ISSUE BRIEF

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A New Vision for Entitlements

by Peter Ferrara

Synopsis: Simply trying to cut promised entitlement benefits is not a promising reform strategy. The solution lies in fundamental structural reforms to create new safety net programs that would be far more effective in achieving social goals, with only a fraction of the spending of current programs. This is the key to making entitlement reforms politically feasible.

Introduction

America cannot afford all of the entitlement promises it has already made. Federal projections show that without reform, our nation's big 3 entitlement programs, Social Security, Medicare, and Medicaid, will cause federal spending to explode in the coming decades from about 20% of GDP today, where it has remained stable for over 50 years now, to close to 40%.

With state and local spending, government in America would consume well over 50% of GDP. That would fundamentally change our economy from a high growth, capitalist, free enterprise system, to a no-growth, Swedish socialist system.

This looming crisis of Big Government has led some to start considering fundamental change in our whole approach to entitlements. One recent effort in this regard is "Rethinking Social Insurance", by Stuart Butler of the Heritage Foundation and Maya MacGuineas of The New Century Foundation.[1] This paper is intended as a constructive critique of their proposal, and suggests a politically superior strategy.

We cannot hope to avert the coming explosion in entitlement spending simply by trying to cut promised entitlement benefits. The gap is too big, and our political system will not even allow consideration of such cuts. The solution lies in thinking outside the box of our current entitlement structures, and proposing fundamental structural reforms that would reformulate our old, outdated, entitlement programs from the ground up. By creating central roles for highly productive, modern, capital and labor markets to serve the social goals of our current entitlements, we can create new safety net programs that would be far more effective in serving the public and achieving those social goals, while requiring only a fraction of the government spending of the current programs. These same features would make such reforms not only politically feasible, but quite appealing.

Unfortunately, at least in this author's opinion, the approach advocated by Butler and MacGuineas is more likely to stifle entitlement reform than to promote it.

A Budget Knife for Social Security

In regard to the long term entitlement crisis, Butler and MacGuineas state, "There is no solution to this problem except to make significant reductions in the growth of promised benefits of both Social Security and Medicare."[2] But this pronouncement overlooks a range of reform alternatives. As we will see below, a personal account option for Social Security would allow such benefit cuts for the program to be avoided entirely, by shifting the benefits to the private sector, where workers would enjoy much higher benefits instead, and a much better overall deal. That is why personal accounts transform Social Security reform from a total political loser into a powerful political winner.[3] Indeed, personal accounts reduce government spending by several times as much as could ever be achieved by trying to cut Social Security retirement benefits, because personal accounts don't simply reduce the growth of such benefits, but shift vast, entire stretches of government spending from the public sector to the private sector . Medicare presents a much more difficult problem, but personal accounts offer promising, reform prospects here as well, as we will see.

Any politically acceptable reform package would have to include some combination of tax increases and benefit cuts.

Butler and MacGuineas then go on to propose specific benefit cuts, trying to solve the entire entitlement crisis through such cuts. Their top strategy is to propose means testing for Social Security and Medicare. They also propose delaying the retirement age for both programs.

Indeed, Butler and MacGuineas advocate applying such benefit cuts even to current retirees and those near retirement. They write,

> "As quickly as possible, we should phase in a means test for premiums and benefits for Medicare and Social Security….We support including current and near retirees in this change since these demographic groups have fared disproportionately well under our social insurance programs and because the more widely the benefit reductions are spread, the smaller they will have to be…."

MacGuineas, in fact, has argued for such cuts for current retirees for several years.[4]

As a reform strategy, this approach has exactly zero prospects for success. If the only alternatives are benefit cuts or tax increases, our political system is not going to accommodate addressing the problem entirely through benefit cuts. Any politically acceptable reform package would have to include some combination of tax increases and benefit cuts. This is one important reason why the false framing of the issue as benefit cuts versus tax increases is so damaging, as it inevitably leads to some major tax increase.

Moreover, advocating Social Security benefit cuts for current seniors and those near retirement does not advance the cause of entitlement reform. Rather, it counterproductively stifles such reform. Such positions scare away potential political leaders from even becoming associated with entitlement reform. They also short circuit potential grassroots support.

What is most puzzling, however, is why we would even entertain digging up a reform such as means testing when the option of personal accounts has now been developed and is superior both in terms of political prospects and ideology. Means testing, delaying the retirement age, and other benefit cut options are deeply unpopular with the general public. But polls and focus groups show strong, broad support for a personal account option for Social Security, with around two-thirds of the public consistently approving it, including support across all income levels, party lines, and minority groups, as we will discuss below. So it is not true that means testing is more politically realistic and achievable than personal accounts. Indeed, advocacy of means testing and other unpopular benefit cut ideas undermines the chance of political success for personal accounts, as it sours the public on the whole idea of Social Security reform.

As a matter of ideology, personal accounts are even more superior than means testing or other benefit cut options. That is because, again, personal accounts ultimately shift Social Security and other entitlement spending from the public sector to the private sector altogether, a dramatic, long-term reduction in government spending. Means testing and other benefit cuts could never come anywhere close to achieving the same result.

Indeed, from the perspective of liberal as well as conservative ideology, personal accounts should be superior to means testing. That is because the personal accounts are universal, applying to all. That has been the central principle that liberals have long applied to the main social insurance programs, Social Security and Medicare. Indeed, the personal accounts can maintain the exact same safety net for all that Social Security offers today, as we will see. Moreover, the personal accounts offer the prospect of much higher benefits for workers and retirees than Social Security even promises today, as well as major wealth accumulations, vastly expanded capital ownership among working class families, and sharp reductions in the concentration of wealth. Means testing, by contrast, only violates the liberal principle of universal social insurance programs covering all, rather than just those in need, as Butler and MacGuineas frankly admit.

The real problem is runaway big government,... and the future threatened explosion of federal spending as a percent of GDP.

An Automatic Tax Increase Trigger

Butler and MacGuineas go on to argue for fundamental changes in the budget process for entitlements.[5] This is updated and elaborated in more detail in another recent report, "Taking Back Our Fiscal Future"[6], co-authored along with 14 other major Washington budget policy experts, including former CBO Directors Alive Rivlin, Robert Reischauer, and Rudolph Penner, Isabel Sawhill of the Brookings Institution, and Eugene Steuerle of the Urban Institute. This report was published by the Brookings Heritage Fiscal Seminar, a joint project of the Heritage Foundation and the Brookings Institution. It's 16 co-authors "have been meeting informally for over a year, under the auspices of the Brookings Institution and the Heritage Foundation."[7]

That report begins by defining the problem as "Unsustainable deficits in the federal budget threaten the health and vigor of the American economy."[8] It also states upfront,

> "The first step toward establishing budget responsibility is to reform the budget decision process so that the major drivers of *escalating deficits*–Social Security, Medicare, and Medicaid—are no longer on autopilot.[9] (emphasis added).

But "unsustainable" or "escalating" deficits are actually not the biggest problem. The real problem is runaway big government, massive federal spending growth, and the future threatened explosion of federal spending as a percent of GDP. For free market conservatives, a budget with Federal spending at 15% of GDP, and a deficit of 3% of GDP, is far preferable to a balanced budget with Federal spending at 35% of GDP.

Whether the problem is defined as future deficits or future Federal spending makes a huge difference. If the problem is future deficits, then the solution is finding a politically feasible combination of tax increases and benefit cuts, which is the actual goal of the authors of the paper, as discussed below. But if the problem is runaway federal spending, then tax increases are not part of the solution. Tax increases would just support more federal spending, and so are part of the problem. The solution is finding politically feasible, fundamental entitlement reforms that would short circuit the projected explosion of federal spending, or even reduce such spending as a percent of GDP.

The co-authors of *"Taking Back Our Fiscal Future"* recommend that "Congress and the president enact explicit long term budgets for Medicare, Medicaid and Social Security…."[10] These entitlement budgets would be reviewed every 5 years. But the key budget reform recommendation is as follows:

> "The rules for the five-year review must include a trigger or action forcing device that requires explicit decisions when projected spending exceeds budgeted amounts. The trigger might in-

> volve automatic benefit cuts or revenue increases (including premium increases) that could only be overridden by an explicit vote or enactment of alternative policies that would achieve budget outcomes similar to the automatic adjustments. Alternatively, the trigger process could require that a commission make recommendations for closing the gap to the president and Congress on which an up or down vote must be held."[11]

The report then goes on to discuss various tax increase options that might be triggered. These include raising the payroll tax rate, or increasing the earnings subject to the payroll tax (raising the cap on the annual income subject to the payroll tax).[12] Another option mentioned is "replacing or supplementing the payroll tax with a broad-based energy levy or other earmarked tax that would raise revenues."[13] Still another option mentioned is to increase the taxation of Social Security benefits.

The report discusses as well benefit cut options which may also be triggered. Among these are delaying the retirement age, changing the basic benefit formula to reduce future promised Social Security benefits, means testing entitlement benefits, and, under Medicare and Medicaid, reducing even more the fees paid to doctors and hospitals, increasing deductibles and co-payments, and raising premiums paid by retirees.

None of these benefit cut options would reduce future Federal spending by nearly as much as the structural reforms I advocated below. Moreover, these benefit cut options are all deeply unpopular, as are the tax increases, making the political feasibility of this entire reform approach doubtful. Most importantly, the political unpopularity of the benefit cut options means none of them will ever be adopted without compromising with Big Government types for a huge tax increase. Enacting any of these benefit cuts would require bringing almost everyone in Washington along for political cover in a Grand Compromise including stiff tax increases as well as the benefit cuts.

Indeed, at the event at the National Press Club where the paper was released, Rudolph Penner explained more clearly the thinking of the 16 co-authors. He said that he hoped that the proposed budget process reforms "would lead to the kind of outcome preferred by this committee [the 16 co-authors] – the 1990 budget deal." That was the deal where President George H.W. broke his "Read my lips, no new taxes" pledge, which led to his defeat in 1992. That budget deal included a massive tax increase in return for spending reductions, which were soon erased in later budget years. The budget deficit, in fact, increased after that deal.

Even though another huge tax increase was enacted in 1993, the long string of budget deficits was actually not eliminated until Republican Congressional majorities were elected in 1994. President Clinton's budget proposal in January, 1995 projected annual budget deficits continuing at about $200 billion for the next 10 years. The Gingrich led Congress cut taxes on savings and capital investment, producing an economic boom. Then they held down the growth of Federal spending, which along with robust revenues produced by the growing economy, turned the $200 billion annual deficits into $200 billion annual surpluses.

Another co-author of the report, Ron Haskins of the Brookings Institution, published a commentary in the Washington Times on April 7, along with former Congressman Bill Frenzel, that further explained the thinking of the 16 co-authors. Haskins and Frenzel explained the proposal as follows:

> "Specifically, they proposed that: (1) Congress and the President enact 30 year budgets for Social Security, Medicare, and Medicaid; (2) Congress review the budgets every five years; and (3) automatic program cuts or revenue increases be triggered if projected spending exceeds the budget."[14]

The two co-authors described the expected effect of this proposal as follows:

> "The second effect of the trigger proposal will then kick in. Congress and the President will realize they cannot achieve a 30 year sustainable budget for Social Security, Medicare and Medicaid by simply reducing benefits. Rather, the solution will require a combination of benefit cuts and revenue increases."[15]

This budget process reform, indeed, would actually frame tax increases as the alternative to cuts in Social Security, and Medicare. This is not a promising way to frame the tax issue. This is, in fact, the best possible strategy for forcing a tax increase.

What is needed is not budget process reforms threatening counterproductive results, but a vigorous, sustained battle for the actual fundamental changes that would avert the crisis. This is what free market advocates should be fighting for.

Mandated Big Government

Another key strategy to address entitlements advanced by Butler and MacGuineas in their own report is a new system of government imposed individual mandates requiring individuals to save and buy insurance for a wide range of contingencies. These include retirement, unemployment, health insurance, life insurance, disability insurance, long term care insurance, and others. Workers would receive means tested supplements to help pay for the costs of these mandates.

Butler and MacGuineas write,

> "The first step will be to determine precisely what purposes the saving mandate will cover, how much individuals will have to save for each of these purposes, and what basic required insurance packages will be included. We envision requirements to save for retirement and basic health care spending and to purchase unemployment, disability, catastrophic health, and long term care insurance."[16]

Butler and MacGuineas continue,

> "At the same time, the government will have an important role to play in making sure that insurance is affordable and available to everyone. If, for example, individuals with chronic medical conditions are to be able to buy coverage, the insurance risk may have to be spread very widely and premiums cross-subsidized through reinsurance and risk adjustment mechanisms. To a large extent, this can be accomplished within the normal insurance process. But to be sure this happens, government may have to require all insurers to take part in a reinsurance pool with a system of cross subsidies and direct premium subsidies for some individuals."

All of this requires a lot of government control and central planning. Moreover, such mandates pull the government into more and more control over time. Once the government mandates individuals to buy some insurance, then it must specify what insurance coverage and policies individuals must buy to satisfy the mandate. So the government starts to slip into dictating to people what their insurance coverage will be. Because the government is forcing people to buy this insurance, it then becomes drawn into regulating the insurance even more, as Butler and MacGuineas already suggest. It can even be drawn into increased regulation of the underlying transactions insured, primarily to keep costs down.

The problems can be seen most clearly in health insurance. Butler has long advocated that the government should force all individuals and families to buy health insurance. But once the government adopts that mandate, then it must specify what health insurance policies would satisfy the mandate. This translates into the government dictating what insurance coverage these individuals and families must have. That becomes determined by politics and special interests, with people often forced to buy coverage they don't want and don't need.

To ease the mandate burden it is imposing on people, the government is drawn into increased regulation of the insurers themselves dictating in great detail their prices and the coverage they must offer. This often translates into community rating, where insurers must charge everyone the same premiums regardless of health condition or age, and guaranteed issue, where insurers must accept all applicants at the specified rates, again regardless of health condition or age.

As costs rise, political pressure rises to ease the burden of forced insurance further by shifting the costs to employers or to the government. Eventually, the government will be pulled into dramatically increasing regulation of the underlying health care, again to reduce cost burdens. This will ultimately result in the same health care rationing seen in all socialized medicine systems.

The end result of the mandate is consequently likely to be all the elements of the original, early 1990s, Clinton health care plan. Indeed, Hillary Clinton herself adopted an individual mandate for her own, revised, 2008 version of her health care plan, rightly seeing it as another way to achieve her goals, a tribute of sorts to Heritage.

Meanwhile, Butler and MacGuineas correctly note that mandated coverage can be involved in reform plans involving privatization of existing government programs. Such plans would unambiguously reduce government burdens because existing huge government tax and spending programs would be shifted to the private sector. Because of this, such reform plans are worth the risks noted above, which can be minimized on net because the existing government program serves as a reference point. But because of the problems discussed above, such mandates involve a large unnecessary expansion in government when they are not displacing current government programs, or when successful reforms can be adopted that do not involve such mandates. Butler and MacGuineas end by recognizing the problems with the mandate approach, and concede as a result that for these reasons "it would be wise to limit the mandate explicitly to financing alternatives to current programs

A New Vision for Entitlements

Directly assaulting the welfare state with politically naive attempts to sharply slash entitlement benefits is not a promising approach to achieving real reform. To achieve successful, positive, entitlement reforms, we must think outside the box of our current entitlement programs, and promote reforms that thoroughly restructure and modernize these programs, rather than packages of tax increases and benefit cuts.

To achieve successful, positive entitlement reforms, we must think outside the box of our current entitlement programs...

To begin, we must recognize that our entitlement programs are based on old-fashioned, late 19th century models of simple tax and spend redistribution. Social Security, for example, does not involve any savings and investment at all. Close to 90% of the money that comes in is paid out within 30 days in current benefits. Any surplus is lent to the Federal government and immediately spent as well.

Such old fashioned systems retard economic growth with perverse incentives on both the tax and spending sides. High taxes to finance these programs discourage savings, investment, entrepreneurship and work. Welfare discourages work, and government retirement benefits discourage private retirement savings, as workers do not have to save for the benefits the government will pay.

To modernize and restructure these programs with positive, pro-growth reforms, the key is to bring in much greater roles for modern capital and labor markets to serve the goals of these programs. Reformers have to recognize that voters are going to insist upon sturdy safety nets remaining in place. But with positive, pro-growth, structural reforms and the broad benefits of capital and labor markets, we could not only maintain such safety nets, but establish new, modern programs that are far more effective in serving workers, retirees, and the poor, and in achieving social goals, while requiring only a fraction of the government spending of the current programs.

Personal Accounts Instead of the Payroll Tax

One key concept for positive structural entitlement reform is personal accounts for Social Security, where workers would be free to choose to substitute savings and investment accounts for at least part of the current system. These accounts involve expanding the overall Social Security framework to bring in a central role for modern capital markets in serving the goals of the program.

The accounts can start at any size, and then can be expanded over time until workers can choose to substitute the accounts for all of their Social Security retirement benefits. This can be accomplished using just the 6.2% employee share of the Social Security payroll tax, still leaving workers with close to twice the benefits Social Security promises under current law (but cannot pay).

The accounts could be expanded further, eventually substituting private life insurance for Social Security survivors benefits, and private disability insurance for Social Security disability benefits. This can be accomplished with another 2.8% of wages, or a total of 9%, leaving workers even further ahead of what Social Security even promises, let alone what it can pay.

Eventually, the accounts could be expanded to cover the payroll taxes for Medicare, another 2.9% of wages, with the saved funds financing monthly annuity benefits that would be used to purchase private health insurance in retirement. The personal accounts would then total 11.9% of wages, a direct savings of about 25% from the current 15.3%

total payroll tax. Contributing these amounts to the account over a lifetime, average income couples would likely reach retirement with around a million dollars in today's dollars after adjusting for inflation. Such accounts would pay substantially more than Social Security currently promises, while still leaving enough to buy health insurance in retirement which would ultimately take over for bankrupt Medicare. The major cost savings available through Health Savings Accounts would make this even more manageable for retirees. The general revenues that now finance over half of Medicare spending could be used to provide supplements to help lower income retirees purchase adequate health insurance. Those general revenue expenses would be limited to grow no faster than the rate of growth of GDP over time.

Workers in retirement will also be able to use a small fraction of their accumulated funds to buy long term care nursing home insurance, protecting the rest of the funds in their account from such expenses. This would effectively privatize the major portion of Medicaid that now finances such long term care for lower income workers. This would complement perfectly the Medicaid block grants discussed below.

Close to 90% of the money that comes in is paid out within 30 days in current benefits.

These accounts are especially powerful in reducing government spending because they don't just trim the growth of such spending. They would shift enormous amounts of spending from the public to the private sector, dramatically reducing Federal spending over the long run. The fully expanded accounts discussed above would ultimately reduce Federal spending by about 10% of GDP, as the personal accounts replace this spending with market financed benefits. Such spending reductions would involve an unprecedented achievement.

In the process, the payroll tax would ultimately be phased out completely, and replaced with an engine of personal family wealth in the personal accounts. Workers would get much better benefits through these accounts because market investment returns are so much higher than what the non-invested, purely redistributive Social Security system can even promise, let alone what it can pay. Workers across the board would accumulate several hundred thousand dollars in real terms by retirement, directly owned by each worker, which can be left to the family at death. This would do far more to reduce inequality than anything else, yet would do so in a way that reinforces rather than undermines the economy.

What an exciting long term vision for America. Indeed, such reform would be nothing less than an historic breakthrough in the personal prosperity of working people.

The bill introduced in Congress by Rep. Paul Ryan (R-WI) and Senator John Sununu (R-NH) serves as a comprehensive model of how to structure such accounts, with substantial input from the Social Security Administration itself and from experienced Wall Street fund administrators on how to make the concept workable.

That bill also maintained the current social safety net in full, by including a federal guarantee that if any retiree's account cannot pay at least what Social Security would under current law, the federal government would pay the difference. That works because capital market returns are so much higher than even what Social Security promises, let alone what it can pay. As a result, it is extremely unlikely that the fully invested personal accounts would not be able to pay at least what Social Security promises, especially when workers are investing through a structured framework where they are choosing among highly diversified, professionally managed, investment funds approved and regulated by the government for safety and soundness.

The transition to personal accounts can be financed by reducing the growth of other government spending and by the increased revenues resulting from higher economic growth. Indeed, the other structural entitlement reforms discussed below can help greatly in financing this transition. Brian Riedl and the Heritage Foundation have advocated a limit on the growth of total Federal spending that would be more than sufficient to finance the transition.[17] Riedl has also published on behalf of Heritage lists of wasteful Federal spending that should be cut, as has the Cato Institute which would be more than sufficient to finance the transition . The popularity of personal accounts and the need to finance the transition would draw in the public to more actively support reducing such wasteful and even counterproductive spending.

Indeed, the growing literature on the optimal size of government indicates that our government is so overgrown and wasteful that for every dollar of government spending and taxes reduced, the economy actually enjoys a net gain of $2.75.[18] Financing the transition by reducing such spending growth would consequently produce another net gain, not a cost. Such reduced government spending would, in any event, be seen as another benefit of the reform by conservatives and other free market advocates. This would mean that the personal account reform overall would reduce total Federal spending by even more than the amounts discussed above resulting directly from the personal accounts alone. This is the most economically positive and most politically appealing way to finance the transition.

We know such personal account reforms would be politically popular, as many candidates won elections campaigning on such accounts from 1998 through 2004, including President Bush. Indeed, voluminous polling conducted last summer by Newt Gingrich's organization American Solutions found that two-thirds of Americans still support a personal account option for Social Security. After describing a reform proposal similar to the Ryan-Sununu bill discussed above, the survey found that the public supported the plan by 62% to 30%. By 64% to 31%, the public favored allowing workers the freedom to choose such personal accounts. By 67% to 28%, the public favored such a personal account option with a federal guarantee that the worker's retirement benefits would be at least as high as Social Security would pay them in the future under current law. This is the most popular reform alternative for Social Security by far, a world of difference from the public disdain for benefit cuts such as means testing and delaying the retirement age.

> *...two-thirds of Americans still support a personal account option for social Security.*

Block Grant Welfare to the States

A second key concept for positive structural entitlement reform is block grants to the states for the remaining Federal welfare programs. Through such block grants, states would be able to adopt new, modern welfare systems that would effectively eliminate poverty in America. This new system would also eliminate work disincentives and incentives for illegitimacy.

Legislation enacted in 1996 block granted the old Aid to Families with Dependent Children (AFDC) program back to the states. The share of Federal spending on this program was returned to each state in a block grant to be used in a new program designed by the state based on mandatory work for the able bodied. The key is that the block grant is finite, not matching, so it does not vary with the amount the state spends. If the state spends more, it must pay for the extra costs itself. If the state spends less, it can keep the savings. This legislation was based on the long term vision for welfare reform first advanced by Ronald Reagan and his longtime top welfare aide in both California and the White House, the late Robert Carleson.

The reform was wildly successful, with the old AFDC rolls reduced by close to 60% nationwide and close to 80% in states that pushed work most aggressively. Requiring able bodied recipients to work for their benefits eliminates the old welfare work disincentives. But probably even more important are the reversed incentives for state administrators. Previously, the Feds matched increased state spending, so each new welfare dependent signed up brought more federal funds to the state. But with the state now paying all added costs, the focus has changed to getting recipients out to work.

These same reforms should now be extended to the other Federal welfare programs, particularly budget busting Medicaid. Even if the Medicaid block grants allowed each state to keep all of its savings from greater flexibility, positive incentives, and reduced rolls, and Federal spending on the block grants was just not increased, the reform would save the Federal government a trillion dollars over the first 10 years. This would help greatly in financing the transition to personal accounts. If Federal spending growth on the block grants was limited to grow no faster after that than the rate of growth of GDP, then Medicaid would no longer contribute to increasing Federal spending as a percent of GDP.

As discussed above, large personal accounts would contribute to reducing Medicaid spending over the long run, by providing a source of funding for nursing home care insurance for older retirees. Personal accounts and block grants for Medicaid consequently are complementary reforms.

Such block grant reforms should be expanded to Food Stamps, Federal housing assistance programs, and other, smaller Federal welfare programs as well. Indeed, the Federal government operates 85 means tested programs providing assistance to low income families, and they all could and should be block granted back to the states.

What is most exciting is the new welfare safety net systems the states could build with these newly restored powers. For example, suppose all aid to the able bodied was in the form of an offer to work. Report to your local welfare office before 9 am and you are guaranteed a work assignment somewhere paying the minimum wage for a day's work. A private job assignment would be the top priority. If you need more money come back tomorrow. If you have children with no one to care for them, bring them with you and they will receive free day care, where they will be medically examined and treated if necessary.

If you work a minimum number of hours each month, you get a Medicaid voucher that will purchase basic private health insurance. If you work for a continued period establishing a regular work history, you would be eligible for new housing assistance focused on help in purchasing your own home.

The key is that the block grant is finite, not matching, so it does not vary with the amount the state spends.

The new Federal minimum wage will soon be $7.25 an hour, or $15,000 for a full year's work. These workers would continue to receive the EITC and child tax credits. This is an additional $4,000 for one kid, and close to $7,000 for two kids. Then there is the value of the child care and the health insurance.

This is more than adequate as a safety net. At the same time, this system would save the Federal and state governments enormous sums. First, private sector jobs would substitute earned wages for former welfare benefits from all of the block granted programs. These reforms bring in modern labor markets to take over more of the role of providing for the poor, through wages earned in real private sector jobs, rather than through taxes.

Secondly, this reform eliminates all work disincentives from welfare. The only way to get assistance for the able bodied is to work, in this program or in the private sector. This would all but eliminate long term welfare dependency and move millions still too dependent on the government into private sector self-support and self-reliance. The government safety net would truly be used only for short term emergencies.

Moreover, *all incentives for illegitimacy are also eliminated under this system*. Someone, either the father or the mother, will have to go to work to support a child in any event (EITC benefits are only available to those who work as well, and no one can live on a child tax credit of $1,000). Moreover, there is nothing to be gained under this system by avoiding marriage or couples splitting up. So this system does not discourage marriage; indeed, it would encourage marriage, as the couple staying together can help each other with work. A government would not become a substitute for a working husband. The result would be substantially less illegitimacy, fewer single parent households that cannot support themselves, and far more self-supporting, married families.

The government could even reduce administrative costs to a minimum under this system. There would be no need to maintain and investigate eligibility requirements. If Warren Buffett wants to show up for a work assignment before 9 am, no big deal.

Most importantly, this new system would effectively eliminate real poverty in America. Everyone would have a place to go where they could get an assured job and an assured income of $25,000 to $30,000 per year. The disabled who could not work should be cared for through other programs focused on them assuring that they would not live in poverty either. There may still be people in America who choose not to work even though they are capable of doing so. But they should be free to make that choice. They would still always be backed up by the safety net, and they would have their compensating reasons for making their choice. They may have friends or relatives taking care of their needs, or they may have other arrangements. As long as this was their free choice, it should not be considered real poverty.

This new, modern welfare system would be another historic breakthrough in the personal prosperity of lower income people.

Welfare reform requiring work has long been popular, which is why it passed in 1996 despite opposition from many liberals and President Clinton. Now that it has been proven a huge success, it should be even more popular. Indeed, with the true long term vision of what would be possible with such reform, it would be overwhelmingly popular.

Universal health care can be guaranteed to all while making government smaller rather than bigger.

Universal Health Care through the Free Market

Universal health care can be guaranteed to all while making government smaller rather than bigger. This arose out of the best thinking from conservative health care policy analysts as far back as the debate and victory over the Clinton health care plan in 1993-1994. The public does demand a social safety net that does not let anyone suffer without essential health care. But we can provide such a safety net, indeed, a better one than exists today, while expanding and maximizing the role of the free market in health care.

The first element of such a plan would be guaranteed renewability. This means that as long as the premiums are paid, an insurance company cannot cancel a health insurance policy after the beneficiary becomes sick. That would be like a fire insurance policy that the insurer could cancel once the house caught on fire. Such a policy would provide no real protection against the costs of fire, or serious illnesses in the health insurance context, and so would not be real insurance at all. It would be a fraud. That is why this element is already supposed to be in force in every state. To the extent loopholes have developed over time, they should be closed.

The second component would be to provide assistance to low and moderate income workers to assure that they could purchase basic health insurance coverage. This would be best accomplished through reforms to block grant Medicaid and SCHIP back to the states. Each state would decide what level of assistance was appropriate at which income levels within the state.

The final component would be state uninsurable risk pools. Over half the states already have such pools, and they have worked extremely well. Those who do not have health coverage and then become uninsurable because of contracted illnesses would obtain coverage from the risk pool in their state. The state would charge slightly above market premiums for this coverage, to guard against unnecessary use of the pools, with the vouchers available to help low and moderate income workers foot the bill. But such premiums would still not be enough to finance health care for these sick uninsurable individuals. So the state would subsidize the pool to cover remaining costs. This has proved to be a relatively minor cost in the states that have such pools.

Very few people actually become uninsurable. So the risk pool enables them to be covered without exploding costs and exploding big government for everyone else. The block grant funds from the Medicaid and SCHIP programs could be used by the states to pay for these risk pools.

That's it. With these health policy reforms, everyone has somewhere to go to get essential health care when they need it. Those who have health insurance are assured of keeping it with guaranteed renewability. Those who are too poor to buy health insurance would receive assistance to assure they could buy at least a basic, essential plan. Those who nevertheless do not become covered and then become too sick to get coverage would receive essential health care through the state uninsurable risk pool.

Through the block grants for Medicaid and SCHIP government overall would become smaller. Yet a basic safety net demanded by the public would be established to assure that no one ever has to do without essential health care. Widespread adoption of Health Savings Accounts would be the best means for controlling costs.

From a conservative, free market perspective, this is far better than the Big Government health care solutions being elsewhere advocated.

Conclusion

Entitlement reform need not and should not be about benefit cuts and tax increases. Personal accounts ultimately replacing the entire payroll tax with a family wealth engine would produce an historic breakthrough in the personal prosperity of working people. Block granting welfare back to the states would allow a new, modern welfare system to arise that would eliminate poverty in America, while eliminating all disincentives to work and all incentives for illegitimacy and family breakup. This would be another historic breakthrough in the personal prosperity of lower income people. We can provide universal health care through the free market while actually making government smaller. Such reforms are the truly popular alternatives to deal with the long term fiscal crisis.

These entitlement reforms also offer a tremendously exciting opportunity for conservatives, free market advocates, and taxpayer activists. They would dramatically reduce government spending and taxes over the long run. Pursued to the maximum, these policies may not only avoid the enormous increase in Federal spending as a percent of GDP now projected. They may actually reduce it substantially from the current level.

Conservative leaders and organizations should focus more aggressively on this agenda as the heart of free market, domestic policy reforms. We can and should appeal to specific left-leaning interest groups to join in support of these structural entitlement reforms. Indeed, the reforms have been carefully designed to win such support.

But negotiating with liberals and Democrats on a package of tax increases and benefit cuts is unnecessary and counterproductive. That is just going to lead to an enormous tax increase, and distract focus from the real free market, conservative agenda discussed above, which provides the opportunity for massive reductions in Big Government. In particular, budget process reforms including an automatic trigger for tax increases are counterproductive and should be opposed by conservatives, free market advocates, and taxpayer activists.

Endnotes

1. Stuart M. Butler and Maya MacGuineas, *"Rethinking Social Insurance"*, The Heritage Foundation, New America Foundation Fiscal Policy Program, February 19, 2008.
2. Id., p.6.
3. Newt Gingrich, *Real Change: From the World that Fails to the World that Works*, (Washington, DC: Regnery Publishing, 2008), Chapter 12, *Real Change for Social Security*, pp. 147-159, Appendix 1, The Platform of the American People, pp. 254-255; Peter Ferrara, *"The Public Wants Social Security Reform"*, www.forbes.com, November 15, 2007.
4. This same policy prescription is reflected as well in a Heritage publication by Brian Riedl, a senior fellow for budget policy. In that publication, Riedl complains,

   > "[M]any believe that anyone over age 55 should be exempt from entitlement reforms. Yet every year, 4 million more baby boomers turn 55, effectively locking in their future benefits (and taxpayer costs) by this standard. By 2019, all 77 million baby boomers will have turned 55…."

   Brian M. Riedl, *A Guide to Fixing Social Security, Medicare, and Medicaid*, Heritage Foundation Backgrounder no. 2114, March 11, 2008, p. 3. Riedl goes on to state, "Personal accounts by themselves do not reduce the tax liabilities to current seniors." Id., p.3. That is quite true. The only changes that would reduce tax liabilities to current seniors are benefit cuts for current seniors, supported by Butler, MacGuineas, and Riedl. Personal accounts do not involve any such benefit cuts. But personal accounts of sufficient size would eventually phase out all tax liabilities to future seniors. That is because personal accounts shift the payment of Social Security benefits from the public sector to the private sector, where they are financed by savings, investment, and investment returns, rather than taxes.
5. Id., pp. 7-8.
6. Stuart Butler et al., *"Taking Back Our Fiscal Future,"* The Brookings Institution, The Heritage Foundation, Washington, DC: April, 2008.
7. Id., p. 2.
8. Id.
9. Id.
10. Id.
11. Id., p. 6
12. Id., p. 7
13. Id.
14. Bill Frenzel and Ron Haskins, *"What, Me Worry? Ignoring the Entitlement Tsunami,"* Washington Times, April 7, 2008, p. A17.
15. Id.
16. Id., p. 13.
17. Brian M. Riedl, *Restrain Runaway Spending with a Federal Taxpayers Bill of Rights*, Heritage Foundation Backgrounder No. 1793, August 27, 2004; Brian Riedl, *10 Elements of Comprehensive Budget Process Reform*, Heritage Foundation Backgrounder No. 1943, June 15, 2006; Brian Riedl, *What's Wrong with the Federal Budget Process*, Heritage Foundation Backgrounder No. 1816, January 25, 2005; Brian Riedl, *A Budget Agenda for the 109th Congress*, Heritage Foundation Backgrounder No. 1812, December 15, 2004
18. Gerald Scully, *What Is the Optimal Size of Government in the United States?*, NCPA Policy Report No. 188, November, 1994; Daniel J. Mitchell, *The Impact of Government Spending on Economic Growth*, Heritage Foundation Backgrounder No. 1831, March 15, 2005; Gerald Scully, *Public Spending and Social Progress*, NCPA Policy Report No. 232, July 2000; Richard Vedder, *Economic Impact of Government Spending: A 50-State Analysis*, NCPA Policy Report No. 178, April 1993; *A New Political Paradigm: An Optimal Sized Government*, The National Tax Limitation Committee, www.limittaxes.org

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