You’re Hired!

A Trump Playbook for Fixing America’s Economy

Laurence Kotlikoff
Professor of Economics, Boston University

November 2016

Table of Contents

Preface

Dear President-Elect Trump,

I'm a professor of economics at Boston University. As one of many economists who is deeply concerned about the direction of America's economy, I offer you this playbook for economic reform. I developed the extremely simple (postcard length) reforms presented below in consultation with economists specializing, as do I, in policy reform, including tax reform, healthcare reform, Social Security reform, and banking reform.

Most of these reforms have been endorsed by a Who's Who of top economists, including many Nobel Laureates and former top policy leaders. I feel they reflect the broad views of the economics profession. Each plan is designed to appeal to Americans regardless of political allegiance.

This book's source is a platform I presented in competing against you and others as a registered write-in candidate. Let me be frank. During the campaign, I raised, in the strongest possible terms, my concerns about your capacity to lead our country, including your positions on foreign policy and social issues. But you are our next President and deserve the country's respect and assistance. This is the spirit in which I offer this policy playbook.

No one is born ready to serve as President. Anyone who advances to this role becomes a seeker of wisdom, a balancer of facts, and a judge of interests. Half of the country questions your wisdom, facts, and interests. But your obligation to them runs as deep as your obligation to your supporters for a very simple reason. You are all they have. They, like your supporters, are counting on you.

The path to representing both sides lies in advancing a package of new, fundamental policies that neither side has considered, that neither side has opposed, and that both sides can strongly support.

There are economically magical policies in the pages below. Read them, cast your spells, and become everyone’s President, not just in words, but in deeds.

1. The Truth About Our Economy

I start with a description of our economic realities. Many things, particularly our government's fiscal condition are, unfortunately, far worse than was suggested in the campaign.

Wages

Average weekly take-home pay, expressed in today's dollars, was $770 in 1966. It's $720 today.[1] That's 50 years of cumulative negative real (inflation-adjusted) wage growth.[2] Earnings per hour tell the same story.[3] The American Dream, in which each generation has a higher living standard than the previous one, lives and dies with these statistics. And they show the Dream fading before our eyes. There is one way to restore it: by radically and intelligently changing the course of economic policy.

---

[1] https://www.whitehouse.gov/sites/default/files/docs/ERP_2016_Appendix_B.pdf

https://www.gpo.gov/fdsys/pkg/ERP-2010/pdf/ERP-2010-table47.pdf

[2] Yes, fringe benefits have risen substantially. But much of this consists of higher employer-paid health insurance premiums, which have helped the medical profession, but haven't, on balance, dramatically improved Americans' health.

[3]

http://www.pewresearch.org/fact-tank/2014/10/09/for-most-workers-real-wages-have-barely-budged-for-decades

Jobs

Today, the U-6 jobless rate – the government's most comprehensive unemployment measure[4] – is 10 percent. That's far lower than the 17 percent rate recorded at the peak of the Great Recession. But it's still extremely high – over two-fifths higher than the 7 percent rate recorded in 2000 – the best on record. It's the rate we should be targeting.

Unemployment rates are cold numbers that tell us nothing about the underlying human tragedy of being out of work. There are now six million Americans who want a job and don't have one. That's enough adults to fill up Chicago and Los Angeles put together.[5] Each of the 6,000,000 is one of your children, one of your parents, one of your brothers, one of your friends, one of your neighbors, one of your acquaintances or simply one of your many fellow Americans you've yet to meet. Or they are you, if not today, then tomorrow.

Here's the bottom line. Nine years after the Great Recession began and seven years after it ended (when the economy started re-growing, albeit from a very low level), we still have a huge missing-jobs problem. And for many, if not most of those with jobs, we have a huge bad-jobs problem – jobs that don't pay enough.

Real Median Family Income

This measure of economic wellbeing has shown some

---

[4] U-6 unemployment includes part-time workers who want to work full time as well as discouraged workers – those who have given up active job search.

[5] http://www.bls.gov/news.release/empsit.t01.htm

improvement, albeit meager. Real median family income has risen by only 10 percent over the past 30 years.[6] Moreover, this increase is due to households working harder and longer, since they aren't earning more per hour. Extra work can take many forms – more hours per day, more days per week, fewer or shorter vacations, second jobs, becoming a two-earner couple, postponing retirement and other work adjustments needed to keep up with the ever-rising bills. American families are doing all these things to make ends meet. But it comes at a real cost – more time spent working and less time spent with one's family.

Saving and Investment

In the early fifties, our nation saved and invested 15 percent of national income. Today we save and invest just 4 percent. Low investment means lower growth in labor productivity (output per hour worked). And lower productivity growth means lower real-wage growth. In the fifties and sixties, labor productivity grew at 2.8 percent per year. Since 1970, it's grown at 1.9 percent per year. That's a one-third drop.

Inequality

Inequality is alive and well in America. As I'll explain, the fiscal system has dramatically limited its severity. But anyone who looks at the Trump Tower or the Clintons' speaking fees knows we increasingly live in a two-class society.

---

[6] https://research.stlouisfed.org/fred2/series/MEHOINUSA672N

Even worse, inequality is on the rise. Average household real income of the top 5 percent grew 38 percent over the last quarter century.[7] That's four times the growth recorded by the other 95 percent. Over the same period, the wealth share of the richest 5 percent rose to 63 percent from 54 percent. Meanwhile, the poorest half of Americans own a mere 1 percent of total net wealth.[8]

Labor income inequality is also significant and increasing. The college-wage premium has increased 75 percent since the mid-sixties. Today's college grads earn twice what those with only a high school diploma receive.[9] This speaks to the loss of our middle class. Roughly 70 percent of our children never graduate college.[10] So if the poor represent 20 percent of the population and the rich 30 percent, that leaves 50 percent in the middle class. But if, hypothetically, all the rich have four-year college degrees, that leaves no one in the middle class with a college diploma. And the growth in the college-wage premium leaves the middle class close to the poor in terms of what they earn.

Another driver of inequality is the recent decline in labor's share of national income. Labor used to receive about 77 cents out of every dollar produced. In recent years, that share has dropped to 73 cents. This may be the harbinger of even more

---

[7] Between 1989 and 2013, to be exact. See http://www.federalreserve.gov/newsevents/speech/yellen20141017a.htm

[8] Ibid

[9] See, in particular, Figure 1 in Acemoglu and Autor (2011).

[10] http://www.politifact.com/truth-o-meter/statements/2015/apr/08/rick-santorum/70-americans-dont-have-college-degree-rick-santoru

redistribution from workers to owners of capital.

Economic models in which smart machines compete directly with labor, which is increasingly the case, have one strong prediction – a decline in labor's share of national income, which is the sum total of all the wages and asset income we receive.

No one knows the exact net impact of NAFTA or other long-past trade agreements on middle- and low-skilled workers. Most economists, myself included, think they have helped far more than they have hurt. But the daily replacement of people by smart machines is hard to mistake. These machines represent mechanical immigrants when it comes to competing with middle- and low-skilled U.S. workers.

Immigration

Immigration has been a major topic in the Republican presidential debates. But the discussion has been remarkably disconnected from the facts. Notwithstanding the suggestion that illegal immigrants are overrunning our borders, there are and have been more illegal immigrants leaving our country than entering it. Indeed, over the last decade, roughly 1 million more illegal immigrants have left our country than have entered it.[11] This is tribute, in large part, to our immense, decades-long effort to secure our borders. We still need to work extremely hard on border enforcement to eliminate illegal entry into our

[11] http://www.pewresearch.org/fact-tank/2015/11/20/what-we-know-about-illegal-immigration-from-mexico

country. But we shouldn't presume nothing has been accomplished.

The real issue with immigration is legal immigration. We are adding 1 million legal immigrants to the population each year. The great majority are medium or unskilled. This isn't hurting investment bankers or the software engineers at Google. This is hurting low- and middle-skilled U.S. workers.[12]

Population Explosion

Legal immigration is also fueling a veritable population explosion. Unless we reduce legal immigration, our population will rise by one-third – over 100 million people – in just 45 years. That's the current population of the Philippines. Most of these additional people will locate in the nation's major cities. Driving in our major cities at peak hours is already a major challenge. With one-third more people, driving in our major cities may be like driving in Manila – an experience I don't recommend.

America's population explosion has far-reaching implications for wage growth, jobs, productivity growth, public services, infrastructure, congestion, public transportation, the education system, agriculture and our nation's ability to reduce its carbon footprint. It's one thing to consciously let your population explode. It's another to do so with no planning for the consequences.

Many people argue that the country has plenty of space, that

[12] http://cis.org/immigration-and-the-american-worker-review-academic-literature

the Midwest has been emptying out and that the country could easily accommodate twice the number of annual immigrants. The fear is that what happens when other countries have experienced rapid population growth will happen here. People will move primarily into existing urban areas that are already highly congested. Egypt's three-largest cities including Cairo represent far less than 1 percent of its landmass. But they contain a quarter of that country's population.

Education

I needn't tell you our education system is failing our children. Here's the report card. One in five of our children fail to graduate high school. This places us in 22nd place among developed countries with respect to graduation rates – below the average of all 36 developed countries in the OECD. As noted earlier, 70 percent of our children don't attend or finish a four-year college. Our ranking based on college completion rates is 19th among OECD countries.[13] Our high schoolers rank 27th in math on the PISA (Program for International Student Assessment) test.[14] They rank 20th in science and 17th in reading.

The World Economic Forum ranks the United States 48th in quality of mathematics and science education. Sixty-nine percent of our public school students in fifth through eighth grades are taught mathematics by someone without a degree or certificate in mathematics. Ninety-three percent of them are

---

[13] http://www.businessinsider.com/r-us-falls-behind-in-college-competition-oecd-2014-9

[14] https://www.oecd.org/unitedstates/PISA-2012-results-US.pdf

taught the physical sciences by a teacher without a degree or certificate in the subject. We rank 27th among developed nations in the proportion of college students receiving undergraduate degrees in science or engineering. Finally, we graduate more visual and performing arts majors than engineers.[15]

Federal Reserve Policy

The Federal Reserve is an independent branch of our government and needs to remain that way. This means the Fed needs to reach its best judgments in setting policy and stick to them no matter what elected officials and other outsiders think. That said, the Fed can benefit from considering alternative opinions about its actions.

In that spirit, let me suggest a few things for the Fed to consider. In 2007, the sum total of all the money the Federal Reserve had printed since its founding in 1913 was $850 billion. Since 2007, the Fed has printed an additional $3 trillion!

Printing money at an astronomical rate to pay government bills is the kind of behavior one would expect from a third-world country. [16] Fortunately, the vast reliance on the

---

[15] This is a statement about our dearth of engineers. It is not meant to denigrate the arts, which I very deeply respect and appreciate and which I would very strongly support were I president.

[16] Yes, this money has been used to purchase government bonds. But if you look through the sequence of transactions in which a) the Treasury sells bonds to get money to spend on goods and services or to make benefit payments, b) the Fed prints money and buys up those bonds, c) the Treasury pays the Fed interest and principal payments on the bonds the Fed has purchased, and d) the Fed returns those payments to the Treasury as profits of a government corporation, you realize that the Treasury and Fed have, together, engaged in a clever shell game. But the

printing press has not yet kicked off inflation. The reason is that the Fed has been and continues to bribe the banks not to lend out the newly printed money either to businesses or households. Instead, the Fed is paying interest to the banks to keep this money on reserve at the Fed.

So far the policy has worked. Inflation has been extremely low. But if monetary conditions return to the norms of the early 2000s, we'll see prices quickly rise by – and yes this is no typo – 300 percent![17] Such an outcome would spell hyperinflation.

Again, the Fed has to make its own choices. But a monetary policy sold to the public as *quantitative easing* has actually been a super high-risk policy to ease Congress' and the Administration's burden of collecting taxes to pay its bills. If the Fed were really interested in stimulating the economy, it wouldn't be rewarding the banks for not making loans.

The good news is that the current chair of the Fed, Janet Yellen, has brought what I view as reckless money printing by her predecessor to an end. But she is still paying interest on reserves and keeping interest rates abnormally low. I'd recommend a gradual but major change in both policies. Higher interest rates will help the elderly enjoy the level of retirement income they spent their lives saving to achieve, and their increased spending will in turn help stimulate the economy.[18]

---

end result is clear. The combined actions of the Treasury and the Fed entail simply printing up new money to pay for government expenditures.

[17] By monetary conditions I mean the speed at which money circulates in the economy (what economists call the velocity of money) and rate at which banks expand the money supply by making loans (what economists call the money multiplier).

[18] I am not concerned about higher interest rates reducing investment. U.S. corporations are flush with cash that they can invest.

If the quantitative easing were really a clear-cut winning formula, the Fed should purchase all $13 trillion of government debt remaining in the hands of the public. Indeed, it should encourage Congress to cut all taxes to zero, have the Treasury borrow every penny it needs and then have the Fed print up trillions of dollars more to buy up the newly issued bonds.

This would be the height of irresponsibility. But such a policy, albeit, at a smaller scale, is exactly what the Treasury and Fed have pursued for most of the last decade. And, following the Fed's example, the Bank of England, the European Central Bank, and the Bank of Japan have engaged in much the same policy placing their countries at considerable risk for future inflation.

Turning the Corner

Why has the American economy been dead in the water for so long? There are many smoking guns and we're not going to pin down which one is producing the most smoke. Second-rate education is certainly high on the list. So are our miserable saving and investment rates. Competition with foreign workers, competition with machines and competition with low-skilled immigrants, especially in low-skilled jobs, have also done a number on American workers.

But the government has also played a major role in discouraging employment and lowering wages by confronting small businesses with the massive red tape I discussed above and large businesses with rates of corporate taxation that are far higher than in other developed countries. Yes, corporate tax collections are very low due to myriad loopholes. But our corporate income tax, while collecting precious little revenue is, nonetheless, producing huge incentives for companies to operate outside the U.S.

Another job killer is our long-standing decision to have our employers oversee our healthcare, saving and financial investment decisions via the healthcare and retirement plans they provide. Our employers are not our friends, they are not our parents, and they are not our government. They should not be deciding what healthcare we receive, how much we can save on a tax-sheltered basis, how and with whom we invest our savings and, thanks to these decisions, what we pay in taxes. The business of America's businesses should be just that, business. It's time we have our companies get back to their jobs – hiring, investing and, yes, making money. The plans offered below to fix Social Security, healthcare and the tax system will, as a byproduct, do precisely this. The economic impact, in conjunction with the reforms themselves, should prove dramatic.

Finally, let me point out that the largest recession in the postwar period – the Great Recession, from which we are still very much recovering – did not need to happen. Wall Street and politicians were in bed together, and the result was a disaster for Main Street. Fortunately, there is a truly simple means, endorsed by prominent economists, including Secretary George Shultz, Meryn King, former Governor of the Bank of England, and even Barney Frank, the co-author of Dodd-Frank, which will make Wall Street permanently safe for Main Street.

2. Bankrupting Our Children

U.S. official net debt – the debt in the hands of the public, i.e., the debt that hasn't been bought up by the Federal Reserve with newly printed money – stands at $14 trillion.[19] This is a huge sum, equivalent to three quarters of U.S. GDP. But it's just the tip of the iceberg when it comes to actual U.S. red ink. As I mentioned earlier, our politicians have kept most federal obligations off the books and, therefore, out of sight.

Take your future Social Security benefits. Uncle Sam owes you this money no less than he owes you coupon payments on the U.S. Treasury bonds you might possess. But not a penny of his obligation to send you your Social Security checks is added to the $13 trillion when Uncle Sam reports his net debt.

The method of deception is remarkably simple. Congress calls your future Social Security benefits a "transfer payment," whereas it calls your future Treasury coupon payments "debt service." Then it declares that only the present value of future debt service (this is the aforementioned $14 trillion) constitutes official debt. Present value simply refers to the financial method of calculating what a dollar either paid or received in the future is worth today.

---

[19] The gross federal debt stands at $20 trillion, but since the Federal Reserve has purchased $6 trillion of these Treasury bills and bonds, the debt in the hands of the public is $14 trillion.

But what words Congress uses to call the dollars it takes in or hands out doesn't change economic reality. No matter what Congress calls Social Security payments, it owes you, me and everyone else this money just like it owes you, me and everyone else future payments on the Treasury bonds we hold. All of these future payments represent government I.O.U.s.[20]

Even those payments that are far in the distant future are obligations, which can be ascribed a present value. Of course, a dollar that the government will need to pay in, say, 500 years, won't have much of a present value today. But it won't be zero and it can't be ignored in the accounting.

How much should we add to the $14 trillion if we want to include our government's Social Security debt? The answer, according to the system's actuaries, is $32 trillion. This figure looks at the infinite horizon, but does proper present value accounting. It also nets out the present value of all future taxes and the value of the system's trust fund. If we add the $32 trillion in Social Security red ink to the $13 trillion, we get $45 trillion, which is more than triple the official debt held by the public!

---

[20] The two types of obligations have different characteristics (e.g., Social Security benefits stop when you die, whereas the coupon payments stop when the bond reaches maturity), but this is just a matter of proper financial valuation. Social Security's actuaries are, by the way, understating the true value of the system's net liabilities by roughly a quarter because they use a discount rate that's too high given the risk properties of the benefits being promised and the taxes being collected. See http://www.kotlikoff.net/content/true-cost-social-security for an analysis of this.

But why stop with Social Security I.O.U.s? What about Uncle Sam's commitment to pay us Medicare benefits? Projected Medicare benefits also have an actuarial present value, which can be measured and put on the books. In fact, every dollar the government is projected to spend, whether the dollar is labeled "debt service," "transfer payments" or "discretionary spending" (such as defense expenditures or interstate highway repairs), represents a government liability. And every dollar the government projects collecting in taxes represents an offsetting government asset.

Economics tells us we should put everything on the books, including the present value of every dollar the government expects to pay in the future net of every dollar it projects to receive. We economists call this difference the *fiscal gap*, which I previously mentioned.

The fiscal gap is the true measure of a country's financial condition. It boils down, in a single number, the extent to which the government's finances don't add up. It tells us how much we need to raise taxes to cover all the spending the government has planned. Alternatively, it tells us how much we need to cut that spending to live within the taxes the government expects to collect.[21]

So how big is our government's fiscal gap?

$206 trillion!

Yes, you read that correctly. Our true fiscal indebtedness is

[21] This estimate was provided by Berkeley economist, Alan Auerbach, and Brookings economist, William Gale.

more than 10 times larger than the $20 trillion in gross official you've been told our government owes and 15 times larger than official debt in the hands of the public (i.e., debt not purchased by the Fed with newly printed money). Its tremendous size can be summarized with these five words: *Our government is dead broke*.

The fiscal gap is, in essence, our nation's credit card bill. Like our own credit card bills, it can't be wished away and keeps getting bigger, thanks to interest charges, if it goes unpaid. In fact, it's growing at about $5 trillion a year.

There are different ways to close the fiscal gap. One is to permanently raise, starting today, every single federal tax by 53 percent. Alternatively, we could cut all federal expenditures by 34 percent. A third option is to combine a smaller tax hike with a smaller spending cut.

Yes, we can keep waiting to address our fiscal shortfall. But the longer we wait, the more we put future generations on the hook. If, for example, we wait 20 years to act, the required across-the-board tax hike will be 69 percent, not 53 percent. Or if we wait 20 years to cut spending, the required across-the-board spending cut will be 42 percent, not 34 percent.

Herb Stein, President Nixon's chief economist, famously said, "Things that can't go on will stop." This quaint phrase suggests that it makes no difference when we get our fiscal house in order. Nothing could be further from the truth. Here's the truth. *Things that can't go on will stop too late, especially for our children.*

We Americans are a moral people. We believe in doing the right thing. Waiting to close the fiscal gap is highly immoral. The longer we wait, the bigger the tax hikes or spending cuts our children will bear and the more of these burdens we will escape. And make no mistake, forcing, for example, our kids to face 69 percent higher taxes than we've been paying is an act of absolute immorality. It's also destined to destroy their economic lives.

How did the fiscal gap get so large? It didn't happen overnight. Each administration and Congress, going back to the Eisenhower presidency, has done its part to exacerbate our financial shortfall. Much of the fiscal gap is the result of politicians running take-as-you-go policy. The policy works like this. The politicians take money (e.g., Social Security contributions) from young people, give it to old people in cash or healthcare benefits, but keep the young people happy by promising them large benefits when they're old. (Note that the pols don't call this current borrowing and future debt service. Rather they call it current taxation and future transfer payments.)

If there were always enough young people coming along and if they were always earning enough to fully pay off the contemporaneous old people, there'd be no impact on the fiscal gap. But our postwar intergenerational chain letter is failing like all chain letters do, eventually. Ours is running into the baby boomers' baby bust, which refers to the fact that the massive baby boom generation chose to have fewer children per person than its parents did. This is reducing the number of young people relative to old people through time. In addition, real wages have, at least on average, stopped growing.

Yes, the 1 million or so in annual immigration is bolstering the workforce. But it's not helping us with our chain letter. Immigrants, given their skill composition, cost our country roughly as much in benefits as they contribute in taxes.

Ironically, the politicians' take-as-you-go Ponzi scheme has, in part, self-destructed because they didn't understand that their scheme would affect real-wage growth. Taking more money that young people would otherwise have saved and invested and giving it to older people to spend has gradually, but relentlessly, reduced national savings and domestic investment. The lack of investment has, in turn, adversely affected worker productivity and, therefore, what the young earn. This string of events is exactly what economic theory suggests would happen and is fully supported by the data.

Why Aren't Congress or the Administration Disclosing Our Massive Fiscal Gap?

You won't find the $206 trillion fiscal gap on any government website. Why not? Why aren't our main fiscal watchdogs – the Congressional Budget Office (CBO), the Office of Management and Budget (OMB) and the General Accountability Office (GAO) – disclosing the fiscal gap? Calculating it takes just five minutes based on the CBO's long-term spending and tax projections.

Here's why. All three agencies are run by political appointees. And, to paraphrase Jefferson, their bosses care more about the next election than the next generation. I experienced this personally in working with OMB and other outside economists in President Clinton's first year of office.

We prepared a fiscal gap analysis to be published in the President's 1994 Budget. The picture it painted wasn't pretty. It completely contradicted the narrative that President Clinton was a strong fiscal conservative. As a result, the document we prepared so carefully over several months was censored two days before the budget was published.

The same thing happened under President George W. Bush. In 2002, then-Treasury Secretary Paul O'Neill commissioned a fiscal gap analysis for inclusion in the President's 2003 Budget. On December 7, 2002, Secretary O'Neill was summarily fired, and the Treasury economists preparing the analysis (two of whom are former co-authors) were immediately informed that their year-long study would never see the light of day. In President Bush's case, the concern was passage of Medicare Part D. The Bush Administration wanted nothing in the press to suggest that our children couldn't afford paying for the existing Medicare system, let alone a major expansion.

This year, fiscal gap analysis came under even greater attack. The Congressional Budget Office's Director, Keith Hall, refused, to his everlasting shame, to prevent the CBO from providing long-term budgetary forecasts that can be used to form the fiscal gap. The $206 trillion figure is, thus, our best guess of where things stand. My personal intervention with Hall and CBO staff has been met with the response that "No one in Congress is interested in fiscal gap accounting." That's patently false as The Inform Act, discussed below, makes clear.

Moving to Fiscal Gap Accounting?

I co-developed fiscal gap analysis in 1989 – that's almost 30 years ago – with University of California at Berkeley economist Alan Auerbach and Cato Institute economist Jagadeesh Gokhale. We did so under the heading of *Generational Accounting*.

Governments all over the world have been doing comprehensive fiscal gap accounting on a routine or periodic basis. The same is true of the International Monetary Fund, the World Bank and the European Commission. Two prominent left- and right-leaning think tanks – the Brookings Institution and the Cato Institute – are also producing fiscal gap analyses, typically every year. For my part, I've been discussing our fiscal gap in public forums and with the media for years.[22]

In 2014, Senator John Thune, a Republican from South Dakota, and Senator Tim Kaine, a Democrat from Virginia (and Clinton's running mate), introduced the Inform Act. I was heavily involved in conceiving and drafting the bill, while a millennial group called The Can Kicks Back did the yeoman's work to make it a reality. The bill would require that the CBO, GAO and OMB do fiscal gap accounting on a routine basis. Were this to happen, the press would be forced to cover the public releases of the fiscal gap measurements, and the politicians would be forced to address the problem.

Senators Thune and Kaine sent a joint letter to all 98 of their colleagues asking them to co-sponsor the bill. Only a handful of Democrat and Republican senators, five to be exact, agreed.

My reaction was to ask economists for help. I sent an email

---

[22] An example is my July 2014 New York Times Op Ed, entitled *America's Hidden Credit Card Bill*.

to every economist I knew requesting they endorse the Inform Act at www.theinformact.org. And I asked them to forward the email to every economist they knew. To date, over 1,400 economists have endorsed the bill, including 17 Nobel Laureates and almost every American who has received the prize in economics. The endorsers span the entire political spectrum and every top economics department in the country. They also include very senior former government officials.

Once the endorsements came in, I, together with the leaders of The Can Kicks Back, raised over $50,000 to run a full-page ad in *The New York Times* containing a letter to the President and members of Congress asking them to pass the Inform Act. Each and every endorser of the bill was listed in the ad, which ran in *The Times* on October 22, 2013.

The reaction from President Obama? Not a word. The reaction from members of his administration? Not a word? The reaction from members of Congress who hadn't sponsored the bill? Not a word. What about the media? Did anyone in the press write a single word about the bill or its overwhelming endorsement by the economics profession? Not a word.

President-Elect Trump, I urge you to seek immediate passage of the Inform Act, which represents the only way we can gauge our or any country's true fiscal condition.

Closing Our Fiscal Gap

Here's the bottom line. Our country is broke. It's not broke in 50 years or 30 years, or 20 years or 10 years. It's broke today. And we have to act today so we don't confront our children with even bigger tax hikes or benefit cuts in the future.

The reform plans presented below for fixing taxes, healthcare, Social Security and energy policy will collectively eliminate our fiscal gap. They will do so with maximum efficiency and the least disruption to peoples' economic lives. The package of reforms provided here also provide the financial headroom for essential investment in infrastructure, basic research and education. Equally important, they will resurrect our economy and produce many more higher-paying jobs, far higher national saving, massive domestic investment and rapid economic growth.

3. Transforming Our Economy

Our economy has been failing for decades. The politicians have seen to it. It's now time to change course and take the many steps, large and small, to restore the American Dream.

These steps do not include business as usual. Nor do they include destroying our trade relations or reneging on our national debt. The steps most certainly do include fundamentally reforming our tax, Social Security, healthcare and banking systems. They also entail leveraging technology to dramatically improve and equalize education at the primary and secondary levels. And they involve substantially upgrading our nation's infrastructure and funding basic research at a much higher level.

Let's start with tax reform, which is the quickest way to achieve rapid growth in jobs, productivity and real wages.

Tax Reform

Tax reform, if done right, can make a huge difference. A telling example is the Irish Miracle that started in 1987. Thanks primarily to a major and intelligent tax reform, Ireland moved from being one of the lowest per-capita income countries in the European Union to the second highest – *all in the space of a dozen years!*[23]

The tax reform, detailed in the next chapter, would make the

---

[23] https://en.wikipedia.org/wiki/Celtic_Tiger; unfortunately, Ireland was very badly hurt by the global Great Recession, which struck there starting in 2007, and has yet to fully recover.

United States the most tax-attractive country in the developed world. This would bring large amounts of investment to our country. And this influx of capital will lead to many more jobs and significantly higher wages. These impacts won't happen overnight, but they will happen quickly.

When I speak about tax reform, I do so with specific knowledge. First, I'm well-versed in how other countries have changed their tax systems and the effects of those changes. Second, my main area of research is public finance. Hence, I know how to properly design tax and other fiscal reforms. Third, I've been heavily involved in building large-scale dynamic computer simulation models to evaluate fiscal reforms. Yes, the real world doesn't fit perfectly into any economist's model. But I wouldn't substitute casual thought for disciplined thinking about the economy and economic reforms.

Alan Auerbach, a leading public finance economist at UC Berkeley (whom I mentioned earlier), and I began building computer simulation models starting in the late seventies.[24] Our models feature neither supply-side economic voodoo ("tax cuts will pay for themselves") nor demand-side economic voodoo ("increased government spending will pay for itself"). Instead, they are grounded in well-established economic behavior and standard economic theory. This includes the proposition that, absent better design of taxes and other policies, there is no free lunch. Stated differently, if we want to improve the economy in a way that benefits us all, we'd better do so very carefully.

---

[24] See Auerbach, Alan J. and Laurence J. Kotlikoff. 1987. *Dynamic Fiscal Policy*. Cambridge University Press.

Over the years, versions of what is known as the Auerbach-Kotlikoff (AK) model have been used around the world to study fiscal reform, demographic change, education policy, generational policy, trade policy and many other issues. Some of this work has been done at the governmental level. Indeed, both the Congressional Budget Office and the Joint Committee on Taxation have used versions of our model to assess the economy's response to alternative fiscal reforms. For my part, I've used our model to help develop the following proposed tax reform.

Real Tax Reform – a Quick Overview

This tax reform is designed to stimulate the economy, raise real (inflation-adjusted) wages by at least 10 percent, increase GDP by roughly 15 percent, produce at least 25 percent more revenue, improve tax fairness (progressivity) and provide far better incentives to work, particularly for the poor.

The reform eliminates three highly complex and dysfunctional taxes and replaces them with four new and extremely simple ones. It also dramatically modifies the FICA payroll tax.

Here are the highlights. Apart from transition rules[25] that would collect deferred taxes, I eliminate the corporate income tax, the personal income tax and the estate and gift tax. In their place, I institute a business cash flow tax, also called a value

---

[25] This refers to collecting postponed taxes – taxes that companies already owe, but have not yet paid. Examples here are corporate taxes on oversees profits that have not yet been repatriated and personal taxes on 401(k) balances that have not yet been with drawn.

added tax (VAT),[26] a progressive personal consumption tax, an inheritance tax and a tax on carbon.

Replacing the corporate income tax with a business cash flow tax will leave the U.S. with the lowest corporate tax rate in the developed world, namely zero. Yet the business cash flow tax will collect far more revenue from businesses than the corporate income tax. What it won't do is tax, on an effective basis, any income that businesses, be they American or foreign, derive from making new investments in the United States.[27] This is the reason that U.S. and foreign companies will rush to invest and hire here.

The New York Times is very careful when it comes to publishing op-eds advocating tax reforms, especially those that might seem, whether true or not, to help the rich. But *The Times* recently published a column I wrote entitled "Abolish the Corporate Income Tax."[28] The column was based on findings from the AK model.[29] Persuading the very left-leaning *Times'* editorial board that replacing the corporate income tax with a progressive alternative just might make

---

[26] This is Alan Auerbach's "Modern Corporate Tax," but with no deductions for wage payments. For tax aficionados, this is a destination-based, subtraction-method VAT with some wrinkles to ensure that companies operating in the U.S. face no effective taxation on their U.S. investments.

[27] Under the business cash flow tax, businesses get to immediately write off or expense their investment. This fully offsets from a present value perspective the future taxes arising from income earned on this investment. Hence, the bottom-line, effective present value tax on additional investments is zero.

[28]

http://www.nytimes.com/2014/01/06/opinion/abolish-the-corporate-income-tax.html?ref=opinion%20

[29]http://www.kotlikoff.net/sites/default/files/SIMULATING%20THE%20ELIMINATION%20OF%20THE%20U.S.%20CORPORATE%20INCOME%20TAX.pdf

sense for low- and middle-wage workers as well as for the economy was no minor feat. It's testimony to the power of apolitical economic analysis – analysis that invokes neither right-wing nor left-wing free-lunch fantasies – to get people to listen and learn.

The personal consumption tax, the second new tax I'd institute, was first proposed in 1996 by former Democratic Senator Sam Nunn and former Republican Senator Pete Domenici. They called it the USA Tax. At the time, many people felt it would be hard to implement given the reporting requirements. But 20 years is a long time and what once needed to be reported on paper can now be reported electronically. Consequently, personal consumption taxation is now an eminently practical option.

The personal consumption tax would be highly progressive. Only the top 20 percent of households when ranked by spending would pay this tax. All other households would be exempt and file no returns. For them, April 15th would be just another day!

Moreover, the tax would exclude consumption paid out of wages. Hence the personal consumption tax won't penalize anyone for working.[30] What it will do, as explained in the next chapter, is make absolutely sure the rich, particularly the superrich, pay their fair share of taxes.

The proposed inheritance tax would tax all gifts and inheritances received above a high threshold. The tax would be

[30] In effect, the progressive personal consumption tax taxes spending done by the rich out of their existing wealth, not their current or future wages or, for that matter, the wealth they accumulate in the future by other means.

extremely simple and permit no loopholes. The rich could not avoid it with trusts, life insurance policies or other estate-planning tools. None of them would be legal.

The remaining new tax is the carbon tax. This tax would be designed to actually reduce carbon dioxide emissions. As discussed below, given the timing of their implementation, our current carbon policies, including the recent Paris Accord, may actually be raising global emissions and thereby accelerating the increase in the planet's temperature.

Another key provision of the tax reform is eliminating the ceiling on Social Security's FICA payroll tax. Currently, only wages up to $118,500 are subject to the full 15.3 percent FICA tax rate. Under the reform, the FICA taxable-wage ceiling is eliminated. Hence, our nation's highest earners will be treated like today's lowest earners. They will pay FICA taxes on every penny they make.

Improving Incentives to Work, Especially for the Poor

Employment is a two-edged coin. It requires people eager to work not just people eager to hire. Our current federal and state fiscal system has roughly 40 different tax and benefit programs. Many are embedded in the federal income tax. None was designed with any thought as to their combined impact on work incentives. Consequently, for millions of Americans, working and earning more means not just paying a great deal in extra taxes but also losing a great deal of existing benefits.

Take a low-wage single mother with three children earning $35,000. If she earns an extra $1,000, she will pay $153 more in FICA taxes, lose $211 in Earned Income Tax Credits and lose $240 in food stamps. She will also pay state income taxes and state sales taxes (when she spends her wages) totaling roughly $100. Furthermore, this mom will likely be enrolled in Obamacare. In this case, earning the extra $1,000 will cost her $253 in extra healthcare costs.[31] The sum of all these additional explicit and implicit taxes is close to $1,000! Hence, earning the extra $1,000 for herself and her children will produce almost no additional income, on balance. This mother, like millions of our poorest citizens, has been placed in a *poverty trap* thanks to our confiscatory tax and benefit system.

Abolishing America's poverty trap, which, for decades, has been ensuring that the poor stay poor, requires radically changing not just our tax system but also how we provide government benefits. The tax and benefit-program reforms ensure that all Americans – poor, middle class and rich – face an identical 30 percent marginal tax on earning extra income. So the mom earning $35,000 who gets a $1,000 raise will pay $300 in taxes, not $1,000 in the form of additional taxes or lower benefits. A millionaire who earns an extra million dollars will pay $300,000 in extra taxes.

When you put together the effects of all 40 programs, typical U.S. workers now pay 40 cents on every dollar of extra earnings.[32] But, as the above example illustrates, far too many

---

[31] I'm assuming the mom lives in Cleveland. The extra $253 reflects both a decline in payments for care by the government and an increase in health insurance premiums. See http://kff.org/interactive/subsidy-calculator/#state=oh&zip=44101&income-type=dollars&income=35000&employer-coverage=0&people=4&alternate-plan-family=individual&adult-count=1&adults%5B0%5D%5Bage%5D=30&adults%5B0%5D%5Btobacco%5D=0&child-count=3&child-tobacco=0

[32] See http://www.kotlikoff.net/node/541

American workers are in dramatically higher marginal tax brackets. Hence, having a uniform 30 percent marginal tax rate on labor income will significantly improve work incentives, particularly for the poor and for those in their early 60s.[33]

Progressivity of the Fiscal Reforms

The reforms presented here are, collectively, highly progressive. The business cash flow tax represents an indirect consumption tax. Consequently, it taxes the resources – wages and wealth – used to pay for consumption. Hence, the business cash flow tax is, in part, a wealth tax.

Second, the progressive consumption tax will tax all consumption of the rich that's financed out of their wealth. So this represents a second major wealth tax. Third, eliminating the ceiling on Social Security benefits, without providing additional benefits under the old system (see chapter 6), transforms our most regressive tax – the FICA tax – into a proportional tax.

Fourth, the inheritance tax will limit the transmission of wealth across generations in a way that the estate and gift tax are certainly not doing. Fifth, as discussed in the next chapter,

---

[33] There are workers who face a lower than 40 percent effective federal marginal net tax rate. But raising their federal marginal net tax rate to 30 percent in order to lower the marginal net tax rate of those locked into poverty will, for technical reasons, be a major net benefit to society. Many of those in their early sixties face Social Security's Earnings Test. But, as I pointed out in a recent NY Times op-ed with Robert Pozen, entitled *Let Older Americans Keep Working*, the Earnings Test places many workers in their early sixties in marginal tax brackets, when it comes to earning more money, that are 33 percent to 50 percent higher than they'd otherwise face. And, remarkable, the Earnings Test is intentionally designed to raise essentially no revenue.

the tax reform includes a fixed payment per American in lieu of the Earned Income and Child Tax Credit. This is another progressive element since this fixed payment will represent a trivially small share of resources for the rich but an important source of income for the poor.

Sixth, I replace the Food Stamps program with three free meals provided to children five days a week at schools located in low-income neighborhoods as well as direct food distribution to adults and children in these neighborhoods. Parents could join their school-age children for dinner at their children's schools. The mechanisms for food distribution will be via local food distribution centers and mobile food distribution for those who can't easily reach the centers because of travel time or problems with mobility. The last thing anyone wants to do is stigmatize anyone. But we need to give food assistance to the poor while preserving their incentives to work. Providing food stamps and then taxing them away at 24 cents on the dollar earned maintains the poverty trap the poor need so desperately to escape.

For those who believe the current income tax is a hallmark of progressivity and that its retention is essential to retaining a progressive fiscal system, I invite them to meet with some of our nation's roughly 2,000 billionaires. If you ask them what they pay in income taxes, they will smile and say, "The rich don't pay income taxes. We borrow against our wealth to consume as much as we want, don't realize our capital gains or use like-to-like transfers when we want to trade real estate, leave our appreciated assets to our children with a step-up in basis to avoid any end-of-life capital gains taxation, and then use a variety of trusts, life insurance, and other estate-tax avoidance mechanisms, all fully legal, to avoid paying estate taxes." This game of cheat the tax man with high-class lawyers would come to an abrupt end under this taxreform. And those lawyers would be forced to start doing something that's actually socially productive.

'The Business of America is Business'

This is President Calvin Coolidge's famous 1925 quote. It was true back then. It's not true today. Today we've saddled American companies with all manner of responsibilities that keep them from doing what they are here for – to make money and, in the process, hire us.

Putting employers fully or partly in charge of our defined benefit plans, our 401(k)s and similar tax-favored saving plans, our health insurance plans, our retirement account investment options, our life insurance holdings and our disability insurance – all of which help determine our taxes – should never have happened.

If businesses were doing a fine job of handling these responsibilities, it would be one thing. But that's far from the case. An entire generation of baby boomers is about to retire. According to a careful study by Boston College economist Alicia Munnell and her co-authors, over half of U.S. Baby Boomers are woefully ill-prepared financially for a retirement that may last longer than they worked. Many apparently thought someone else was handling their nest eggs – whether their employers or Social Security. Not the case. Their employers didn't contribute enough to their workers' retirement accounts. Nor did they cajole their workers into contributing enough. As for Social Security, it stopped sending out benefit statements years ago, so now many people have no idea how little they will receive.

It's time to get employers out of our personal financial lives and get them back to running their companies. The healthcare reform, discussed in chapter 8, would make employer-based healthcare largely redundant. The tax plan would eliminate federal tax breaks of all kinds to employer-provided benefits. The Purple Social Security plan would provide adequate retirement benefits, life insurance and disability benefits to workers with no involvement by employers (or Wall Street). Eliminating all of these unnatural responsibilities of employers will, like the elimination of the corporate income tax, make the U.S. *the* place to do business.

Eliminating the High Fixed Costs of Starting and Running a Business

It's also time to help businesses, particularly small businesses, operate in all 50 states without having to file, many on a quarterly or monthly basis, 50 state corporate tax returns, 50 annual reports, 50 sales tax returns, 50 state-tax withholding reports, 50 state-unemployment insurance contribution reports and so on. The U.S. Small Business Association is trying to make it easier for businesses to start up in a single day. Their strategy is to streamline all the local permits and licenses they need to apply for.[34] That's a major improvement, but what it is not doing is helping small businesses handle the massive

[34] https://www.sba.gov/about-sba/sba-initiatives/startup-day

paperwork on the next day and all the days thereafter.

I'd establish a free federal website that companies could use to file all these documents and tax returns for all 50 states via a single return that would spit out the various tax liabilities for all 50 states. This would not preclude states from setting their own tax policies. It would simply facilitate filing the various returns across states based on the company's profit and loss statement. The system would be set up to strongly incentivize states and localities to base their tax collections on a uniform set of inputs.

Can this be done? Yes. Private accounting and back office management companies do this now. It just costs businesses an arm and a leg in time and money. The federal government could hire the best of these companies to build and maintain the free website I have in mind.

Expanding High-Skilled and Reducing Low-Skilled Legal Immigration

As noted earlier, America has a negative net rate of illegal immigration but a large positive rate of legal immigration that adds an extra million or so primarily low-skilled workers to our population each year.

We are a land of immigrants, and we have and always should welcome large numbers of immigrants each year, especially refugees (regardless of their religion!) to our shores. But if we admit a large enough number to materially damage the earnings prospects of low- and middle-income workers, we've gone overboard. I think our current rate of low-skilled legal immigration has done just that.

I'd cut legal immigration of low-skilled workers by half. This will start taking pressure off low-skilled U.S. workers. By the same token, I'd raise high-skilled legal immigration by one-third. This will enhance the productivity of low-skilled workers, who will have more high-skilled workers with whom to work. It will also shrink the skill gap in wages. Over time, I think, it will make a very big difference in restoring our middle class.

For those who differ on this proposal, ask yourself whether you would open our borders to everyone in the world and who would be most hurt by such a policy. This would quickly lead the U.S. to Third World status as measured by income inequality. We'd have a relatively tiny number of massively rich people and a massively large number of incredibly poor people with very few middle-class people in between. This, unfortunately, is what our immigration policy is promoting, albeit to a far smaller degree.

Or if you are a CEO and are making a bundle hiring low-skilled workers, ask yourself: how would you feel about a policy of permitting 1 million of so immigrants each year with exactly your skill set – all eager and prepared to take away your job?

Federal Support of Day-Care/Pre-School

Paying for childcare is another major work disincentive, whose alleviation can boost the economy in both the short and long run. In the U.S., new mothers from low-income households pay roughly 30 cents of every dollar they earn on childcare, making it much harder for them to rejoin the workforce and get ahead.

In Sweden, on the other hand, the figure is just 3 cents. Why the difference? The Swedish government, like a number of other advanced economies, provides highly subsidized daycare and pre-K centers for young children.[35] No surprise, then, that in Sweden the labor force participation rate of mothers with young children is one-third higher than in the U.S.[36]

We need to help mothers get back to work when they feel the time is right. Given the extra taxes that working moms pay, providing subsidized childcare could well pay for itself or at least cover much of its costs. Subsidizing daycare and pre-K centers can also help children learn critical socialization skills.

Let me quote Nobel Laureate James Heckman on this subject. Heckman has spent much of the last decade studying the importance of and economic returns to investing in very young children, particularly those in economically disadvantaged households.

> *The highest rate of return in early childhood development comes from investing as early as possible, from birth through age five, in disadvantaged families. Starting at age three or four is too little too late, as it fails to recognize that skills beget skills in a complementary and dynamic way. Efforts should focus on the first years for the greatest efficiency and effectiveness. The best investment is in quality early childhood development from birth to five*

---

35 http://work.sweden.se/plan-your-move/school-and-preschool

36 http://www.unavarra.es/digitalAssets/140/140609_Paper_Eva_Garcia-Moran.pdf

for disadvantaged children and their families.[37]

Supporting Family Planning

Planned Parenthood is helping women access their legal right to have an abortion within roughly the first 22 weeks of a pregnancy. Equally importantly, it is heavily involved in family planning.

There is an enormous fiscal payoff to family planning. Indeed, it is a crucial long-term investment for the economy. Opponents of family planning appear to be focused on whether or not a woman has a right to terminate unwanted, unplanned or forced pregnancies within the legal parameters set by the Supreme Court. I fully support the Supreme Court's decisions on this matter. But regardless of your feelings on abortion, family planning in advance of pregnancies is an entirely different matter. In our country, a quarter of a million teenagers have children annually.[38] Partly as a result, one in 10 children are growing up with grandparents. A total of 25 million children – more than one in three children – are growing up in single-parent households.[39] Even worse, children from single-parent households are, themselves, much more likely to have children as teenagers and much less likely to obtain secure

---

37 http://heckmanequation.org/content/resource/invest-early-childhood-development-reduce-deficits-strengthen-economy

38 http://www.cdc.gov/teenpregnancy/about/index.htm

39 http://datacenter.kidscount.org/data/tables/107-children-in-single-parent-families-by#detailed/1/any/false/869,36,868,867,133/10,11,9,12,1,185,13/432,431

jobs, let along well-paying jobs.[40]

The composition of families has changed radically over the years. In 1970, single women with children comprised 11 percent of the population. In 2010, they comprised 41 percent. The majority of these single-parent families are living in poverty. Worse still, 43 percent of the children in these families will remain impoverished into adulthood.

The societal costs are staggering. They include healthcare, welfare, food stamps, education and other subsidies, women not being able to enter the workplace, higher crime rates, and higher costs of incarceration. Effective family planning can go a long way to mitigating these costs. In 2010, the government spent $2.4 billion on family planning services. The savings from reduced Medicaid, food stamps and welfare benefits appear to be vastly larger than these costs.

Colorado recently funded free contraceptives for all the safety-net health centers in the state. Women who voluntarily wished to plan their families were able to freely choose the method and get educated in its use. The result was a 40 percent reduction in teen birth rates, a 35 percent drop in abortions and a 25 percent decline in high-risk pregnancies.

Conservatives should love family planning because it greatly reduces government outlays, reduces abortions and gives more single women a chance to enter the work force, all at a modest cost that is more than made up in the first years. Liberals should love the huge potential reduction in poverty rates and the greater flexibility women have to manage their

[40] http://prospect.org/article/consequences-single-motherhood

lives.

A greater investment in family planning may be the single most effective way of solving many of our most difficult domestic problems. Effective family planning requires not only investment but also education, so that every teenager and young adult, male and female, understands the benefit of family planning for their future.

Meaningful Educational Reform

Our educational system has been and is playing a major role in turning America into a society of haves and have-nots. The *No Child Left Behind* educational reform passed in 2002 held great promise, but it didn't work. Too many students failed the standardized tests and too many schools received failing grades. The response in our latest education bill – *Every Student Succeeds* – retains standardized federal testing in grades three through eight, but lets each state decide, within limits, how to handle failing schools.

Unfortunately, *Every Student Succeeds* is also no guarantee that every student will succeed. In many ways the new law simply throws up Uncle Sam's hands and tells state and local governments, "You figure it out." That said, this may well be our best move. By restoring more autonomy to states and local governments, we'll effectively end up running thousands of experiments across the country that can help each school district, each school and each teacher learn the best means to educate their particular students. This may involve charter schools, vouchers, magnet schools, home schooling, reliance on the Common Core and other current educational initiatives.

In short, when it comes to elementary and secondary education, if the federal government doesn't know what's best, it's in no position to dictate what's best. On the other hand, it has an obligation to intensely study what is and isn't working and make that knowledge instantly available to educators around the country.

Mr. Trump wants to shut down the Department of Education (DOE). I think doing so would be deeply misguided. The Department of Education is here to help determine what works – not just here at home but in other countries as well.

Making Vocational Education a Business Profit Center

One example of where the DOE can matter is vocational education. The DOE can learn and disseminate key lessons from Switzerland, Germany and other countries where education, particularly vocational education, is a major success. Those countries have lower youth unemployment rates and their education systems know how to work with businesses, large and small, in providing vocational education that pays off directly in terms of concrete, reliable jobs. These vocational programs often start and end in high school. Others extend to community colleges. Australia provides a successful example of using technical colleges, called TAFEs, to produce task-specific certifications that lead to immediate employment.

Companies that become truly engaged in vocational education do so, in large part, out of self-interest, namely to recruit new hires. The DOE should be working with top education officials from Switzerland, Germany, Australia and other countries to understand the precise nature of their vocational-education success stories and relay these formulas not only to educators but also to heads of human resource departments of American companies, both large and small.

This connects to the following key message to American CEOs, to wit:

"Yes, you have an obligation to your bottom line. And yes, we need to get government out of your hair and let you do your job. But you have an obligation to society at large, particularly when it comes to employing Americans and paying them decent salaries. You also can play a major role in educating and recruiting today's youth. Bear in mind that today's workers are your current customers and that today's students are your future customers. The more you automate, outsource, offshore, etc., the less money your customers will have to buy what you make. And the less you help train America's youth, the fewer qualified workers you will find to hire."

It's time for American business to understand that the welfare and education of Americans are in large part its responsibility and that having each U.S. company act penny wise will be dollar foolish for overall American commerce, including their own businesses.

Leveraging Technology to Equalize Educational Opportunity

We don't know enough yet about primary and secondary education to say for sure how to improve it. But I have two strong prior beliefs. The first entails leveraging technology to equalize educational opportunity. The second is to promote pre-K education.

Let me start with technology, where we have a unique opportunity at extremely low cost to do two major things: a) effectively lower classroom size and b) dramatically improve the quality of teaching. This is readily done by instructing our Department of Education to offer, free of charge, online learning to all schools across the country, as well as subsidies for equipment to deliver this learning to students on a one-on-one basis – learning that proceeds at the student's own pace.

These online courses would be available for each subject in each grade and would be produced by the top teachers in our country. The online classes would be engaging and challenging. Each lesson would be linked to an online test that checks a student's absorption of what was taught. Advancement to the next lesson would be predicated on achieving a passing score on the prior lesson. This makes learning dynamic and responsive to each student. None of us learn the same way. Technology can help us cater the educational experience to the learning style of every student. For example, if a particular way of explaining fractions doesn't work, the online education would automatically try an alternative method.

This type of educational innovation is already underway. New York City is now engaged in a massive experiment in online and blended learning.[41] The term *blended* is critical. It means blending hands-on traditional teaching with new online educational tools. What's definitely not involved here is putting

---

[41] http://ww2.kqed.org/mindshift/2011/03/18/new-york-city-schools-blended-learning-experiment

teachers out of jobs. Instead, it's using new technology to help teachers do their jobs better and more easily. It also gives teachers more one-on-one time to spend with their students.

Very Early Education

The work by James Heckman and many other top researchers on educational achievement points to the need for early educational intervention with children not just to learn basic skills but also to learn patience, determination, perseverance, grit, call it what you will. There is growing evidence that developing grit and its close relatives as well as the ability to cooperate, work in teams, respect authority and respect one's peers – in short, to play well in the sandbox – may be as important as one's inherited genes in determining future economic success.

On that score, let me quickly point out that no one has yet discovered a smart gene. Moreover, which genes get activated is not predetermined at birth but is influenced in part, if not in the most part, by one's environment. This is why there is a pressing need for pre-natal education and parental education to assist parents in having and sustaining healthy babies during and after their pregnancies. It's also why I support universal federally funded pre-K education.

Halving Class Sizes in Low-Income Schools

There appears to be good evidence that dramatically reducing class size can materially improve educational outcomes.[42] Consider, then, establishish a federal version of Teach for America, which would add a federally paid teacher's aide to assist each teacher in each low-income school in the country. These aides would be available only to schools that did not cut back on their own number of teachers and teaching aides per student and that used their classroom space to the extent possible to reduce class sizes in half.

Getting Parents Involved

Children have two sets of educators – their teachers and their parents. It's beyond time for parents to step up and make a serious commitment to their children's educations. To help make this happen, I'd make the abovementioned online courses available to parents so they could learn precisely what their children are learning. In this regard, I'd ask Congress to subsidize Saturday-morning parent education classes, which would teach mothers and fathers the skills needed to reinforce their children's educations when they are with their children at home. Some of these classes need to be centered around social, i.e., non-cognitive skills, so that parents can better teach their children the behaviors that will make them successful in the workplace.

Other Initiatives

[42] http://www.brookings.edu/research/papers/2011/05/11-class-size-whitehurst-chingos

What else can the federal government do to improve primary and secondary education? Plenty. It can subsidize smaller class sizes. And it can expand its assistance to teachers in enhancing their own subject-matter educations by obtaining masters or doctoral degrees or otherwise furthering their subject-matter knowledge and teaching skills. I think No Teacher Left Behind should be an integral part of our country's educational agenda. Finally, teaching cannot be an occupation that pays less than plumbing, nor can it be done by just anyone regardless of their established knowledge. We need to pay our teachers better and, in exchange, expect a higher level of competence and achievement.

Letting Students Borrow for Higher Education at the Federal Borrowing Rate

These days far too many students are going broke going to college. Outstanding student debt exceeds $1 trillion.[43] Saddling an entire generation with excessive debt will leave them unable to buy homes and cars and start families, especially given their relatively low wages and high rates of unemployment. It will also push them to default. Over 7 million young men and women are currently in default on their student loans.[44]

Were I President, I would ask Congress to permit students to borrow for college tuition, as well as for room, board and

---

43 http://www.brookings.edu/~/media/projects/bpea/fall-2015_embargoed/conferencedraft_looneyyannelis_studentloandefaults.pdf

44 http://ticas.org/sites/default/files/pub_files/cdr_2015_nr.pdf

books, at the 30-year Treasury bond rate, which currently stands at 2.6 percent. This is far lower than prevailing student loan rates, which range from 4 to 8 percent. I would impose a 1 percentage-point higher rate for those not completing their degrees. If the government is going to co-invest with students on their education, students have to fulfill their end of the bargain.

I would also permit those with outstanding student loans to refinance them at the same rate. These loans would be 30-year loans. Repayment would be limited to 10 percent of one's salary. Loan repayments would be deferred during spells of unemployment, periods of disability, periods of military service and periods of service with the Peace Corps, AmeriCorps and other federal service agencies. The balance of loans not repaid after 30 years, regardless of the length of deferment, would be forgiven.

This policy invests in our children's education. It's something we should do even were the payoff low. But the payoff will be high given current data on the college-high school wage premium and the significant difference in unemployment rates between those who complete high school and those who complete four years of college.

Basic Research and Development

President-Elect Trump, government support of basic research and development within government research centers or via government peer-vetted grants should be particularly high on your agenda. This R&D has brought us the internet, GPS, the human genome project, heart monitors, solar panels, optical digital recording technology, fluorescent lights, communications and observation satellites, advanced batteries now used in electric cars, modern water-purification techniques, supercomputers, more resilient passenger jets, better cancer therapies, and the list, which includes some key technology used by Google, goes on.[45]

What a spectacular record. Yet we've let federal R&D fall from 10 percent of GDP in the 1960s to less than 1 percent today. [46] Funding of NASA, the National Science Foundation, the National Institutes of Health, the Department of Energy and the Department of Defense have all been reduced and continue to be reduced relative to the size of the economy. In the field of particle physics, our country seems to have simply left the field when it comes to constructing large-scale particle accelerators. The big breakthroughs these days are occurring at CERN in Switzerland – the European Union's Organization for Nuclear Research.

Our government should ramp this research back up in all areas, including finding cures for both physical and mental illnesses. I think this is one of just two kinds of spending that can potentially pay for itself. The other is infrastructure investment.

Infrastructure Investment

---

45 https://www.americanprogress.org/issues/economy/report/2012/12/10/47481/the-high-return-on-investment-for-publicly-funded-research

46 http://www.aaas.org/page/historical-trends-federal-rd and data from www.bea.gov

The American Society of Civil Engineers grades our country's infrastructure every four years. The year 2013 is the most recent year it awarded a grade. The grade was D+. The Society also estimated that raising our infrastructure grade from D+ to A would cost $3.6 trillion. Infrastructure here refers to everything from our electrical grid to our airports, to our waste and drinking water systems.

The Society of Civil Engineers, like all guilds, past and present, is self-interested. More infrastructure work means more employment for its members. So we have to take its assessment with a grain of salt. Yet the Society backed up its D+ with significant detail. For example, it determined that precisely 85,033 bridges are "functionally obsolete." This is polite language for saying the bridges are unsafe. It's actually a worse rating than the "structurally deficient" rating given to the I-35W bridge in Minneapolis before it spectacularly collapsed on August 1, 2007, killing 13 people and injuring 145. Another example is the 14,000 dams the Society rates a "high hazard," meaning they can fail at any time and will kill people when they do.

The Flint lead-water poisoning of up to 6,000 children that occurred from 2014 through 2016 and Amtrak's 2015 train derailment near Philadelphia, which killed eight and injured 200, are more evidence of what the Society of Civil Engineers is warning about. It's not just the failure to replace failing infrastructure. It's also the failure to properly inspect, maintain, oversee and update the infrastructure that still has useful service lives.

We also aren't creating much in the way of new infrastructure. Take subways. We have 10 or so major cities, including Houston, Phoenix and Dallas, with over 1 million inhabitants but no subways, even on the drawing boards.[47] This would be less of a problem if our population wasn't on pace, as mentioned, to increase by 100 million in 45 years. But it is. That extra 30 percent more people are going to need transportation not just within but between cities. Yet we have achingly slow movement when it comes to high-speed rail and airport infrastructure that is also being updated at, according to the engineers, so slow a pace as to merit a grade of D. Road repair and upgrading the country's electrical grid are also of critical necessity.

Inadequate infrastructure investment is not just a matter of public safety, although public safety is paramount. It also engenders major economic costs, as the Society's report makes abundantly clear. Much of this cost comes in a form that we may not immediately recognize. I'm referencing here the cost of our time, whether it be wasted sitting in traffic, traveling on slow trains or waiting to take off from overcrowded airports. Time is money, and, when we waste it due to ancient infrastructure (or outdated, mindless government bureaucracies), our living standards are lower as a result. It's high time to fix, upgrade and update our existing infrastructure and pay for it with taxes or reductions in less critical spending – not by printing or borrowing money, either on or off the books.

[47] http://www.governing.com/columns/urban-notebook/When-Will-the-US-Build-Another-Subway.html

4. Fixing Taxes

The personal income tax, the corporate income tax and the estate and gift tax all harm our economy on a daily basis by reducing our incentives to work, reducing incentives to invest in our country and distorting decisions about how to invest and what to produce. Each is riddled with loopholes, which let the rich, particularly the super rich, off the hook. And each comes with major compliance costs.

In 1913, when first instituted, the personal income tax ran 400 pages.[48] Today the code is almost 75,000 pages long! All those pages are there for three reasons: to provide loopholes for special interest groups who have bribed our politicians with explicit and implicit campaign contributions, to keep tax lawyers, accountants and government bureaucrats fully employed, and to drive us crazy.

The personal income tax is horribly complex because it's actually multiple tax systems disguised as one. Yes, it includes basic income taxation with eight progressive tax brackets.[49] But there's also the Alternative Minimum Tax, the Earned Income Tax Credit, the Child Tax Credit, the taxation of Social

48 http://finance.townhall.com/columnists/politicalcalculations/2014/04/13/2014-how-many-pages-in-the-us-tax-code-n1823832

49 Including the zero bracket.

Security benefits, the Medicare high-income premium tax[50], PEP (the phase out of personal exemptions), PEASE (the phase-out of itemized deductions), the separate taxation of capital gains, the separate taxation of dividends, the high-income Medicare asset-income surcharge tax, the high-income Medicare labor-income surcharge tax, the taxation of retirement account contributions and withdrawals, the treatment of health savings accounts, the tax treatment of 529 educational saving plans, carried-interest taxation, and, well, I'll stop now to preserve your digestion.

The corporate income tax, meanwhile, collects less than 2 percent of GDP but is very successful in getting companies to headquarter offshore. Examples include Burger King, which is now Canadian, Medtronic, which is now Irish, and Tyco International, which is now Bermudian. These corporate inversions garner most of the press, but the far bigger story is that large international corporations, whether headquartered in the U.S. or abroad, face a 35 percent effective marginal corporate tax on the return to their U.S. investments. If they invest in any other developed country in the world, they face, on average, a 19 percent corporate tax.[51] As should be obvious, our 84 percent higher corporate tax rate makes our country uncompetitive. And much of the fallout lands on America's workers, who find far less demand for their services.

---

[50] This extra premium is determined based on federal personal income tax's determination of modified adjusted gross income, even though it is collected by the Social Security Administration.

[51] http://www.policyschool.ucalgary.ca/sites/default/files/research/tax-competitiveness-chen-mintz.pdf

The estate and gift tax is also a very bad joke. The top marginal rate is 40 percent, but only 1 percent of the $1 trillion or so bequeathed each year by the super rich is actually paid in taxes.[52] This comes thanks to a range of trust and life-insurance gimmicks that the rich use on a routine basis.[53] One tax expert, George Cooper, wrote a book about the estate tax that he appropriately titled "The Voluntary Tax."[54]

Tax Reform

I've examined a host of tax reform proposals over the years, such as the FairTax, the Flat Tax, the USA Tax, the Value Added Tax (VAT), the Rubio-Lee Tax Plan, the Sanders Tax Plan, the Trump Tax Plan, the Clinton Tax Plan, the Modern Corporate Tax, the Competitive Tax Plan, the X-Tax, the Growth and Investment Tax Plan and several others. I've done and continue to do research on the economic effects, work incentives and fairness of different tax reforms. Indeed, together with several co-authors, I've done most of the basic research on the FairTax and testified to the House Ways & Means Committee about its merits.[55] I've also developed two tax reform plans of my own: The Purple Tax and the Common Sense Tax.

---

[52] http://www.bloomberg.com/news/articles/2013-09-12/how-wal-mart-s-waltons-maintain-their-billionaire-fortune-taxes

[53] https://www.estateplanning.com/Understanding-Estate-Taxes

[54] http://www.amazon.com/Voluntary-Tax-Perspectives-Sophisticated-Regulation/dp/081571551X

[55] The FairTax replaces all federal taxes with a federal retail sales tax.

Almost all of these proposed reforms have great merit compared with what we now have. But none strikes me as achieving the right balance among our significant revenue needs, the requirement to maintain tax fairness/progressivity and the provision of far better work incentives. Consequently, I’ve combined what I think are the best elements of many of the above-listed plans in my own tax plan, which I’ve formulated in consultation with a number of public finance experts.

When it comes to targeting revenue, the goal is to generate about 5 percent more revenue as a share of GDP. This is essential to help close the fiscal gap. The plans provided here for fixing Social Security and healthcare will, over time, produce significant spending cuts without undermining retirement income or healthcare coverage. These reforms will, in conjunction with the higher revenue, suffice to fully eliminate the fiscal gap.

To repeat, the tax reform proposed here eliminates the personal income tax, the corporate income tax and the estate and gift tax *entirely*. (I would include transition rules to make sure unpaid taxes are collected.) In their stead, I would introduce four new taxes, significantly modify the existing FICA payroll tax, replace the Earned Income and Child Tax Credits with a direct payment to all Americans and eliminate the Food Stamp program in favor of direct food provision.

The latter two policies in conjunction with the Purple Healthcare Reform are meant to help eliminate the poverty trap that confronts the poor with a terrible choice: *Stay unemployed or go to work for little or no net income after we’ve made you pay more taxes and taken away some or all of your tax credits,* *food stamps and healthcare benefits.*

Under the complete set of fiscal reforms, every American, with no exception, gets to keep 70 cents of every dollar he or she earns. That may seem low. But for most Americans, it's actually higher or far higher, especially in the case of far too many poor households, than what they now get to keep.

Another significant benefit of the tax plan is that the vast majority of Americans – roughly 80 percent – won't need to file any tax returns or deal with any government bureaucrats in meeting their tax obligations, receiving basic health insurance and receiving income in old age.

Criteria for Tax Reform

Fixing our tax-transfer system is imperative. But the fixes must obey three constraints: they can't worsen inequality, they must dramatically improve work incentives and, in conjunction with other fiscal reforms, they must raise enough revenue to ensure Uncle Sam can pay all his bills over time, leaving no fiscal gap for our descendants to cover.

The Business Cash Flow Tax or VAT

The business cash flow tax rate would be 20 percent. It will collect far more revenue than the corporate income tax it replaces. The tax will be very easy for any business to calculate. A company simply has to pay 20 percent of its annual total cash receipts,[56] less its total purchases of goods

[56] More precisely, these receipts would be from sales to domestic customers. Exports would be

and services, including investments.

Rather than taxing profits from new investment at 35 percent, the business cash flow tax effectively taxes profits at zero percent. The reason is that while the additional sales revenue generated from investing will be taxed at 20 percent, the initial investment is deductible at the same 20 percent rate. The present value of the initial deduction exactly offsets the present value of the future taxes, leaving the effective tax on the investment at zero. This well-known means of making America the most tax-advantageous place to invest in the developed world (called immediate expensing), is part of most of the above-referenced tax reforms.

Republicans have long been opposed to the business cash flow tax because they didn't want to add yet another tax system on top of those we now have. That's clearly not part of this tax plan, which eliminates three federal taxes that are, when examined closely, a true disgrace to all Americans – whether Democrat, Republican or, like me, aligned with neither party.

Interestingly, Republican opposition to the VAT appears to have lessened considerably after Senator Cruz included the VAT as part of his tax reform proposal. Just to be clear, the fact that Senator Cruz is calling for a VAT, which is used throughout the developed world, and that I'm calling for a VAT, albeit at a higher rate, does not make me a fan of the senator, let alone of his other policy positions. It does make me someone who can listen and learn from a Senator Cruz or a Senator Sanders with open ears.

---

excluded based on the World Trade Organization's decision to permit destination-based VATs, i.e., not to declare the exclusion of exports from the VAT tax base as an illegal trade subsidy.

Subjecting All Wages and Self-Employment Income to the FICA Tax

Removing the ceiling on payroll taxes makes high earners do what everyone else does, namely pay payroll taxes on all their earnings. This increase in progressivity will not, however, be offset by higher Social Security benefits. As described in chapter 9, I'm proposing a modern, personalized version of Social Security, whose benefits are independent of future Social Security payroll tax contributions.

Future Social Security payroll tax contributions will be used, over time, to pay off the Social Security benefits we now owe. But, under the Purple Social Security plan, no one will accrue additional benefits under the old system. Instead, they will get everything they are due under the old system as they proceed through retirement. But they will also receive benefits under the new system, which I call the Personal Security System. This is one of the purple bipartisan plans I've worked out in recent years. Purple is, of course, the combination of red and blue.

Chapter 6 has the details, but let me hasten to say that the Purple Social Security plan, while it features personal accounts, government matching contributions, contribution sharing (between spouses) and collective investment in the market, involves no involvement whatsoever by Wall Street and, therefore, provides no income whatsoever to Wall Street. Everything is done by a computer, and the government guarantees that the value of our Personal Security Accounts (PSAs) never falls below the sum of our contributions, adjusted for inflation.

Some further points about the Social Security payroll tax. Going forward, everyone, including those in state and local government jobs who have been exempt from Social Security taxation, will have to pay the Social Security FICA tax. On the other hand, I would ask Congress to limit the Windfall Elimination and Government Pension Offset provisions to reflect only the pre-reform years of uncovered employment. Second, all income from LLC and subchapter S companies will be subject to FICA taxation. Third, the current market value of all compensation in the form of stock and employee fringe benefits will be subject to FICA taxation. Finally, when exercised, the value of stock and stock options realized in excess of their market value at issuance will be subject to FICA taxation.

The Progressive Personal Consumption Tax

The progressive personal consumption tax would exempt the first $100,000 in consumption. Consequently, the great majority of households, roughly 80 percent, won't need to worry about this tax. It would also exempt consumption paid out of labor earnings. Its rate would start at 5 percent and rise to 30 percent. All consumption, including the imputed consumption services, called imputed rent, derived from ownership of personal wealth (e.g., homes, yachts, planes, jewelry and art, whether those durables are located in the U.S. or abroad) above $5 million, would be included in the tax base.

This tax would also be very easy to calculate. Households subject to the tax would simply add up all their inflow of funds (receipts), including borrowing and imputed rent but excluding labor earnings, over the course of the year and subtract out funds they invest. The difference is their consumption apart from imputed rent, which would be added in. Investment would be defined to include investment in homes, yachts, etc., because those durables could be rented out.[57]

Investment would also be defined to include expenditures on higher education for oneself or one's children, including tuition, special fees and room and board. And it would include charitable contributions, since I want to retain incentives for the rich to continue to make their enormous contribution to our country in funding private charities, including those sponsoring the arts, which are sorely underfunded in our country.

Warren Buffett is an example of an extremely rich person whose pockets are lined with gold. But his heart appears to be filled with gold as well. The same can be said of Bill and Melinda Gates and many other super-rich Americans who care intensely about others, particularly the poor. In Buffett's case, he is contributing his wealth to the Gates Foundation, which is dedicated to eliminating global poverty and improving education at home and abroad. I'm not a religious person, but this is God's work by anyone's definition and shouldn't be penalized by the tax system.

---

[57] But if the rich live in their homes, yachts, etc., they are effectively renting them out to themselves. In this case, they will need to include the amount of imputed rent to their taxable receipts. For example, if the rich buy a yacht and lease it, but use it part of the year, whether or not they call it personal or business use, they will need to impute rent of their use of the yacht for that part of the year and pay the consumption tax on that amount.

Ensuring the Rich Meet Their Tax Obligations

The personal consumption tax as well as the inheritance tax is the only way we will get all of the rich to pay their fair share of taxes. Under the current tax system, a billionaire (and we have close to 2,000 of them) can, if he or she so chooses, spend his or her entire life paying little or no personal income taxes. Let me review the simple method. They can and routinely do simply borrow money, pledging their assets as collateral, to pay for their spending. Consequently, they don't sell their assets, which means they don't pay capital gains taxes. Instead, they leave their assets to appreciate in value, which will happen on average. When they die, they can convey these assets to their heirs with no capital gains tax levied on the increase in value (appreciation).[58] Furthermore, in conveying their estates to their heirs, they use irrevocable trusts and other means to avoid the estate and gift tax. Meanwhile, the rich are consuming whatever they want and making the rest of us pay for their public services, including the protection afforded by our military, that they enjoy.[59]

This problem goes away under the tax plan. The rich pay taxes each year on every dollar they consume in excess of $5 million. Supporters of Senator Sanders who are particularly concerned, as am I, about inequality, may think that a top rate of 30 percent on the consumption by the rich is too low. But

---

[58] This is called "step up in basis."

[59] As mentioned, our cat's name is Riley and he's got a very cushy existence – a veritable fat cat but without a weight problem.

this ignores the 20 percent business cash flow tax or VAT. The VAT is also a tax on consumption, just collected in an indirect manner.

Here's why. When all of the business tax returns are combined, the VAT ends up taxing all of national income less investment, which equals national income less savings (since savings equals investment), and income minus savings is consumption. The VAT excludes imputed rent on homes and other durables, which constitute about 25 percent of total U.S. consumption. Hence, and I apologize for all the wonky numbers, a 20 percent VAT is effectively a 15 percent consumption tax. Consequently, the richest people in our country will pay 30 percent plus 15 percent on their spending, apart from charitable contributions and expenditures on higher education, for a combined 45 percent tax rate.[60]

What if the rich continue to borrow to consume? No problem. That borrowing is taxable, as are all inflows of cash that are not invested. What if the rich invest all their money, live on the streets and don't spend a penny? That's a great thing for the economy and for workers in particular. It means we all get to work with their assets. But won't that worsen the concentration of wealth and its associated political? This is where the inheritance tax comes in.

---

[60] One critically important point: Given that exports aren't included in revenues and imports are subject to the value added tax, a destination-based VAT, which is what I'm proposing, taxes consumption done within the U.S. It does not tax the consumption of the rich to the extent they consume abroad. The proposed plan would rectify this by having the rich pay a 20 percent surtax on consumption done abroad apart from imputed rent implicitly received abroad, which is already taxed under the progressive consumption tax.

Taxing Inheritance

As we all know, the rich, particularly the super rich, are incredibly adept at transferring their wealth to their offspring without paying any or much in taxes. But the proposed inheritance tax will tax all cumulative net inheritances received in excess of $5 million at a 20 percent rate.[61] This threshold will be adjusted for inflation. Cumulative inheritances will be calculated as the sum of all past inheritances and gifts (valued in today's dollars) received in excess of a $20,000 annual exempt amount, which would be indexed to inflation.[62] Before the annual net excess inheritances are added together to see if the individual has exceeded his or her lifetime exemption, each year's excess (of the $20,000) inheritance will be measured in current year dollars to keep the inheritance tax neutral to inflation.[63]

In addition, to the extent the children of the rich don't invest their inheritances, i.e., to the extent they spend them on their often-lavish lifestyles, they will pay progressive consumption taxes on those inheritances.

Taxing inheritance is far more sensible than taxing bequests. A billionaire who dies and leaves her fortune to every

[61] The inheritance tax base would include distributions of both principal and income from trust accounts as well as borrowing from those accounts or any intergenerational loans and use of homes owned by trusts.

[62] This threshold would be $50,000 in the case of disabled children.

[63] There is a no bias under this proposed inheritance tax to transfer resources later in life to defer the inheritance tax. The reason is that the tax reform entails no capital income taxation whatsoever.

American in the country in equal measure is mitigating inequality. But a billionaire who leaves all her wealth to a single person who is already very rich is exacerbating inequality. The progressive nature of the proposed inheritance tax (zero taxation on the first $5 million of inheritances and 20 percent taxation thereafter) provides strong incentives to share the wealth.

Taxing Carbon

The evidence for global warming and climate change is overwhelming. Here are some of the distressing facts provided by NASA, the National Academy of Sciences, the Royal Academy and the scientific journal *Nature*.

Carbon dioxide in the air is at its highest level in 650,000 years. Humans have raised CO_2 levels by 40 percent since the industrial revolution, with more than half of this increase occurring in the last four decades. Since 1900, the planet's average temperature has risen by 1.4° Fahrenheit. Nine of the 10 warmest years on record have occurred since 2000. In 2012, the Arctic summer sea ice shrank to its lowest level on record. Greenland is experiencing accelerating ice loss. The melting of the West Antarctica ice sheet in conjunction with other ice melting could raise the sea level by six feet by the end of this century.[64] This would largely put New York, Boston, Miami,

---

[64] See http://climate.nasa.gov/; https://royalsociety.org/~/media/Royal_Society_Content/policy/projects/climate-evidence-causes/climate-change-evidence-causes.pdf; http://www.nature.com/articles/nature17145.epdf?referrer_access_token=pav7d40qwLb30zhD0WS9wNRgN0jAjWel9jnR3ZoTv0M-pvJMg7VLINRa2mnTNsvXfjbAFNU4M9sSVFBNmnefzi_Tg5VLId6wPZa0y-lyfG-vEm6wcKjYMZNyVQpVGpxNuBQy2dtzpSq0NcRjB0jdNugzK

New Orleans and other major U.S. cities under water.

In the 2015 Paris Accord, 195 nations affirmed that the time for debate on climate change is over and that immediate action is needed. Those who claim that this is manufactured hysteria by politically correct scientists need to ask themselves the following questions.

"What if I am wrong? What if the climate is indeed changing? What if we actually do have only a very short window to reverse global warming before the planet passes a grave tipping point?" The melting of the West Antarctica ice sheet is an example of such a tipping point. Once the ice sheet melts, there is no refreezing it.

These "What If?" questions do not allow a response of "Sorry, I was wrong." We cannot simply sit back and leave ourselves, but primarily our children, at severe risk. We cannot play dice with their physical lives anymore than we can play dice with their economic lives.

Our country is second only to China in CO_2 emissions. Historically, we have done the most to raise the planet's temperature. It is our responsibility to do the most to lower it. Development of hydropower, wind, solar, wave, hydrogen, biofuels and geothermal clean-energy sources is imperative.[65]

A carbon tax is the straightforward means by which we can control emissions and coordinate federal and state emissions

---

U2KRX4P5kAvVABO4bobVehZVtXXvH_xPVB_Pb9hyLrFbV5Vi-6oiqRH2hl6CJ8PGCLd5PP2giy4I38IeOtvP-ln_aTqqbuaDcDEIlmN&tracking_referrer=www.nytimes.com

[65] This list intentionally excludes nuclear energy, which, given the centuries-long disasters at Chernobyl and Fukushima, is far too risky an option for our children if not for ourselves.

policies. But it's important to understand the dynamics of carbon taxation. If we set a low tax rate now and a higher one in the future, producers of dirty energy will produce more, not less, in the short run. The reason is simple. They'll seek to profit from their stocks of oil, natural gas and coal when they can make the most money, net of tax.

In this regard, the 2015 Paris Accord may actually be backfiring. The Accord asks its 195 national signatories to specify their contributions to reducing CO_2 emissions and to raise those contributions over time. But there is no legal enforcement of these pledges and no hard deadlines. The one sure thing the Accord does is to put dirty-energy producers on notice that their days are numbered. Unfortunately, this greatly incentivizes them to accelerate their extraction of fossil fuels and, thereby, increase the planet's temperature. The current extremely low price of oil is striking testimony to the "use it or lose it" calculus underlying today's oil production.[66]

The proposed carbon tax would be set at $80 per metric ton. This will raise the price of gasoline by roughly 80 cents per gallon. This is three times the initial tax rate considered by the JCT and the CBO in their 2014 study of carbon taxation.[67] I'd keep this *absolute* tax (the $80) fixed, so that the carbon tax *rate* would fall over time due to inflation as well as projected

[66] There are other major factors at play here. ISIS is threatening to overrun all of the Gulf States. This simply reinforces "use it or lose it." And the low prevailing price is producing greater production by cash-strapped countries like Venezuela and Russia to maintain state revenues.

[67] https://www.cbo.gov/sites/default/files/113th-congress-2013-2014/presentation/49830-revenue neutralcarbontax_0.pdf

fossil fuel price rises. This would give fossil fuel producers what the planet needs: a strong incentive to delay their production and sale of dirty energy to the future when the tax rate is lower and the climate will be less at risk. A low, steady burn of fossil fuels is safer for the planet than a high, rapid burn.

The JCT and CBO are staffed with many excellent economists. But both are agencies of Congress. When they analyze policies, they are strongly influenced by what they consider politically feasible as opposed to what's economically needed. They do so because their bosses – members of Congress – are politicians, and their job is to keep their bosses happy. In their 2014 study, the two agencies considered a relatively low initial tax, but one that rises over time by 2 percent in real terms (at a rate that is 2 percentage points higher than the rate of inflation). This corresponds to what the Paris Accord promises: higher, not lower, emission penalties over time.

Unfortunately, this is the exact opposite of what the economics of extractable resources, dating back to seminal work in 1931 by Harold Hotelling, recommends.[68] Hotelling's classic study, which isn't even referenced by the JCT and CBO, tells us that a rising rate of carbon taxation will accelerate emissions, that a constant rate of carbon taxation will have no

---

[68] I refer here to Hotelling's Rule developed in his seminal 1931 paper published in *The Journal of Political* Economy. See https://www.jstor.org/stable/1822328?seq=1#page_scan_tab_contents. Thanks to technological change and other factors, Hotelling's rule that fossil fuel prices would rise through time at the interest rate hasn't held up. But his basic insights can't be ignored when it comes to carbon taxation.

impact on emissions and that a declining rate of carbon taxation will slow emissions.[69]

It may be counterintuitive to tell fossil fuel producers that they will be treated badly now but far better in the future. But that's precisely what's needed to keep them from focusing on "use it or lose it."

Two final points. With the carbon tax in place, I would immediately approve the Keystone pipeline project. Also, I would seek approval by the World Trade Organization for countries to impose tariffs on imports based on the carbon content of those imports coming from countries that did not act immediately, either through a high (but falling) carbon tax or similar policies that incentivize dirty energy producers to delay their production.

President-Elect Trump, I realize you do not believe climate change is manmade. I advise you not substitute your judgement in this matter for that of the world's top scientists. If, in the years ahead, your view is proven correct, we will, with a carbon tax, have plenty of fossil fuels available to burn. The question you must address is What if you are wrong? What if the world's top scientists do have it right? Do you want to bear major responsibility for the potential irreversible and cataclysmic damage these top scientists now predict – damage that will make your grandchildren's and great grandchildren's planet potentially uninhabitable?

What I'm proposing hedges the planet's bets, but also achieves your goal of getting the government out of micro

---

[69] Rising extraction costs changes the story somewhat.

managing the energy industry. If carbon emissions are properly taxed there is no or at least far less reason for government involvement in regulating the use of fossil fuels.

Replacing Tax Credits With a $2,000 (Inflation-Indexed) Payment per Person

The Earned Income Tax Credit (EITC) and the Child Tax Credit are our most important poverty-alleviation policies. Unfortunately, both are clawed back through the tax system as workers earn more money. In the case of the EITC's claw back, earning an extra dollar can cost more than 20 cents in lost EITC benefits. This is part of the aforementioned poverty trap.

Let me be clear about this trap. When the poor work they stand not only to pay FICA taxes. They also stand to lose the Earned Income Tax Credit, their food stamps, their Medicaid benefits or their Obamacare subsidies. In some cases, the marginal rates of taxation, when combined, put the poor in tax brackets above 100 percent, meaning they lose money from working.

Under the tax reform everyone would face the same 30 percent tax rate on their labor earnings. Part of the means of achieving this is to eliminate the EITC and Child Tax Credit and simply provide a lump-sum payment to each American, regardless of his age or income. This "negative income tax" approach to providing basic support has been endorsed over the years by both conservative and liberal economists, including two now deceased Nobel Laureates – the University of Chicago's Milton Friedman and Yale University's James Tobin.

The other two elements needed to eliminate the poverty tax are replacing food stamps with direct food distribution and changing the healthcare system so a) everyone has basic health insurance coverage, b) the provision of basic health insurance doesn't bankrupt our country, and c) the provision of basic health insurance doesn't dramatically undermine people's work decisions, which is now the case. Let me tell you now about direct food distribution and leave healthcare reform to chapter 7.

Replacing Food Stamps With Direct Food Distribution

No one in America should go hungry. But providing food assistance in a manner that reduces work incentives by over 20 cents on the dollar earned is no answer. I propose replacing food stamps with Food Distribution Assistance. This would be provided to children living in low-income neighborhoods at their schools in the form of three free meals a day. Adults, any adult, could receive basic food for free at food distribution centers, which would also be located in low-income neighborhoods. Food would also be delivered on request to those who cannot travel to the distribution centers.

Summing Up

Under this book's combine fiscal reforms, the marginal tax rate on earning money from working is 30 percent for everyone. It consists of the 15 percent FICA tax plus the 15 percent effective tax on working associated with the VAT. (Yes, the proposed VAT tax rate is 20 percent, but the VAT covers only about 75 percent of total income since it excludes imputed rent on homes and other durables.) No one will lose any federal benefits, be they cash assistance, food assistance or health insurance, when they work.

The tax plan is designed to increase federal revenues by 5 percent of GDP, dramatically increase the incentive of companies to hire and invest in America, ensure the rich actually pay their fair share of taxes, limit the perpetuation of wealth inequality from generation to generation, provide everyone with the same incentive to work and eliminate the poverty trap, which arises under our tax and benefit system, leaving millions of low-income households with little or no incentive to work.

5. Fixing Healthcare

We are now spending 5.2 percent of GDP on Medicare, Medicare, CHIP (Child Health Insurance Program) and Obamacare. This figure is projected (by the Congressional Budget Office) to rise to 9.1 percent by mid-century and to 13.3 percent of GDP by the end of the century. To put these figures in perspective, total federal revenues are 17.5 percent of GDP and projected to reach 18.1 percent of GDP in 2025 and remain at that level through 2100. Consequently, we are on a long-run path to have 4.8 percent of GDP (18.1 percent minus 13.3 percent) available, in terms of tax revenue, for all other spending. But all that other spending is projected to cost 16.4 percent of GDP.

Our $206 trillion fiscal gap is in good measure due to the projected growth in federal healthcare spending relative to GDP. Indeed, if we could keep federal spending on healthcare at its current share of GDP, the fiscal gap would fall by three-fifths!

Hence, unless we are prepared to impose dramatically higher taxes on ourselves and our children, we need to get and keep control of federal healthcare spending. But we need to do so in a way that satisfies the following principals.

First, basic health insurance coverage should be provided to all Americans free of charge. Second, all Americans should be free to purchase supplemental coverage from their basic health insurance provider. Third, basic health insurance should be privately provided with people free to choose their doctors and hospitals among those included in their insurer's network. Fourth, federal healthcare costs must be capped and affordable on a long-term basis. Fifth, the basic health insurance system should provide incentives to prevent overuse of healthcare services. It should also incentivize healthy living. And sixth, medical malpractice reform is needed to limit the costs of defensive medicine.

The healthcare reform satisfies all these conditions. I call it the Purple Healthcare Plan, since, again, both Republicans and Democrats should find it highly appealing. The plan eliminates Medicare, Medicaid, Obamacare and tax subsidies to employer-provided healthcare. As you can see at www.thehealthcareplan.org, the plan has been vetted and endorsed by a long list of top economists, included five Nobel Laureates as well as a large number of non-economists from all walks of life.

Here are the plan's 11 basic features:

First, all Americans receive a voucher each year to purchase a uniform basic health insurance plan from the private insurer provider of their choice. The voucher pays in full for the policy, and the federal government pays the insurance provider the full amount of the voucher.

Second, the private insurer chosen is responsible, over the course of the year, for all healthcare costs that are covered under the basic plan. The one exception is the co-pay and deductible specified in the basic plan.

Third, Americans can switch insurance providers of the *basic plan annually.*

Fourth, all health insurers need to offer the uniform basic plan in exchange for the voucher as well as offer supplemental coverage at a uniform price to anyone who takes basic plan coverage (there is no denial of coverage).

Fifth, the vouchers will vary in size, but they will all purchase exactly the same basic health insurance policy with exactly the same set of coverages. Those with higher expected healthcare costs will receive larger vouchers. The purpose of making the vouchers individual-specific is not to provide difference health insurance to different people. The purpose is to keep insurance providers from having an incentive to subtly encourage the sick to go elsewhere. In other words, larger vouchers will directly compensate the insurer for insuring Americans with higher expected medical costs and make insurers just as eager to enroll the sick as the healthy.

Sixth, the size of each person's voucher will be determined based on electronic medical records that document the person's objective health indicators. The voucher will incorporate a reasonable profit margin for health insurers.

Seventh, each year a panel of doctors will set the coverages of the uniform basic plan such that the sum total of the vouchers equals, but never exceeds, 7 percent of GDP. The figure 7 percent of GDP reflects the 2015 ratio to GDP of the costs of Medicare, Medicaid, CHIP, Obamacare and the tax subsidy to employer-based healthcare.[70]

[70] http://kff.org/private-insurance/issue-brief/tax-subsidies-for-private-health-insurance/; https://www.cbo.gov/sites/default/files/113th-congress-2013-2014/reports/49763-VA_Healthcare_Costs.pdf; https://www.cbo.gov/about/products/budget_economic_data#1

Eight, insurance companies will contract with doctors and hospitals to provide the basic plan to all their clients.

Ninth, each year every American will receive a new voucher and be free to choose the doctors and hospitals included in their chosen insurance company's network.

Tenth, health providers can offer participants incentives to improve their health.

Eleventh, Congress will pass legislation limiting malpractice claims in order to mitigate the practice of defensive medicine.

Here's the beauty of this plan. It turns basic health insurance into a commodity, like wheat. Since all insurers will compete to provide the same basic insurance plan, there will be intense competition to provide the best quality of care and in order to re-sign the participant at the end of the year. This will squeeze out the excessive costs being paid insurance companies for running their businesses. It will also limit what top insurance company managers can afford to pay themselves.

Even more important, the plan provides basic health insurance to everyone in the country without driving the country broke. In so doing, it makes, as indicated, a massive contribution – 60 percent – to reducing the fiscal gap.

Is the 7 percent of GDP cap realistic given that the population is aging and that medical costs rise with age? I have four responses. First, roughly 16 percent of today's U.S. population is now 65 and older. By mid-century, that figure will be 22 percent. Hence, the U.S. will be older, but not that much older.

Second, the intense competition of insurance providers to supply the basis plan should drive quality up and prices down. If the government says that services of type X needs to be used for situation Y, insurers will seek the least expensive means to provide these services without sacrificing quality. Sacrificing quality will limit the number of repeat customers and, thus, their profits.

Third, our economy should begin to grow at a robust rate thanks to the combinations of reforms I've outlined. Seven percent of a larger economy means more healthcare can be provided in absolute terms. Stated differently, I expect the economy to grow more rapidly than healthcare costs.

Fourth, if the public feels we should spend more on the basic plan, I would propose raising the 7 percent figure, provided we simultaneously raise taxes or reduce other spending to keep the fiscal gap at zero and that any changes to taxes and spending are not differentially targeted at the young and middle-aged.

Finally, the plan is progressive. Although everyone gets the same basic health insurance plan, the value of this plan is much greater to those with pre-existing conditions. Since the poor are less healthy on average than the rich, the poor will receive, on average, larger vouchers than the rich. For many of the poor, the size of their vouchers will be dramatically higher.

This may sound like single-payer healthcare. It isn't. It's a single-insurer healthcare system with a totally private provision of healthcare services. Yes, the federal government uses tax dollars to pay for everyone's basic health insurance policy, but unlike, say, the British National Health Service, the government does not own the hospitals, hire the doctors, buy the drugs, etc.

In short, the Purple Health Insurance Plan is a much more efficient and affordable version of our current healthcare system in which the federal government pays, either directly or indirectly, for one of every two dollars of healthcare expenditures.

One final benefit from the Purple Health Plan: it will provide our veterans the same choice of healthcare insurers and their associated healthcare providers as everyone else in the country.

6. Fixing Social Security

Social Security is the financial backbone of most Americans' retirements. For 20 percent of retirees, it's their sole means of support. For 50 percent, it's their major source of income. And for 70 percent, it's either their sole, major or second-most important income source. It's no wonder that the system has so much political support. The elderly are a major voting block and are rightfully concerned that no one touch their Social Security.

Unfortunately, the system is in grave financial trouble that can no longer be ignored. It also puts large numbers of workers in their early 60s into a 50 percent perceived higher tax bracket, giving them every incentive to stop working when the exact opposite is what they really need to do.[71] As if these two concerns weren't bad enough, the system is unfathomably complex, thanks to 2,728 basic rules in its handbook and hundreds of thousands of rules about these rules in its program operating manual system.

This complexity makes it impossible to figure out which of the system's nine benefits we can and should collect and when to do so. Only a highly sophisticated computer program can provide the right directions. But since most people aren't using software, most are taking the wrong benefits at the wrong time,

[71] http://www.nytimes.com/2015/08/15/opinion/let-older-americans-keep-working.html?_r=1

losing benefits because they weren't aware they were available or both. You can have an IQ of 200, the best education money can buy and still lose tens to hundreds of thousands of dollars in lifetime Social Security benefits because you didn't know some critical Social Security gotcha that its maniacal architects concocted.

As I mentioned, my small company makes personal financial planning software, including a program to help people figure out their best Social Security collection strategy. In order to help our engineers program our software, I had to become very well versed in the system's provisions. This took years of questioning current and former Social Security technical experts.

It was a daunting task as Social Security has its own internal language (e.g., the word "entitled" has an entirely different meaning from the word "eligible") and its rules have endless exceptions to the exceptions. To help keep things straight in my brain I decided, one day, to write down the mathematic formula determining benefits for a spouse at a given age.

Social Security's Benefit Maze

It took most of a week to get it entirely straight. When I finally got the formula right, and stared at it for a while, I realized that it was one of the most complex mathematical expressions I'd ever encountered. The formula, if you will forgive a few lines of geek talk, encompasses 10 mathematical functions, some of which are continuous (smooth), some discontinuous, some discrete (taking on only two values) and some maximum functions (select the larger of two or more numbers) and other minimum functions (select the smaller of two or more numbers). Indeed, one function is a maximum function defined over a minimum function.

In contemplating this monster formula, I also realized that I was looking at the solution to a horribly cruel puzzle that bureaucrats had designed as some kind of intellectual sporting event with complete disregard as to how it would affect ordinary people trying to collect what they'd paid year in and year out in FICA taxes. I also realized that the puzzle provided a tremendous and durable ego boast to its creators. They had produced a special Rubik's Cube that only they and a few others could fully solve. Consequently, the vast number of Social Security's 40,000 staff would have to rely on them for "technical assistance" – to the extent they were available to help. Otherwise, the staff would do its best on its own, and if the public lost a boatload of benefits as a result, so be it.

I've had many a lesson about how Social Security's staff treats the public. To be brief, it's a horror show. While the vast majority of its employees are well meaning, they aren't sufficiently well trained to provide correct answers more than half the time. However, because they are understaffed and constantly harassed, they adopt an attitude of complete certainty in providing answers even when they know enough to know their answer could be completely wrong.

The result of all the complexity and, frankly, bureaucratic incompetence is that Social Security benefits are largely a lottery. Countless numbers of people have lost huge sums of money because either a) they didn't know they were eligible for certain benefits, b) they took their benefits early when they should have waited to collect far higher benefits, c) they didn't understand that their Social Security decisions could affect their spouse's benefits and vice versa, d) they got divorced too early, e) they got married when they shouldn't have and, yes, the list goes on.

Social Security Is Broke Today, Not Down the Road!

Even were the system in decent financial shape, the case for fixing it from the ground up would be overwhelming. But the system is in horrific financial shape. Its fiscal gap – the present value of its projected future benefit commitments net of both its projected future taxes and the value of its trust fund – is $26 trillion.[72] This is clearly not the main source of the government's overall $206 trillion fiscal gap, but it's an important component.

Unfortunately, since the rest of the government's fiscal affairs are in worse shape, Social Security can't look for help from other parts of the overall federal budget. The entire fiscal system is 53 percent underfunded. The $26 trillion of Social Security red ink is 31 percent of the present value of the system's projected taxes. Hence, Social Security is 31 percent underfunded.

Saying that Social Security is 31 percent underfinanced is another why of saying that Social Security's 12.4 percent FICA payroll tax rate needs to rise, immediately and permanently, by almost one third to permit the system to pay all its promised benefits over time. That translates into 3.8 cents more in FICA taxes on every dollar earned up to Social Security's taxable

[72] https://www.ssa.gov/oact/tr/2015/VI_F_infinite.html#1000194

earnings ceiling, now $118,500.

Social Security's Zero-Sum Generational Game

Telling the vast majority of American workers they need to fork over another 4 percent of their pay for the rest of their working lives and receive absolutely nothing in return is not something our politicians have been eager to do.

The only candidate to make much of an issue of Social Security's finances this campaign season was Governor Christie. Unfortunately, even he never conveyed that Social Security is 31 percent underfinanced. Had he done so, the public might have drawn a comparison with Detroit's pension system, which was roughly 20 percent underfunded when it helped force the city to declare bankruptcy.

Senator Sanders has been the most vocal of all the candidates when it comes to Social Security. His campaign website describes it as "the most successful government program in our nation's history." The Senator correctly points out that many of those living solely on Social Security are living in dire poverty because their benefits are so low. He proposes expanding benefits by $65 per month. On an annual basis, this is, $780. That, by the way, is less than the $2,000 annual payment per person I'm proposing.

What the Senator isn't worried about is the system's existing finances. Perhaps he hasn't examined Table VIF1 in the 2015 Social Security Trustees Report. This table reports the system's $26 trillion unfunded liability. But the table is relegated to the far end of the report's appendix – so that no one will see it. No surprise there. The decision to hide this table was made by the system's "trustees," all of whom are political appointees.

Like our overall fiscal gap, resolving Social Security's gap is a zero-sum game, generationally speaking. If we don't raise Social Security's employer plus employee payroll tax by 31 percent starting today, we'll need to raise it by an even larger percentage when someone finally takes the problem seriously. This, of course, means our children and grandchildren will face an even higher payroll tax rate than 16.2 percent (12.4 percent plus 3.8 percent). It also means that many of us will retire before the payroll tax rate is raised and, thereby, avoid the problem entirely.

On his website, Senator Sanders says that anyone, particularly Republicans, who claim Social Security is broke are "dead wrong."[73] The senator supports his view that the system is solvent by pointing to its $2.8 trillion trust fund and noting that the system can pay benefits in full for the next 19 years, and three quarters of scheduled benefits thereafter.

With all due respect to Senator Sanders, he's miles off base about Social Security's finances. The system's $26 trillion shortfall, calculated by the system's own actuaries, properly assumes that the $2.8 trillion trust fund is an asset of the system. In other words, even taking into account the $2.8 trillion worth of assets held by Social Security and also taking into account all the future taxes it will collect, the system is still $26 trillion in the red. That's because the projected future benefits, valued as of today, exceed the present value of projected future taxes (plus the trust fund) by $26 trillion.

[73] https://berniesanders.com/issues/strengthen-and-expand-social-security

Furthermore, telling us that the system is OK for the next 19 years and then would be short one quarter of what's need to meet its obligations is hardly reassuring to today's and tomorrow's Social Security beneficiaries. They are all counting on receiving 100 percent of their benefits for the rest of their lives, not 100 percent for 19 years and 75 percent thereafter.

Were Senator Sanders writing in this space, he'd no doubt say that the $26 trillion shortfall takes into account all future benefits (and taxes) and not just the system's finances over Social Security's traditional 75-year forecasting horizon. He'd also say that the 75-year fiscal gap is far smaller. All true. But today's newborns will be 75 in 75 years and expecting to collect benefits for the rest of their lives – benefits they paid for. Hence, there is no economic logic to truncating the financial analysis. Again, take it from the Nobel Laureates and other economists who endorsed infinite horizon fiscal gap analysis at www.theinformact.org as the only valid way to assess fiscal sustainability, be it for a country as a whole or a given fiscal system.[74]

The Purple Social Security Plan

It's time to fix Social Security from the ground up without sacrificing its key objectives. If we are going to ask younger generations to pay most, if not all, of the current system's unfunded liability, let's give them a modern Social Security system that is simple, transparent, fair, efficient and

[74] Forming the present value of revenues and expenditures projected out to infinity may seem impossible, but there is a very easy way to do so using high school algebra.

fully-funded. In conjunction with the tax and healthcare reforms, the Purple Social Security Plan eliminates our fiscal gap.

The plan deals with the retirement portion of Social Security. Here are its 11 provisions:

1. Grandfather in current Social Security beneficiaries. That is, pay them the Social Security benefits they've already earned over time. Finance these payments from Social Security FICA tax proceeds, which will be expanded under the tax plan. Over time, these revenues will be added to general revenues as the accrued liabilities of the existing system decline relative to the size of the economy.

2. Freeze the current Social Security system by filling zeros in workers' earnings records for years after the reform begins. This means just consider the earnings records of workers during the year before the reform.

3. Require all workers under 60 to contribute 10 percent of their wages to Personal Security Accounts (PSAs). This 10 percent compulsory personal saving contribution is in addition to the 12.4 percent FICA tax.

4. Allocate each worker's contribution 50-50 to his/her own PSA and to his/her spouse/legal partner's PSA.

5. Government contributes to the PSAs of low-income workers, the unemployed and the disabled.

6. All PSA balances are invested in a global market-weighted index fund of stocks, government

bonds, corporate bonds and real estate trusts.

7. From ages 61 to 70, all PSA balances for each cohort (defined by year of birth) are gradually sold to purchase TIPS (Treasury Inflation Protected Securities).[75]

8. All investing, sales, purchase of TIPs and provision of benefits is done by a single government computer at zero cost. Wall Street plays no role and collects no fees.

9. The government guarantees that PSA balances when they are sold and converted to TIPS equal at least what was contributed adjusted for inflation. I.e., the government guarantees PSA participants against real losses.

10. PSA participants who die prior to age 70 bequeath unconverted balances to their heirs.

11. Starting at 62, each cohort-specific pool of TIPs is used to make payments to surviving PSA participants in proportion to their share of PSA assets used to purchase that pool of TIPS.

Summary

Personal Security Accounts features progressive government

[75] The Treasury would issue TIPS of annual durations up to 50 years. The portfolio of TIPS purchased with each sale of a cohort's PSA balances would be laddered to pay out a constant real stream of income per expected surviving cohort member.

contribution-matching, contribution sharing among spouses/legal partners, uniform investment returns, a government guarantee of a zero real return minimum and collective cohort-specific annuitization represent a modern Social Security system. It is, I believe, what we would choose to establish if we could start Social Security from scratch today. But we can't start Social Security from scratch. We can simply freeze the existing system, pay off all benefits owed as they come due and run the PSA system in parallel.

How will this reform help reduce the country's fiscal gap? First, payroll tax revenues will continue over time even though the old Social Security system is being phased out. Indeed, since I eliminate the payroll tax ceiling as part of the tax reform, payroll tax revenues will be substantially higher. Second, no one will accrue additional benefits under the old system. Hence, the government will only need to pay Social Security's accrued benefit liabilities, not its projected benefit liabilities. Its accrued liabilities are, I understand from speaking to Social Security actuaries, roughly $60 trillion less than its projected liabilities.

Some might view the 10 percent compulsory contribution to PSA accounts as a disguised tax. But the PSA accounts will be the private property of each account owner. Yes, the government will be forcing us to save 10 percent of our wages. But it won't be handing that money to others. It will be using a computer to invest our money at zero cost in a fully diversified global portfolio, plus providing a guarantee against experiencing any losses on a cumulative basis. That's an investment anyone would want. And it will pay out our money to us in the form of real annuity payments that depend on our cohort's realized mortality and the size of our own account balances at the time they are annuitized.

Furthermore, we should all be saving at least 10 percent of our pay for our retirements anyway. We Americans are very poor savers. Our decades-long experiment with tax-favored retirement accounts makes that clear. Far too many of us chose not to contribute to retirement accounts or not to contribute very much. That's, in part, why the Baby Boom generation, of which I'm a member, is so poorly prepared for retirement. Having the government force us to save is what Social Security is in large part about. The PSA system forces us to save for ourselves. What it doesn't do is force our kids to pay for our benefits.

7. Fixing Wall Street for Real

Thanks to rampant fraud, regulatory failure, corporate greed, political kickbacks, insider ratings and policy failures, our financial system collapsed in 2008, putting 8.5 million Americans out of work and wiping out trillions in retirement savings. Unfortunately, the Dodd-Frank banking legislation did nothing to address the two core problems precipitating the banking crisis: leverage and opacity. Consequently, the financial system is poised to re-detonate.

Traditional banking is unsafe at any speed. Even a very low, 10 to 1 leverage ratio (meaning the bank has borrowed $9 of every $10 it holds in assets) can lead to a bank run. The reason is simple. If the value of the bank's assets falls by just 10 percent, its liabilities will exceed its assets. If enough of the banks creditors believe the bank is broke or may be broke because others think it may be broke, they will run to retrieve their money before other creditors take all the money that's left. The run will guarantee the bank is either bailed out, bought out or forced to declare bankruptcy.

The fragility of traditional banking is dramatically worsened by opacity – the failure of banks to disclose the precise nature of their assets. If you and other creditors/lenders to a bank can't tell what the bank is doing with your money, the slightest piece of bad news about the bank's assets can spark a run. The run can instantly spread to other banks as creditors of those banks question whether they can really trust that their own banks have the money they've promised to repay them and, if not, whether other creditors will withdraw all the money that's left. Panic, whether well-founded or not, can quickly undermine our trust-me banking system. It can do so even more quickly today than in 2008 when Lehman Brothers collapsed because Dodd-Frank has reduced the likelihood that Uncle Sam will arrive in the nick of time to make creditors whole.

The specter of bank failure is a signal to non-financial companies that money will be tight and that other companies will be laying off their workers as a result. But one company's workers are another company's customers. Hence, bank runs trigger firing runs in which companies fire their workers because they think other companies are or will shortly be firing their customers. Thus the massive economic collapse of 2008 was triggered as much by collective panic as anything else. Yes, major banks were and had failed, but the Fed was stepping up to provide loans to all comers, including RV dealerships and other companies to which the Fed had never made loans. Still, if you have to make payroll and you're no longer sure your customers will have jobs, you don't take chances. You lay off your workers before you, yourself, go under. In the months immediately following Lehman Brothers' collapse, roughly a half a million workers on Main Street were tossed out on the street every month because the banking panic had led to an economic panic.

If the banks were selling hot dogs, no one would care if people fled the market for weiners because of a rumor, whether true or not, that they contained E. coli. If the market collapsed and there were no more hot dogs, we could easily live without them, for years, if necessary. But the banks aren't selling hot dogs. What they are doing is running a public good, namely the financial highway system. We wouldn't let one of the primary participants in our regular highway system, namely gas stations, collectively gamble with their businesses and periodically fail (simultaneously) leaving us unable to drive or transport goods. No. Congress would immediately pass a law making it a criminal offense for gas station owners to gamble with their businesses.

In the case of Wall Street, there is no such law. Why not? It's simple. The banks, particularly the handful of very big banks, have bribed Congress (not with cash in brown paper bags, but with campaign contributions) to let them borrow money, keep their creditors in the dark about how the money is invested, pocket the winnings and leave taxpayers to cover their losses. Heads I win, tails you lose is working for the banks. It's not working for us.

It's time to end trust-me banking. It's time to fix the financial system from scratch. *Limited Purpose Banking,* does that. It eliminates leverage by banks and all other financial intermediaries, and it forces all financial intermediaries to disclose online, in real time and in fine detail their assets and liabilities.

The plan is remarkably simple. As you can see at thepurplefinancialplan.org, Limited Purpose Banking has been formally endorsed or strongly supported by prominent economists and policymakers. The list includes five Nobel Laureates in economics; Mervyn King, former Bank of England Governor; George Shultz, a veteran of two U.S. administrations; Robert Reich, who served as secretary of Labor; and former U.S. Senator Bill Bradley, the Stephen Curry of his day.

In my 2010 book, *Jimmy Stewart Is Dead*, I discussed the 2008 financial crisis from an economist's perspective and presented my Limited Purpose Banking proposal. I chose the book's title to point out that we don't live in Bedford Falls. Nor do we have our close and trusted friend, George Bailey, running the local bank. The Christmas movie that we've all seen many times over – *It's a Wonderful Life,* depicting George (played by Jimmy Stewart) saving his bank with the words "trust me" – wasn't playing in 2008 and it's not playing today.

I sent the plan and later my book to Congressman Barney Frank (of Dodd-Frank), hoping it would influence the Dodd-Frank legislation. I had met Congressman Frank once before and wanted to meet with him before the new banking law was passed. That didn't happen. But Congressman Frank did ask me to meet with him shortly after the Dodd-Frank bill was passed.

When we met, the book was on his desk. He told me he'd read it in full and that a) it was exactly the right answer, b) Dodd-Frank was a "stop gap" measure, and c) he would work in the fall to enact my plan. I was delighted to hear this. But the Democrats lost control of the House, and Congressman Frank lost the Chairmanship of the House Financial Services Committee. Whether Congressman Frank recalls our meeting and what he said and whether he still supports my proposal is for him to say. But at our meeting he certainly did.

Limited Purpose Banking

The essence of Limited Purpose Banking (LPB) is to limit financial middlemen to their legitimate purpose, namely intermediating (connecting lenders to borrowers and savers with investors) rather than gambling. The way to arrange this is very simple. You just make all the financial intermediaries operate as 100 percent equity-financed mutual funds.

Most of us are very familiar with equity-financed mutual funds since we have our 401(k)s or other retirement accounts invested in shares (equity) of mutual funds. The mutual funds accept our contributions, give us back shares to their funds and then invest the money in the assets in which they specialized. If the assets they buy perform well, our mutual fund shares go up in value. If they perform poorly, our shares lose value. But regardless of what happens to the value of our mutual fund assets, the mutual fund itself stays in business. It never goes out of business. And, indeed, not a single equity-financed mutual fun failed in the crash of 2008.

Today there are more mutual funds, some 10,000, than there are banks. Thanks to a recent Securities and Exchange Commission ruling that largely forces money market funds to stop falsely claiming they can back your investment to the buck (i.e., you can’t lose what you invested), almost all of these 10,000 mutual funds are 100 percent equity financed and, thus, can never fail. Each of these equity-financed mutual funds can be thought of as a small bank, but one that’s failsafe.

The general idea, then, of Limited Purpose Banking is very simple. It recognizes that equity-financed mutual funds can never fail and requires that all financial intermediaries operate as holding companies (like Fidelity Investments or Vanguard) that issue only 100 percent equity financed mutual funds. This ensures that we never again have a financial run with its attendant economic fallout – never.

In contrast, breaking up the big banks into small banks or restricting commercial banks to invest in particular types of assets – the policies respectively advocated by Senator Sanders and Senator Clinton – provides no guarantee whatsoever against future financial panics. In the Great Depression, one third of the banks failed and virtually all were small. And the financial collapse of 2008 involved investment banks, mortgage companies and a huge insurance company, not commercial banks.

There are two types of mutual funds that already exist in the marketplace. Both would be used under LPB. The first is an open-end mutual fund, which invests in liquid assets and permits its shareholders to redeem (cash out) their shares whenever they want. The other type of mutual fund is a closed-end fund, which buys and holds assets.

An example of a closed-end mutual fund is one that invests in mortgages. The mutual fund might buy and hold 30-year mortgages. The shareholders of the mutual fund would collectively receive all the payouts of these mortgages over time and take a hit on those mortgages that defaulted. But the shareholders aren't locked into this investment. They are free to sell their shares to others on the secondary market.

Closed-end equity-financed mortgage mutual funds that are quite similar to what I just described have been operating in

Denmark since 1795. They are also prevalent in Germany and Sweden. They are called covered bonds. The bonds are, effectively, the shares of the mutual fund and they are covered by (or invested in) mortgages.

What happens to checking accounts under LPB? They are replaced by cash mutual funds that literally hold only cash. Their cash holdings would be held on reserve (in safe keeping) with the Federal Reserve. People could write checks on their cash reserve mutual funds. They'd also be able to withdraw their cash holdings at ATM machines. And they'd have debit cards, which they could use to make purchases. The use of the card would electronically transfer funds from the buyer's cash mutual fund to the seller's cash mutual fund. They would be no different from today's debit cards.

In the 1930s, a number of prominent economists from the University of Chicago and Yale University argued that the way to keep the banks from failing again was to make banks invest deposits placed in checking accounts in either cash or highly liquid short-term government securities. This proposal was called *Narrow Banking*. When they hear about LPB's cash mutual funds, some people incorrectly conclude that LPB is simply another name for or version of Narrow Banking. That's absolutely not the case. Yes, LPB's cash mutual funds represent a way to keep the payment system from ever failing since we'll always have secure cash holdings to pay for our purchases. But Limited Purpose Banking reforms the entire financial system, not just the payment system. Narrow Banking, for example, permitted banks to borrow to make mortgages and other loans. That's definitely not the case under LPB. Under LPB, banks become mutual fund holding companies and, if they want to connect lenders to would-be mortgagees, they just set up a closed-end equity-financed mutual fund that buys mortgages.

Another key feature of Limited Purpose Banking is the treatment of the derivatives market. Under LPB, all derivatives are provided via closed-end pari mutuel funds, which operate just like racetrack betting.[76] To get the idea, think about people betting on horses A and B. But let horse A reference IBM defaulting on its bonds over, say, the next six months and horse B reference IBM bonds not defaulting over the next six months. A closed-end mutual fund, which sells shares that pay off if IBM does default as well as shares that pay off if IBM doesn't default, is, in effect, running a credit default swaps (CDS) market. CDS is a crazy name for an insurance policy, but that's what it is – insurance against a bond's defaulting. Someone who wants to be insured against IBM defaulting on its bonds in the next six months would put their money on horse A by buying the shares of the mutual fund that pay off if default occurs.

AIG, the world's largest insurance company, went under in 2008 because it sold CDS – guarantees that certain bonds wouldn't default – and then took the premiums it earned and

---

[76] Pari mutuel betting at the racetrack was developed in 1867. It involves people betting against each other, not against the house. Thus people come to the racetrack and, for example, bet on horse A or horse B. Once the race begins, the window closes (no more bets are taken, making the fund closed end, i.e., closed to new investment with an end date for the closing), and the winners of the race share the pot, less the track's fee. There is no risk that the winner won't get paid because all the money is on the table. This is the sense in which pari mutuel betting is 100 percent equity financed. Each person (investor) placing a bet gets a stake to (shares of) the pot (the investment) that pays off if his or her horse wins. And pari mutuel betting is also a derivatives market because the bet is derived from (based on) an external event, namely which horse wins.

invested them in a risky manner. That’s very different from AIG simply playing the role of a middleman that organizes betting between those that do and don’t expect a given bond to default over a given period of time. Running such a betting system can never lead to AIG’s failure because all the money is on the table, and it’s the betters’ money, not AIG’s. How do we insure that the money’s actually there and not stolen by AIG? Easy, we require that all LPB closed-end mutual funds hold (custody) their cash and other securities with the Federal Reserve.

Next suppose betting on horse A means betting that GM’s stock, now selling for $200 a share, will rise to $300 a share within three months. Horse B means betting, simply, that it won’t. In this case, the closed-end mutual fund running this bet constitutes an options market since the payoff would depend on whether the stock was above $300 at the end of the three months. Absolutely all derivatives can be run this way, and no mutual fund offering derivatives will every need to be bailed out as did AIG.

Eliminating the Regulators

The politicians have established a vast financial regulator sector to pretend that the banks are being supervised when in reality, in the words of President Franklin D. Roosevelt, they “gamble with other people’s money.” We saw how well all those regulators performed in 2008. Dodd-Frank vastly increases the amount of regulation and number of regulatory bodies. This does nothing to prevent another financial collapse. But it does help two parties – the large banks, since only they can afford the compliance costs, and government bureaucrats.

Under Limited Purpose Banking, there aren't hundreds of federal and state financial regulatory institutions. There is only one regulator, called the Federal Financial Authority, with a very limited mandate, namely to verify and disclose in fine detail and in real time the precise holdings of each and every LPB mutual fund.

Fortunately, the vast majority of bank regulators will find themselves doing what the vast majority of tax attorneys, accountants and IRS staff will be doing – looking for jobs that make a real contribution to society. I don't mean to be mean or cavalier here about people having to change jobs. I have many friends who work in these professions and have done so honorably for years. But they too recognize that spending one's life helping people or companies avoid taxes is not socially productive. Neither is calculating tax liabilities and enforcing tax collection when taxes can be vastly simplified and paid with far less personal filing.

Breaking Up the Big Banks

Many people wants to break up the large banks. But doing so has nothing whatsoever to do with the core problems with trust-me banking – leverage and opacity. In the early 1930s, one-third of the banks failed. The vast majority of them, as measured by their holdings of assets, were small. Hence, having a large number of small banks doing the same things that a small number of big banks do is no guarantee against bank runs and financial crisis. In many ways, breaking up the big banks would make a banking run far more likely, since the government would be letting the creditors to large banks know the government will protect their interests when push comes to shove. This makes them less likely to run to retrieve their money when they hear news about, for example, banks holding liar loans, but have no idea precisely what's involved.

If one really thinks the big banks should be broken up into small banks, adopting Limited Purpose Banking is the ideal answer. It forces the big banks to reorganize themselves as mutual fund holding companies that own lots of small banks, namely 100 percent equity-financed and fully disclosed mutual funds.[77]

Transitioning to Limited Purpose Banking

Moving to Limited Purpose Banking is very simple. We simply need to prohibit all borrowing by incorporated financial institutions and mandate that all such institutions reorganize as mutual fund holding companies. Banks will also need to convert their checking accounts to cash mutual funds. There are straightforward ways to do this, and plenty of excess reserves that banks can use to fully back their cash mutual funds, dollar for dollar, with cash. As for their existing loans, banks can continue to manage those assets. But their main task will be establishing and marketing open- and closed-end equity-financed mutual funds.[78]

Summary – Implementing Limited Purpose Banking

---

[77] For the record, although I'm a proponent of equity-financed mutual fund banking, I don't work for and have never worked for the mutual fund industry.

[78] My books *Jimmy Stewart Is Dead* and *the Economic Consequences of the Vickers Commission* (available for free at kotlikoff.net) provide detailed discussions of the transition.

Here's how Limited Purpose Banking (LPB) works in closer detail.

1. LPB applies to all incorporated financial companies, be they commercial banks, investment banks, insurance companies, hedge funds, credit unions or private equity funds.
2. All financial corporations (i.e., all financial intermediaries protected by limited liability) must operate exclusively as mutual fund holding companies that market open- or close-end mutual funds.
3. Mutual funds are not allowed to borrow. Stated differently, they have zero leverage. And, since they are 100 percent equity-financed, no mutual fund can ever fail. Hence, the banking system will never again experience a run and collapse.
4. Mutual fund holding companies are required to offer cash mutual funds, which hold only cash and are used for the payment system.
5. Cash mutual funds are naturally backed to the buck. But no other mutual fund, including money market funds, will be permitted to declare they are guaranteeing investment returns.
6. A single regulator – the Federal Financial Authority (FFA) – hires private companies that work only for it. Their job is to verify, appraise, custody and disclose in precise detail and in real time the assets held by the mutual funds.

7. Mutual funds buy and sell FFA-processed and disclosed securities at auction. This ensures that issuers of securities, be they households or firms, receive the highest price for their paper (borrow at the lowest rate).
8. All derivatives are marketed via closed-end mutual funds that operate just like a pari mutuel betting at the race track, namely with all money on the table.

8. Conclusion

President-elect Trump, as you know, these are challenging economic times. The country's broke, our economic institutions are dysfunctional, the middle class is vanishing, the economy's stagnating, we are saving and investing next to nothing, we are locking the poor into poverty, we are under-educating our children, jobs, especially well-paid jobs are hard to find, we are growing ever more unequal, and we are increasingly pointing a finger at one another.

This simple, non-partisan playbook represents nothing short of a new New Deal. It strongly connects to your core values and those of Secretary Clinton. It jumpstarts the economy by making the U.S. the most tax-attractive country in which to invest. It repeals Obamacare, Medicare, Medicaid, and employer-based healthcare, but provides uniform basic healthcare to all, but with private provision, intense competition and subject to a fixed, affordable annual budget. It ends today's poverty trap with a new welfare system that doesn't penalize the poor for working. It preserves Social Security for current participants, but sets up a new, progressive, fully funded, safe system for the next generation of workers and gets employers out of the retirement saving and investing business. It leverages new technology to equalize education and reduce class size. It makes sensible changes to immigration that takes the pressure off low- and middle-skilled workers and ends our population explosion. It makes taxes fair and hyper efficient, leaving everyone the same incentive to work, elimination all taxation on new saving, but ensuring that the rich, including the superrich, pay their fair share.

Mr. Trump, you were elected, in large part, based on three words, "I'll fix it." This new New Deal will satisfy this pledge and, in the process, truly help make America great again.