. But since that time, the movement has changed.

EDITOR'S NOTE

Bridgett Wagner and Mary Katharine Ham

For the past six months, we at The Heritage Foundation have been redesigning *The Insider*, making it into a tool that can move as fast as the movement. The first step was to create InsiderOnline.org, which collects studies from all over the world of conservative thinkers and stores them in a database that grows every day.

InsiderOnline.org presents the same research that used to appear in the *Insider's* pages, but it allows studies to be posted the day they're released. Now that InsiderOnline.org takes care of the nuts and bolts of policy research, the new *Insider* magazine is filled with features that bolster our conservative beliefs, showcase policy battles around the movement, and offer strategies for success.

In this first issue of the new *Insider*, we examine three ways to advance liberty: Social Security reform, tax reform and health care reform. The January 1978 *Insider Newsletter* featured an Arthur Laffer analysis of the Social Security system that didn't mention the word "reform," and the only tax reform on the table was President Carter's tax reform proposal. *The Insider* is proud to have been part of a movement that has made advancing freedom in health care, Social Security and the tax system a priority and a reality over the past 26 years.

The Heritage Foundation wants InsiderOnline.org and the new *Insider* to be tools that connect allies, bring minds and ideas together, and, most importantly, help win the battles that advance liberty. Please visit us at *insideronline.org* or e-mail *insider@heritage.org* with questions or comments. We look forward to working with all of you as we march toward more freedom.

Bridgett Wagner
Director of Coalition Relations
Mary Katharine Ham
Editor of The Insider *and InsiderOnline.org*

THE INSIDER

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The Insider is published quarterly by The Heritage Foundation's Coalition Relations Department. Begun in 1978, *The Insider* brings together knowledge and news from all parts of the conservative movement. The Coalition Relations Department serves as Heritage's liaison to a network of some 500 policy groups and over 2,000 leading scholars and activists worldwide.

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Conservative Solutions For Advancing Liberty

What We Believe

Who We Are

What We Do

Flat Tax or Sales Tax? A Win-Win Choice for Everyone

by Daniel J. Mitchell

THE CURRENT TAX CODE of the United States is irreversibly broken and should be repealed. The tax laws undermine the country's prosperity by imposing needlessly harsh penalties on work, savings, and investment. Although many taxpayers face confiscatory tax rates and often are forced to pay more than one layer of tax on their income, the politically well-connected can take advantage of special deductions, credits, preferences, shelters, and loopholes to minimize their own tax liability. The result of this double standard is a tax system that not only penalizes productive behavior, but also violates the fundamental constitutional principle of equal treatment under the law.

Replacing the current system with the flat tax or the national retail sales tax would restore the principle of fairness to the tax system because both would treat all taxpayers equally. Both the flat tax and a national sales tax would replace today's discriminatory tax structure with a single low rate. In addition, either plan would eliminate the current tax code's bias against savings and investment and promote the kind of capital formation that America needs to boost workers' incomes and raise long-term economic growth. In addition, because far fewer personnel and far less paperwork would be needed to collect "contributions" under either plan, the ultimate result would be a dramatic downsizing of the Internal Revenue Service (IRS) bureaucracy and billions of dollars in compliance costs saved each year.

Both rest on the fundamentally sound principle that all income should be taxed at one low rate and only one time, and that the tax should be collected in the least intrusive way possible. The only obvious difference between the two is the collection point of those taxes. A flat tax is collected up front, imposing a single layer of tax on income when it is earned, and a sales tax imposes one layer of tax when the income is spent.

HOW DOES THE FLAT TAX WORK?

For many Americans, the flat tax means simply that everyone would be taxed at "just one rate." The flat tax eliminates inequalities in the current tax code by treating all taxpayers—and income—equally. With the exception of exemptions based on family size, all income would be taxed, but only one time. For fairness and simplicity, there would be no deductions, credits, preferences, or loopholes. To achieve even further simplicity, taxes on most business and capital income (such as dividends and interest payments) would be withheld and paid at the business level.

Under the flat tax, the current Internal Revenue Code's 480 forms would be replaced by two simple postcard-size forms. Individual taxpayers would receive a generous allowance based on family size but would be responsible for paying a tax of 17 percent on any wage, salary, and pension income above that amount. The tax on all other income, including interest, dividends, rents, royalties, and business profits, would be withheld and paid at the business level (much as an employer withholds and pays individual income tax for workers).

Because the government would not be allowed to tax any income more than once, both the capital gains tax and the death tax would be eliminated. The flat tax also would get rid of all itemized deductions like the write-off for home mortgage interest, charitable contributions, and state and local income and property taxes. On the business side, the flat tax wipes out all features of the current code that undermine U.S. competitiveness, including the alternative minimum tax, rules on pensions and deferred compensation, depreciation (which would be replaced with first-year expensing), international tax provisions, and uniform capitalization rules. Instituting the flat tax would not affect payroll taxes for Social Security and Medicare.

HOW DOES THE NATIONAL SALES TAX WORK?

The national retail sales tax proposal would repeal the personal and corporate income tax code and replace it with a tax on all final sales of goods and services to consumers. Although such a tax resembles the state sales taxes most Americans pay already, a national retail sales tax is much broader in scope and would require a tax rate roughly equal to the rate imposed by the flat tax. All economic output, including such activity as services that traditionally escape state sales taxes, would be subject to the tax. Like the flat tax, a national retail sales tax would treat all economic activity equally, but taxpayers would receive a universal credit—a measure that would have the effect of protecting all taxpayers from having to pay tax on purchases up to the poverty level.

To protect lower-income citizens from taxation, a national sales tax would require the government to send all households periodic rebate checks, the net effect of which would be to offset the tax burden on purchases up to the poverty level. A family of four, for example, would receive a rebate from the government equal to the tax on purchases up to the poverty level. The rebate mechanism in the sales tax proposal would serve the same role as the family allowance in the flat tax.

FIVE PRINCIPLES OF REFORM

Either one of these reform plans would comply with these five principles for fundamental reform:

1 A single flat rate. Under both plans, income is taxed at one low rate. This would ensure that the government treated taxpayers equally and would address the problem of high marginal tax rates. The single low rate also would promote faster economic growth by minimizing tax penalties on work, risk-taking, and entrepreneurship.

2 **No bias against savings and investment.** Implementing either the flat tax or a national sales tax would eliminate the current tax code's bias against capital formation by ensuring that no income is taxed more than one time. Because double taxation of capital income is a pervasive problem in the current law, going to the flat tax or a national sales tax would stimulate higher incomes and faster growth by minimizing the tax penalties on savings and investment.

The single low rate also would promote faster economic growth by minimizing tax penalties on work, risk-taking, and entrepreneurship.

3 **Equality.** Adoption of the flat tax or a national sales tax also would end the discriminatory treatment caused by a tax code that grants preferences or imposes penalties on certain behaviors and activities. Either reform would change the code so that all taxpayers—and all income—are treated the same under the law.

4 **Simplicity.** With 480 forms and 8 billion pieces of paper, the current IRS system has become a nightmare of complexity. Even though the flat tax and a national sales tax have different collection points, both would lower the cost of compliance and generate huge savings. Under the flat tax, individuals and businesses would fill out one simple postcard-size form. With a national sales tax, wage earners would be spared the need to interact with the tax system, and businesses simply would submit to the government a monthly form remitting the taxes they collected.

5 **No double tax on U.S. companies in the global market.** Both the flat tax and sales tax are based on the common-sense proposition that governments should only tax income earned inside national borders. This is in stark contrast to the current system, which undermines U.S. competitiveness by double-taxing income earned in other nations.

RESPONDING TO THE CRITICS

Notwithstanding its many benefits, some people continue to oppose tax reform. Their assertions, however, are not supported by the evidence. For example:

Criticism: Both the flat tax and a national sales tax are unfair because the rich and the poor would pay the same rate.

Response: The only reasonable definition of fairness is that everyone should play by the same rules—the very principle that underlies both flat tax and sales tax reform plans. Under the flat tax, a person who has ten times the taxable income of another would pay ten times as much in taxes. Likewise, under a sales tax, the rich person who consumes ten times as much as a poor person would pay ten times as much in sales tax.

Criticism: Tax reform would give the rich an undeserved tax cut.

Response: The tax system should be designed to collect the money needed to run the government in the fairest and least destructive manner possible. For those who currently face confiscatory tax rates to receive a tax cut is eminently fair. It is worth noting that there is a big difference between tax rates and amount of taxes paid. In all likelihood, upper-income taxpayers would pay even more in taxes after tax reform because the incentives to shelter and underreport income would be reduced significantly.

Criticism: Implementing a national sales tax would create the risk that the United States might end up like Europe, with both income and consumption taxes.

Response: Advocates of a national sales tax properly vow that complete and irreversible elimination of the income tax must occur before the plan can be enacted. The only certain way to prevent future politicians from pulling a bait-and-switch on a trusting public, however, would be to amend the Constitution by repealing the 16th Amendment, which gives Congress the power to impose an income tax.

Criticism: The flat tax allows people living off dividends and interest to escape all taxes.

Response: Under the flat tax, businesses withhold and pay taxes on dividends and interest before sending the money to individuals. Thus, income from interest payments and dividends would be treated the same as the income in a worker's paycheck—as an after-tax payment.

The current U.S. tax system is an unmitigated failure. On both economic and moral grounds, the tax code should be repealed.

Criticism: Tax reform would do nothing to relieve the burden of payroll taxes.

Response: By and large, this criticism is true. Payroll taxes have climbed dramatically in the past two decades. For better or worse, income taxes and payroll taxes are different revenues funding different programs and, therefore, probably will be addressed separately.

Criticism: Tax reform would reduce government revenues.

Response: The current tax burden is much too high. Moreover, it is economically desirable and, by most estimates, politically necessary for tax reform to lower the overall burden of taxation on Americans. Even though faster growth, lower unemployment, and higher income probably would offset most or all of the foregone revenue as time passed, there could be some short-term decline in government revenue collections. If this decline became an obstacle to passage of a flat tax or national sales tax plan, lawmakers should use it as an opportunity to scale back as many federal programs as possible.

CONCLUSION

The current U.S. tax system is an unmitigated failure. On both economic and moral grounds, the tax code should be repealed and replaced with a system that treats all taxpayers—and all income—fairly and equally. Both the flat tax and a national sales tax satisfy this standard, and both would improve the economy's performance substantially.

Many advocates of tax reform prefer the flat tax because it would not require an amendment to the Constitution prohibiting income taxes. Such an amendment would require a two-thirds vote in Congress and approval by 75 percent of the state legislatures. Nonetheless, if support for a national sales tax and such an amendment grows, flat tax partisans would do well to join the effort.

Advocates of tax reform should seek instead to highlight the benefits and similarities of the two plans and, when the opportunity arises, rally behind the one that has garnered more political and popular support. Both the flat tax and the sales tax would simplify the current tax code, boost income, stimulate the economy, and end the bias against savings and investment. ■

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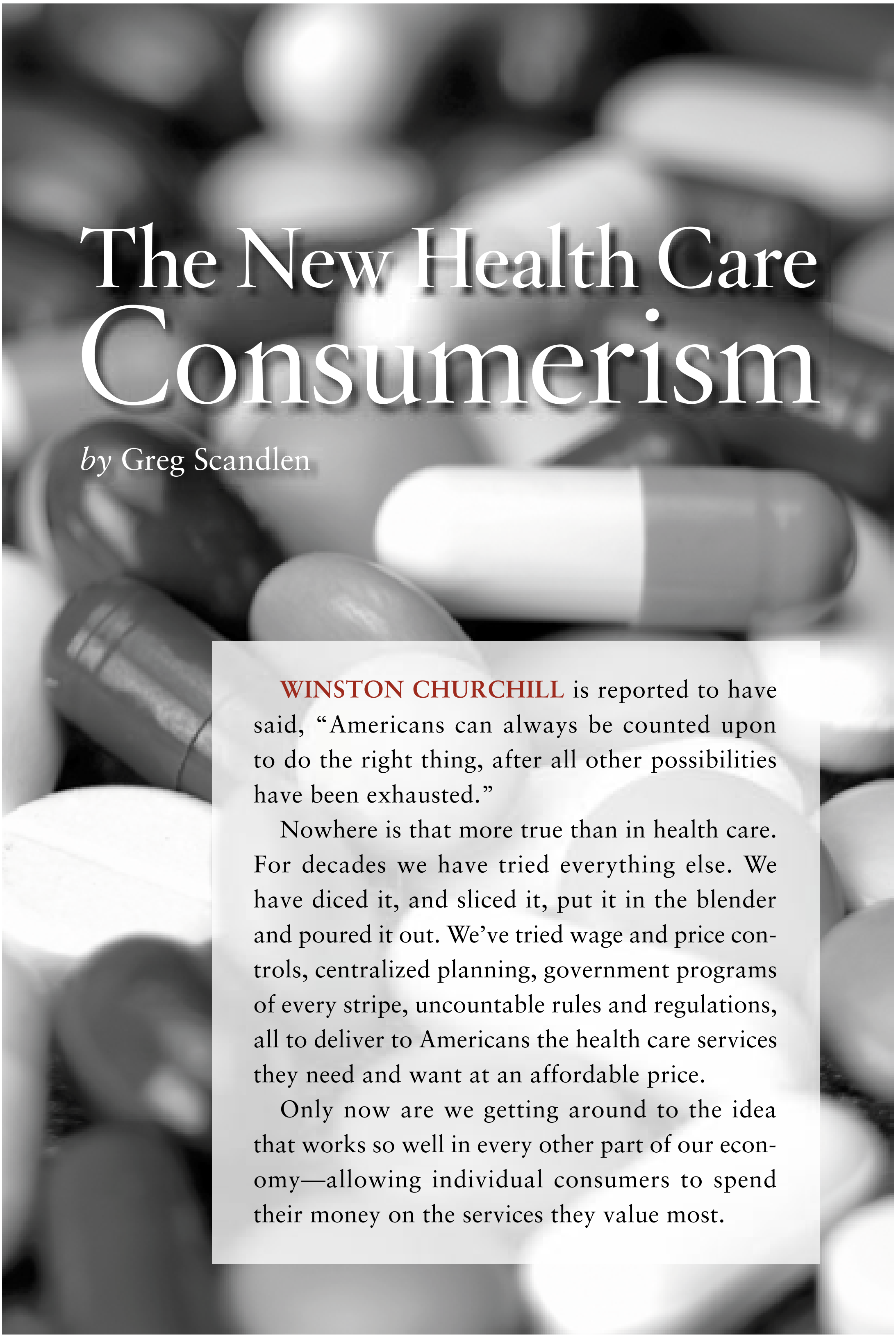

The New Health Care Consumerism

by Greg Scandlen

WINSTON CHURCHILL is reported to have said, “Americans can always be counted upon to do the right thing, after all other possibilities have been exhausted.”

Nowhere is that more true than in health care. For decades we have tried everything else. We have diced it, and sliced it, put it in the blender and poured it out. We’ve tried wage and price controls, centralized planning, government programs of every stripe, uncountable rules and regulations, all to deliver to Americans the health care services they need and want at an affordable price.

Only now are we getting around to the idea that works so well in every other part of our economy—allowing individual consumers to spend their money on the services they value most.

The most recent detour was the embrace of managed care as the Great Solution to our health care problems. Managed care was based on the premise that we had to get away from "fee-for-service" medicine, and move to a capitated system. That is, if we pay doctors and hospitals a fee every time they provide a service, they will keep providing services until we are bankrupt. Managed care proposed paying providers for the number of patients they saw, not by the number of services they provided. It was argued that this would remove the incentive to over-provide services. Physicians would be responsible for a certain number of patients and give whatever care those patients needed. The managed care company would make sure the physicians were doing the right thing.

The essential issue in health care financing is the growing disconnect between payers and consumers.

This idea was eagerly embraced by employers and government programs as the answer to all our problems. Unfortunately, doctors and patients weren't so crazy about it. Doctors didn't like having bureaucrats second-guessing their medical decisions, and patients didn't like being denied services and access to specialists. The approach has been reviled in the press and, as it turns out, it didn't actually save much money.

This shouldn't be surprising. Managed care was based on a faulty premise. The essential problem in health care has never been fee-for-service payment. The problem is third-party payment.

THE VIRTUES OF FEE-FOR-SERVICE

Most of what we buy in our lives is done on a fee-for-service basis—haircuts, plumbers' services, baby-sitting—and none of it is excessively inflationary. The provider of the service may want to induce us to buy more than we really want or need, but because we are reluctant to part with our money, we resist their inducements.

There is a healthy tension that results in an equilibrium of interests. The barber wants our money, and we want a haircut. We would like to talk the barber into cutting our hair for free, but that isn't going to happen. And the barber would like to talk us into getting a haircut every day, but that won't happen, either. Somehow we manage to come to an agreement that increases the well-being of both of us. The barber gets the money he would like to have and we get the haircut we would like to have, and we both walk away happy. The barber thanks us for the money, and we thank him for the haircut. Both are winners.

Health care used to be like that, too. The doctor would perform a service for a sum of money. The patient would receive the service and pay out the money. Both parties gained. Both parties were happy. Costs were rational and services were plentiful. Then came third-party payment, and everything changed.

As with any service, once someone else is paying the bill, the reasons to be cautious with spending are removed. People traveling on expense accounts stay in better hotels than people who spend their own money. College freshmen with new credit cards from their parents are notorious for spending money. And people with health insurance say, "I don't care what it costs, Doc. I'm covered!"

Some people will argue that health care is "inelastic." That is, health care services are so important that cost doesn't matter. Someone who has been hit by a truck isn't going to quibble over the cost of treatment. That may be true, but relatively few health care services are of the immediate life-and-death variety. Most are planned well in advance while the patient is entirely capable of making cost/benefit calculations.

The empirical evidence of consumer discretion in health care is plentiful, starting with the famous Rand Health Insurance Experiment that was completed in the early 1980s. This study tested a variety of cost-sharing options over an eight-year period, from one that paid 100 percent of the cost of services to one that paid only five percent with a stop-loss limit.

Project director and Harvard University professor Joseph Newhouse concluded, "Use of medical services responds unequivocally to changes in the amount paid out-of-pocket.... Per capita expenses on the free plan are 45 percent higher than those on the plan with a 95 percent coinsurance rate...." He adds, "The more families had to pay out of pocket, the fewer medical services they used." Importantly, the lower use of services did not have a negative effect on health outcomes.

As a result of this growing reliance on third-party payment, we overspend on health care services compared to other parts of our economy.

WHEN THIRD PARTIES SET LIMITS

Both logic and experience tell us that third-party payment will lead to excessive demand for health care services. But what happens then? Third-party payers are not going to just blindly pay for everything consumers feel like getting. They will not write a blank check to be filled out by the physician and the patient. They will try to limit the use and cost of services.

That is exactly what payers—employers, insurers and the government—have been trying to do for at least 30 years now. The list of laws and programs aimed at constraining health care costs is a very long one, starting with President Nixon's wage and price controls, to comprehensive health planning, hospital rate-setting commissions, benefit redesign, second surgical opinions, utilization review, preadmission certification, quality assurance, and a whole alphabet soup of federal activities—PSRO, DRG, RBRVS, COBRA, ERISA, HIPAA, DEFRA, TEFRA. Most recently, we have enjoyed a ten-year infatuation with managed care. Some of these activities fail miserably. Others seem to work for a while, but only for a couple of years until health care inflation is right back where it was before.

The problem is that none of it deals with the essential issue in health care financing—the growing disconnect between payers and consumers. In 1960, more than 55 percent of total health care spending was paid directly by consumers. That number dropped to 27.8 percent in 1980, and continues to drop, reaching 19.6 percent in 1998, and 15 percent in 2000. Over five out of six health care dollars are now paid for by a third party, and the expenses that consumers pay directly tend to be the least essential ones like vision and dental, over-the-counter medications, and in-home nursing care.

As a result of this growing reliance on third-party payment, we overspend on health care services compared to other parts of our economy. From 1961 through 2000, the growth in National Health Expenditures has been far higher than the increase in Gross Domestic Product in all but five years. In many years the increase in health spending is two or three times the overall Consumer Price Index.

Consumers are exempt from feeling the costs of care. Not only do they over-consume, but they have no idea that there is a problem and do not support payers' efforts to constrain costs. Public opinion surveys have been taken nearly every year since 1973, asking whether the United States spends too much, too little, or just the right amount on health care services. With remarkable consistency over a 30-year period, about two-thirds of the population say the United States doesn't spend enough on health care. At no time in 30 years has more than ten percent said we spend too much!

Since the public thinks we don't spend enough on health care, it is not surprising that they don't support cost containment efforts. Not only do they fail to support these efforts, but they get angry when someone tries to deprive them of the services they think they need. Since they don't feel cost containment is justified, any effort to limit the supply of services is taken as a personal affront—mean-spirited insurance companies or employers depriving people of needed services just to enhance their profits.

The big question facing us in the next ten years is what gets paid for and what doesn't. The even bigger question is who decides?

FIVE COUNTRIES, ONE PROBLEM

As a result, a large majority of Americans believe the health care system is broken and needs to be rebuilt. But importantly, so do large majorities of Canadians, Britons, Australians, and New Zealanders. They all think their own health care system is broken and needs to be rebuilt. Yet these five countries each have different financing systems.

How can so many people in such different systems all believe there is something fundamentally wrong with their own way of financing health care? Because despite superficial differences in whether the government, employers or insurers pay the bills, in every case a third party is paying for the vast majority of care. In every case a promise is made that citizens may have all the care they want for free or nearly so. And in every case, it isn't true.

Each country has its own method for preventing consumers from getting the care they want. It may be limiting the supply of doctors, using waiting lists for services, rationing by price, using "medical necessity" standards, or outright denial of care. In every case, third-party payment is accompanied by third-party rationing. Consumers know that care is being withheld, and they don't like it.

The problem will get worse before it gets better. Every year there are new drugs and new techniques introduced to the health care marketplace. Human genomics is only one example. Others include nanotechnology, molecular level treatments, and some 400 new drugs currently in the research pipeline. We are also rediscovering ancient remedies such as acupuncture and herbal medicines. The universe of what can be considered health care is rapidly expanding. No third party can possibly pay for it all—or even 85 percent of it.

CHANGING THE SYSTEM

The big question facing us in the next ten years is what gets paid for and what doesn't. The even bigger question is who decides? Will it be employers, insurers, the government, independent assessment agencies? Or will it be consumers?

Many people in health care are arguing against consumers. The whole movement around "evidence-based medicine" is an attempt to bureaucratize this decision-making process. Stripped bare of all the niceties, the evidence-based medicine movement maintains that neither patients nor clinicians should be making decisions about appropriate care. Panels of researchers and bureaucrats should endorse certain types of treatment and disallow others—regardless of the preferences and values of the person being treated. This is the ultimate destination of third-party payment. Patients are just grist in the mill, and physicians are mere functionaries. The only values that count are the values of the payer.

Americans are as capable of expressing their preferences and choices in health care as they are everywhere else.

Note that we are not talking here about eliminating insurance, but of reducing third-party payment, which is a very different thing. Third-party payment means that a patient pays a premium to a carrier, and the carrier pays the doctor or hospital for services delivered to the patient. Insurance is a two-party contract between a consumer and an insurance company. The consumer pays a premium, and the insurer pays the consumer when a "loss" occurs. It is not up to the insurer to decide who is a good doctor or what is an appropriate course of treatment. That is between the patient and the doctor. These two-party contracts enable the patient/consumer to know what things cost and to behave accordingly. The consumer may then control how the money gets spent, rewarding those who provide good services, and punishing poorer services.

All societies express their values by rewarding money to some and withholding money from others. The party that controls the money is the party that gets to decide who should be rewarded. The principle applies to socialist regimes as well as to capitalist ones.

But in capitalist societies, we trust consumers to make the most of those decisions based on their own needs, values, and priorities. The consumer is the payer, the consumer controls the money, and the consumer decides who is rewarded and who is not. We do not ask our employers to make those decisions for us.

Many employers are coming to the conclusion that there is no reason the same system cannot apply to health care as well as it does to every other area of our lives. Americans are as capable of expressing their preferences and choices in health care as they are everywhere else. But they need to understand that resources are limited and trade-offs are required.

Admittedly, this is a leap from where we have been. It is a change from the direction we have taken for half a century. The change will not happen overnight. It will be gradual and incremental. But the beginnings are already in place.

The first significant development was the enactment of Medical Savings Account (MSA) laws, first by 17 states in the early 1990s, and then by Congress in 1996. The essential idea behind MSAs is that people could save premium dollars by raising their deductibles and put those savings into tax-advantaged accounts to pay directly for routine services. The important consequence of the MSA law is that it forced a rethinking of the role of the consumer in health care spending. Until then, it was nearly unthinkable that health care consumers could be trusted to control some portion of their health resources.

Those attitudes did not last long once they were exposed to the light of day. Economists, insurance company executives, human resource managers, benefits consultants, and public policy makers all had to reconsider their views of health care consumers. Paternalism was dealt a fatal blow.

Now, employers, insurers, and benefits consulting firms are all looking for ways to replicate MSA-type programs in the rest of the market. They have come up with "personal health accounts" which allocate a sum of money to each employee. Medical services are paid out of the account, and unspent balances are carried into the next year. The accounts are tax-favored because they are never distributed to the employee. They are funded solely by the employer, available only for health care expenses, and may never be "cashed-out." Because there is no "constructive receipt" of the funds, there is no taxable event, and the money remains on the employer's books until it is spent on health care services.

When everything else is said and done, the only person who is truly responsible for your health care needs is you.

In June 2002, the Internal Revenue Service approved this approach to health care financing and created a new name for it—Health Reimbursement Arrangements (HRAs). HRAs avoid most of the restrictions of MSAs. The only limitations are that the funds may be contributed solely by the employer and may be spent only on health care services.

Consumerism is also showing up in all sorts of otherwise conventional benefits programs. Employers and insurers are using the Internet to enable employees to make enrollment decisions, develop personal health profiles, shop for physicians by price and style of practice, gather information about treatment alternatives, create support groups for patients with similar conditions, and, in some cases, actually make appointments online.

CONCLUSION

Finally, even without all these programmatic changes, employees are being asked to bear more responsibility as employers raise deductibles, coinsurance, and co-payments to offset some of the rate increases they have experienced in recent years.

Perhaps more than anything else, it is health care inflation that is causing a switch to a consumer-based system. Payers will simply not pay without end, and ultimately, when everything else is said and done, the only person who is truly responsible for your health care needs is you.

And that is the bottom line. No one else cares as much about our own health as we do. Other parties may help pay for it, other people may offer suggestions and advice. But no one else will suffer our pain for us. No one else will die for us. There is no experience more intimate and personal for each of us than our own life, our own health, and our own death. And there is no one else who can take responsibility for that process. There is no part of our lives that requires consumer empowerment more than health care. ■

__Greg Scandlen__ is the director of the Center for Consumer Driven Health Care at the Galen Institute, a free-market think tank based in Alexandria, Va. This article is reprinted with the permission of the Center for Consumer Driven Health Care.

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Misleading the Public

by David C. John

AS POLITICAL LEADERS debate how best to fix Social Security, many policymakers are focusing on the wrong issue. Their sole concern seems to be the date when the Social Security retirement and survivors trust fund will run out of its paper assets. This mistaken emphasis misses the fundamental point about Social Security's problems: There is no cash in the Social Security trust fund, and there never has been any.

The Social Security trust fund is merely an accounting device filled with IOUs that future taxpayers must repay. Far too soon, payroll taxes will be insufficient to pay all of the promised benefits. Unless Congress promptly takes action, taxpayers will have to pump hundreds of billions of additional tax dollars into Social Security to pay the promised benefits.

HOW THE FUND OPERATES

Workers pay their Social Security taxes through their employers. Each employer periodically sends a lump sum payment to the U.S. Treasury that includes all of the income taxes and Social Security and Medicare payroll taxes paid by both the employer and its employees.

The Treasury both receives the payroll taxes (and income taxes that higher-income retirees pay on their Social Security benefits) and pays monthly benefits on behalf of the Social Security Administration (SSA). The money stays in the Treasury's hands until it is either paid out as Social Security benefits or otherwise spent by the government. In fact, no money ever goes into the trust fund. Instead, the trust fund balance is the result of two accounting entries by the Treasury.

First, the Treasury estimates how much of the aggregate tax receipts are Social Security taxes and "credits" the Social Security trust fund with that amount. Then the Treasury "subtracts" the total amount paid in monthly Social Security benefits from the trust fund balance. No money actually changes hands; these are strictly accounting entries.

Any "money" remaining in the trust fund is converted into special-issue Treasury bonds, which are really nothing more than IOUs. In addition, the Treasury pays interest on the trust fund's balance by crediting the trust fund with additional IOUs. These are also strictly accounting entries, and again no money changes hands. After crediting the trust fund with the proper amount in IOUs, the government spends the extra Social Security tax collections just like any other tax revenue—to finance anything from aircraft carriers to education research.

At the end of 2002, the Social Security trust fund had a balance of $1.22 trillion. During 2003, the Treasury received $544 billion in Social Security taxes and paid out $406 billion in Social Security benefits. Therefore, the trust fund received $138 billion in these special-issue Treasury bonds, resulting in a trust fund balance of $1.36 trillion at the end of 2003.

HOW THE FUND DIFFERS FROM PRIVATE-SECTOR TRUST FUNDS

Private-sector trust funds invest in real assets ranging from stocks and bonds to mortgages and other financial instruments. However, the Social Security trust funds are only "invested" in a special type of Treasury bond that can only be issued to and redeemed by the Social Security Administration. As the Congressional Research Service noted in a report on May 5, 1998:

When the government issues a bond to one of its own accounts, it hasn't purchased anything or established a claim against another entity or person. It is simply creating a form of IOU from one of its accounts to another.

According to the Office of Management and Budget under the Clinton Administration in 1999:

These [trust fund] balances are available to finance future benefit payments and other trust fund expenditures—but only in a bookkeeping sense. These funds are not set up to be pension funds, like the funds of private pension plans. They do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury, that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures.

In short, the Social Security trust fund is really only an accounting mechanism. The trust fund shows how much the government has borrowed from Social Security, but it does not provide any way to finance future benefits. The money to repay the IOUs will have to come from taxes that are being used today to pay for other government programs. For that reason, the most important date for Social Security is 2018, when taxpayers must begin to repay the IOUs, not 2042, when the trust fund is exhausted.

CONCLUSION

Social Security's financial crisis will begin far sooner than many politicians claim. In less than three years, the first wave of baby boomers will reach retirement age. Once that happens, Social Security (and Medicare) will be on a slippery slope toward insolvency. While Social Security can continue to use its tax receipts to pay full retirement benefits until 2018, Congress cannot wait that long to act. Misleading the public into believing that Social Security is secure until 2042 or beyond will only make the impending crisis more difficult to avoid.

Furthermore, huge impending deficits are only one of the problems facing Social Security. The sad reality is that millions of workers receive a dismal rate of return on their Social Security retirement taxes. Making matters worse, the current program does not enable workers to build up investments and cash savings to supplement their monthly Social Security checks.

The debate about Social Security's future should be about how to improve each American's personal retirement security and how to enable each American to build a nest egg for the future. Otherwise, Americans will lose a real opportunity to improve the lives of future retirees. The best way to fix Social Security is to provide younger workers with the opportunity to invest part of their Social Security taxes in personal retirement accounts. ■

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THE SEVEN PRINCIPLES OF SOCIAL SECURITY REFORM

by David C. John

Social Security should not be reformed or "saved" for its own sake but only if the revised system more effectively provides the benefits workers need at a price they can afford. However, just calling legislation a reform does not necessarily mean that it actually is one.

The seven principles described here outline how real Social Security reform would both resolve Social Security's problems and provide workers with greater retirement security. Legislation to establish Social Security personal retirement accounts that meets these seven "tests" would provide Americans with a more secure standard of living in retirement.

1 **The benefits of current retirees and those close to retirement must not be reduced.** The government has a moral contract with those who currently receive Social Security retirement benefits, as well as with those who are so close to retirement that they have no other options for building a retirement nest egg. If the benefits of younger workers cannot be maintained given the need to curb the burgeoning cost of the program, then they should have the opportunity to make up the difference by investing a portion of their Social Security taxes in a personal retirement account.

2 **The rate of return on a worker's Social Security taxes must be improved.** Today's workers receive poor returns on their Social Security payroll taxes. As a general rule, the younger a worker is or the lower his or her income, the lower his or her rate of return will be. Reform must provide a better retirement income to future retirees without increasing Social Security taxes. The best way to do this is to allow workers to divert a portion of their existing Social Security taxes into a personal retirement account that can earn significantly more than Social Security can pay.

3 **Americans must be able to use Social Security to build nest eggs for the future.** A well-designed retirement system includes three elements: regular monthly retirement income, dependent's insurance, and the ability to save for retirement. Today's Social Security system provides a stable level of retirement income and does provide benefits for dependents. But it does not allow workers to accumulate cash savings to fulfill their own retirement goals or to pass on to their heirs. Workers should be able to use Social Security to build cash nest eggs that can be used to increase their

retirement incomes or build better economic futures for their families. The best way to do this is to establish, within the framework of Social Security, a system of personal retirement accounts.

4 Personal retirement accounts must guarantee an adequate minimum income. Seniors must be able to count on a reasonable and predictable minimum level of monthly income, regardless of what happens in the investment markets.

Reform must provide a better retirement income to future retirees without increasing Social Security taxes.

5 Workers should be allowed to fund their Social Security personal retirement accounts by allocating some of their existing payroll tax dollars to them. Workers should not be required to pay twice for their benefits—once through existing payroll taxes and again through additional income taxes or contributions used to fund a personal retirement account. Moreover, many working Americans can save little after paying existing payroll taxes and so cannot be expected to make additional contributions to a personal account. Thus Congress should allow Americans to divert a portion of the taxes that they currently pay for Social Security retirement benefits into personal retirement accounts.

6 For currently employed workers, participation in the new accounts must be voluntary. No one should be forced into a system of personal retirement accounts. Instead, currently employed workers must be allowed to choose between today's Social Security and one that offers personal retirement accounts.

7 Any Social Security reform plan must be realistic, cost-effective and reduce the unfunded liabilities of the current system. True Social Security reform will provide an improved total retirement benefit. But it should also reduce Social Security's huge unfunded liabilities by a greater level than the "transition" cost needed to finance benefits for retirees during the reform. Like paying points to obtain a better mortgage, Social Security reform should lead to a net reduction in liabilities. ■

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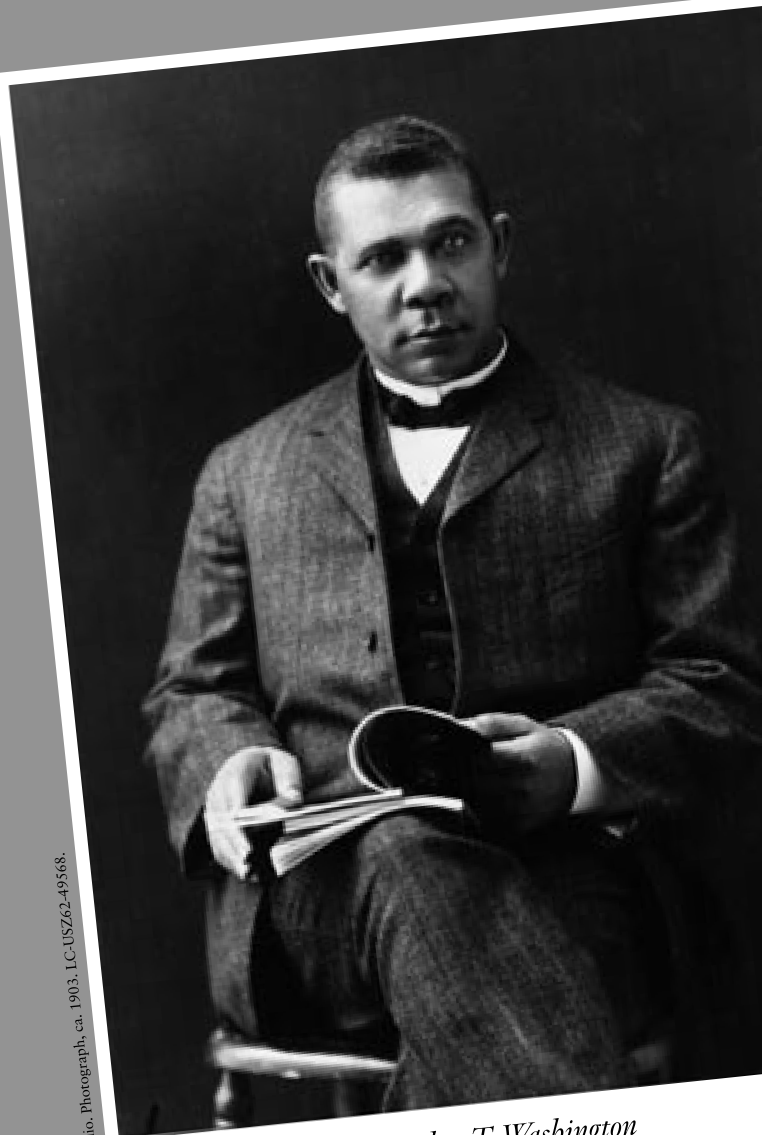
FOR MORE INFORMATION:

www.heritage.org/research/socialsecurity/issues2004.cfm
www.socialsecuritychoice.org
www.socialsecurity.org



Cheynes Studio. Photograph, ca. 1903. LC-USZ62-49568.

Booker T. Washington

What is Black Conservatism?

by Lee H. Walker

This speech was part of a panel discussion at The Heritage Foundation's 2004 Resource Bank Meeting in Chicago.

GOOD MORNING. I am Lee Walker, president of The New Coalition for Economic and Social Change, a nonprofit education and research organization based in downtown Chicago. It is a privilege to be here today, and I thank The Heritage Foundation for allowing me to pull together this panel for the annual Resource Bank Meeting. This panel was a creation of The New Coalition for Economic and Social Change, so please allow me a few minutes to explain what The New Coalition is.

The New Coalition was founded in 1980 following a major conference in San Francisco at the Fairmont Hotel. That meeting was the first time since Booker T. Washington died in 1915 that a predominantly black group gathered to discuss conservative public policies. Of the speakers before us that day, one is in this room—Ed Meese III. Along with Ed were Milton Friedman, Thomas Sowell, Clarence Thomas, and Walter Williams.

I became president of The New Coalition and "keeper of the flame" in 1993 after taking an early retirement from the headquarters office of Sears, Roebuck and Company. I have been working full-time on The New Coalition for the past 11 years—without a salary, I might add. If I do not earn something in 2004 (if it is only a dollar a week) I am going to sue myself for reparations! The New Coalition's mission is to cultivate effective multi-ethnic spokespersons, with conservative and libertarian views, and to help them gain access to forums where major public policies are being debated. We at The New Coalition are committed to creating a genuine dialogue between blacks and other ethnic groups on the one hand, and the largely white conservative and libertarian movement on the other.

WHAT IS BLACK CONSERVATISM? Black conservatism is not a new mindset within black America. The first institution of conservative thinking was the black church. It has been written about and discussed by a number of writers and thinkers during the past 24 years but never really defined. For much of the past 50 years it has often been dismissed as an oxymoron or something less than a respectable point of view. In 1908, Kelly Miller, the first black scholar to graduate from Johns Hopkins, who later became Dean of Howard University, wrote an essay titled "Radicals and Conservatives."

Miller described the followers of Booker T. Washington as conservatives. I believe the word "conservative" is best used as an adjective and not a noun. Thus conservatism is best understood as a state of mind and a type of character, a way of looking at the social order. It's a set of traditional principles and a philosophy. Conservative Americans want to reserve the best of the past and make improvements; conservatism is not about radical change unless the times demand it. I had an opportunity to discuss black conservatism with Dr. Russell Kirk at a meeting like this one on April 15, 1983. Why do I remember the date? He autographed and dated my copy of "The Conservative Mind." We talked about Booker T. Washington, the most powerful black American of his time, and perhaps of all time, and surely the most influential conservative thinker of the 19th and 20th centuries.

BLACK VERSUS WHITE CONSERVATISM

A conservative black's overriding interest is in preserving and extending liberty and freedom as expressed in the Declaration of Independence. Being familiar with the long history in which freedom was denied to our ancestors, parents, and even to us in our own lives, we are especially sensitive to threats to it today. You might say history has made blacks experts on reclaiming freedoms. We do not need to read white economists or political philosophers to teach us about what it is like to be deprived of basic freedoms.

Our first concern when addressing public policy will always be, "are we maximizing liberty and freedom?" We never want to debase the dignity of any human being.

Conservatism is also about conserving the best of the past. Conservative blacks are committed to this as well. The oldest and still most important conservative institution in black America is the church. That is where much of our leadership came from, and many of the first schools open to blacks, and many fine schools serving black students across the country today. In many black communities, churches serve as engines of economic development, too. Discussing the similarities and differences between white and black conservatism is similar to discussing how black and white Christians differ. They may belong to the same denomination and even the same church, but when they attend church on Sunday mornings, the service and the experiences may be very different.

WHY "BLACK CONSERVATIVES" ARE RARE

Over the past two decades, conservative and libertarian ideas have gained an important foothold in the black community. Surveys show a majority of blacks consider themselves conservative, not liberal, on many issues. On some social issues and school reform, blacks are "to the right" of whites. Yet self-proclaimed "black conservatives" are rarely seen or heard in public debates. The reason is obvious: Conservatism in the black community is widely associated with white racism. Black and white liberals work to create that perception in countless speeches, columns, and television ads during political campaigns. Some white conservatives do the same. The perception, if left unchallenged, eventually is accepted as reality. Unfortunately, conservatives have done little to challenge that perception.

Then there's the double standard. A white liberal can say, "I am for affirmative action," to a predominantly black audience, and he's met with a standing ovation. If a black public figure such as Colin Powell is for affirmative action, he is met with skepticism and criticism from the liberal black leadership for not taking a firmer stand. The uses of the terms "affirmative action" and "conservative" in public debate actually have a lot in common, and help explain why the words so fiercely divide both black and white communities.

Affirmative action has been perceived by whites as being good for blacks and bad for whites. Conservatism has been perceived by blacks as being good for whites and bad for blacks. The logic is almost entirely the same on both sides—the only people we see on television or in newspaper who benefit from affirmative action are blacks, and the only beneficiaries of conservative policies we see are whites, and often wealthy and privileged whites at that. Yet whites have enjoyed and benefited from affirmative action—and by this I mean favorable treatment not based on merit—more than any other group in America.

But how often do we see these white beneficiaries of affirmative action in the news?

Similarly, blacks benefit the most from conservative policies. Tax cuts make a bigger difference to low-income families, entrepreneurs, and small investors than to the rich and secure. Deregulation lets small companies and people with new ideas compete with big corporations which often hide behind the high cost of complying with complex regulations. Social Security privatization would be a boon for blacks, who often die before they become eligible for Social Security benefits. But how often do we see the black beneficiaries of conservative policies in the news?

THE PROGRESS BEING MADE

Having said that, let me hasten to add that we are making real progress in communicating to whites that not all blacks seek government assistance at the expense of their freedom, and to blacks that not all conservatives are racists. A young man from a Chicago suburb called Thomas Sowell last month, and wanted to know how he could learn more about conservatism. Tom told him to read "The Federalist Papers."

Later I received a call from a Heritage Foundation employee saying, "Lee, my husband wants you to talk to this young man." I did, and that young man is attending this conference today. I received an e-mail just last week from a young lady who is a banker. She says, "I am 32 years old, married, with two children. I spent a long time in the Gulf War." She then recited all of the conservative principles we share. She said, "But I am not a Republican."

And I said, "Welcome to the fold. We'll move the movement ahead if this is not about party."

Adam Meyerson from The Heritage Foundation wrote some 20 years ago, "A substantial minority of African Americans are going to begin identifying with political conservatism rather than political liberalism." And when that happened, he said, many would be Democrats. A recent study from the Joint Center for Political Studies in Washington, DC, shows Meyerson was correct. It indicates that younger blacks are much more concerned about their economic future than older blacks, and are more likely to be an independent than wedded to the Democratic Party. The earthquake has started. I am hearing and feeling the tremors all the time. ■

Lee Walker *is founder and President of The New Coalition for Economic and Social Change. This speech was part of a panel at The Heritage Foundation's 2004 Resource Bank Meeting in Chicago. It is reprinted with permission from Walker, who has turned the panel discussion into a collection of essays called, "The Conscience of Conservative Blacks."*

FOR MORE INFORMATION:

www.newcoalition.org
www.nationalcenter.org/P21Index.html
www.conservativebrotherhood.org

A Think Tank's Bottom Line

by Bridgett Wagner

What is the bottom line when there is no "bottom line," Peter Drucker asks in his book, *Managing the Non-Profit Organization: Principles and Practices*. Profit and loss may not be enough by themselves to judge the performance of a business enterprise, but they are certainly the most visible measure. Nonprofits must go beyond the balance sheet.

Each of these goals requires a shift in opinion or understanding of an issue, and that requires a rigorous education or marketing effort. To put together your marketing plan you must decide: Who are the decision-makers and what will it take to move them? What resources are required—people, products, money? And what is the timeline?

For think tanks, performance is spoken of in terms of "impact on public policy."

For think tanks, performance is spoken of in terms of "impact on public policy."

But how do you measure impact? How do you identify concrete measurable results when your vision is to build a freer and more prosperous society? Or, in the case of The Heritage Foundation, your vision is "to build an America where freedom, opportunity, prosperity, and civil society flourish?" You can start by defining "freer" and "more prosperous"—lower taxes, fewer regulations, smaller government, etc. But these are long-term goals, and progress can be slow. These long-term goals can be broken down further into more immediate goals that relate to specific pieces of legislation, regulations, ballot measures, administration initiatives or court decisions. In the case of taxes it might include eliminating the marriage penalty and death tax. And a more tactical goal might be the implementation of dynamic scoring by the tax committees in Congress and by the U.S. Treasury and Office of Management and Budget.

Because think tanks operate in an environment of scarce resources, we must always focus our efforts and target our resources. For each goal, specific constituencies or target audiences should be identified who are instrumental to your success. These might include:

- Members of your state legislature or Congress
- Governor or President
- Appointed officials
- Local media—print, radio, TV, Internet
- Business and community leaders and their associations
- Other policy experts
- Anyone who influences a targeted constituency

And, perhaps most importantly, don't forget your donors. Detailed marketing strategies should be developed for each, and resources allocated to achieve results.

Shifts in opinion and behavior occur over longer periods of time, but think tanks need to demonstrate impact on a regular basis to build credibility among the policymaking community and media, to motivate and enlist decision makers, and to renew donor support. Incremental steps are important to identify in advance so that it's possible to measure performance against the plan and demonstrate impact.

You can measure these incremental steps by tracking the number of:

- Times you've been asked to testify before legislative committees
- Visits to your Web site or downloads of documents citing your position
- Media calls and appearances
- Briefings conducted for policymakers
- Editorials endorsing your position—with or without attribution
- Other organizations taking up your position
- Politicians adopting your position

A shift in polling numbers on an issue and growth in donors or contributions are also concrete measures. And you can even calculate the dollar advertising equivalency of your media hits—based on the cost per column-inch of advertising for the newspaper articles about your organization or its projects and cost per minute of advertising for radio/TV interviews. The idea is that you build these measures into your marketing plan and report on them regularly.

As opinion shifts and the debate moves forward, the plan must be revised and updated because your target audience may have changed as well. And, be prepared to revisit old strategies on issues you thought were settled. As Heritage President Ed Feulner often says, "In policymaking, there are no permanent victories—or permanent defeats!"

Every small step forward has to be defended even as we work to advance policy change further. Laws can be changed and reversed tomorrow. That's why the real impact of think tanks has to be measured over the long term. Sure, we need to measure whether we've changed laws and policies, but even more important is whether we've changed minds. Is our network growing? Do policymakers and opinion leaders come to us for advice and guidance? Even better, are our alumni now serving in the government or editing the opinion journals and newspapers of influence? Have we dominated the debate to the point that our ideas are mainstream? Then more Americans will share our vision and join us in building an America where freedom, prosperity, opportunity and civil society flourish. ■

Think tanks need to demonstrate impact on a regular basis to build credibility among the policymaking community and media.

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www.insideronline.org
www.spn.org/newsite/main/iframe_toolkit.php
www.atlasusa.org/toolkit/index.php?refer=toolkit

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