AMERICAN RENEWAL

A Conservative Plan to Strengthen the Social Contract and Save the Country's Finances

Essays by

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Introduction

PAUL RYAN

America emerged from the 20th century as the world's sole superpower, having achieved unprecedented strength and prosperity. Our constitutional republic created a miracle of human progress emulated throughout much of the world. Today, this great American triumph is facing enormous political and economic challenges, from without but also from within.

The system of self-governance we founded nearly 250 years ago is being challenged worldwide—by China's repressive regime and other authoritarian strongholds. Totalitarianism, once thought to be consigned to history in the wake of the West's victory in the Cold War, is back, competing for dominance in our digitized world. The digitally fueled polarization characterizing the free world invites the question of whether democracies can muster the durable political consensus to tackle the major challenges confronting our societies.

In this third decade of the 21st century, I believe America will face an inflection point. Our fiscal policy is on a collision course with our monetary policy, and the economic devastation resulting from a debt and currency crisis could inflict enormous, possibly irreparable, damage.

Predicting at precisely what point a huge debt—and running high deficits—will catalyze an economic disaster is inherently difficult and speculative, in part because of the United States' unique economic status, including holding the world's reserve currency. The rules that apply to other nations don't always apply to the United States, or at least not in the exact same way. Yet the US cannot forever defy the laws of economic gravity. The US has run up large budget deficits and debts in the past, but those moments of national emergency, such as world wars and global financial crises, were usually—at least until recently—followed by periods of fiscal repair.

The difference now is that various factors—demographics, health, inflation, and declining labor force growth and productivity—have built in an unsustainable rise in our national debt. (See Figure 1.) What's more, the federal government's unfunded liability for our present three generations of Americans—retirees, workers, and children—falls somewhere between an estimated $100 and $200 *trillion*.[1]

The federal government is making promises to its citizens that it cannot keep.

Because of this trend, the Congressional Budget Office (CBO) projects that real gross domestic product (GDP) will grow much more slowly over the next 30 years than it did over the past 30. The most positive outlook for this indebted future is a slower, more stagnant American economy. Rather than a currency or debt crisis, like the 2008 financial crisis, a long slump would set in. While Japan, with similar structural fiscal problems, is known for its "lost decade," America could easily fall into a lost generation—in which income mobility, growth, and innovation slow to a crawl. If we stay on our present path, that projection is the better-case scenario. There are worse ones.

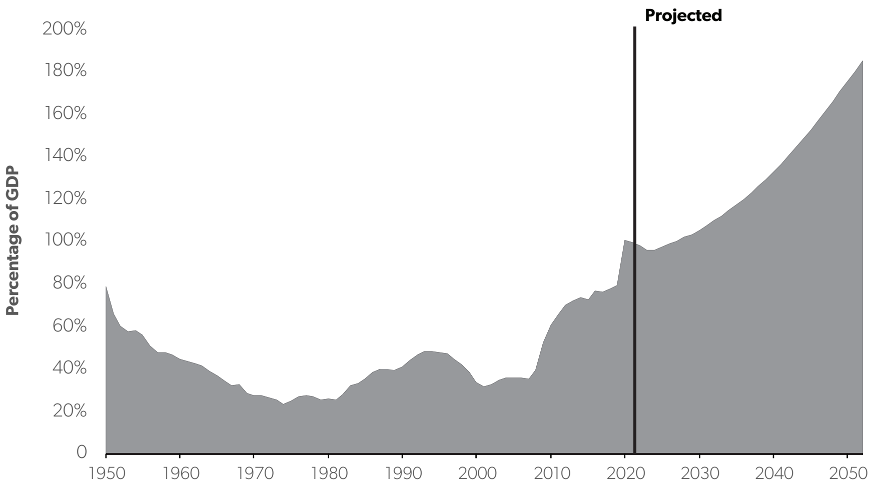
According to the CBO,

> Persistently rising debt would . . . elevate the risk of a fiscal crisis—that is, a situation in which investors lose confidence in the U.S. government's ability to service and repay its debt, causing interest rates to increase abruptly, inflation to spiral upward, or other disruptions to occur.[2]

The CBO goes on to say,

> It would increase the likelihood of less abrupt, but still significant, adverse effects, such as creating widespread expectations of higher rates of inflation, eroding confidence in the U.S. dollar as the dominant international reserve currency, or making it more difficult to secure financing for public and private activities in international markets.[3]

Figure 1. The Tidal Wave of Debt (Federal Debt Held by the Public, 1950–2052)



Source: Congressional Budget Office, *The Budget and Economic Outlook: 2022 to 2032*, May 25, 2022, 19, Figure 1-8, https://www.cbo.gov/system/files?file=2022-05/57950-Outlook.pdf.

It is perfectly natural and can even be prudent for a government to borrow money to pay for important national objectives, so long as it has a reasonable chance of paying off such debt. This is where the US today parts company with past generations. We cannot possibly pay off the upcoming tidal wave of debt as our system is presently constructed without massively debasing our currency, the dollar, which would wipe out the savings and purchasing power of the American people. Unless we change course, the forthcoming debt and currency crisis will at some point dramatically reduce Americans' living standards.

The story of America is one of historic human accomplishment—but the future is not secured. The dollar's dominance as the world's reserve currency is in jeopardy of being displaced. Upward mobility is stalling—and in some cases reversing. The twin American ideas that the economic condition of one's birth does not determine the outcome of one's life and that each generation is better off than the past generation are no longer true for millions of Americans.

Imagine a situation unfolding in which our fellow citizens, who depend on the promise of health and retirement security, see their Social Security and Medicare benefits cut in real terms. Or consider the fate of those living on the edge of poverty when the safety net becomes unaffordable. If we think we live in angry, polarizing times today, imagine the civil strife that would happen if *this* scenario unfolded. Add to that how our adversaries would respond if our military were slashed as the result of emergency budget surgery.

America is facing a fiscal crisis entirely of its own making. All of this is well-known. All of this was predictable. All of this is avoidable. But we are where we are. And, today, our politics are fundamentally unserious. That's the bad news.

The good news is that these problems are solvable. And we are not helpless or powerless before them. The solutions to these monumental challenges are achievable; it's a matter of summoning the will.

The best news is that we do not have to sacrifice the mission of our essential programs. It's imperative that we have retirement and health security for all Americans, a vibrant safety net that helps people rise, and an economy that grows and increases the living standards of all citizens. We need inclusive prosperity. In the process, we must maintain the world's greatest military to protect our nation and safeguard freedom.

To accomplish these essential objectives, we must reform and redesign an array of federal government programs. We need to begin soon. And *American Renewal: A Conservative Plan to Strengthen the Social Contract and Save the Country's Finances* shows us the way.

This book is a joint effort at offering solutions to America's generational challenge. It is a plan to confront our main socioeconomic problems with specific, concrete, achievable policy solutions—ones that restore our social contract while avoiding a debt catastrophe. This needs to be done for us, and it especially needs to be done for future generations. The American idea needs defenders.

Taken together, the chapters in this book offer a sweeping set of policy proposals from 19 scholars—including 16 from the American Enterprise Institute—that seeks to reform the social safety net, America's major entitlement programs, the tax code, and our monetary system in a way that revitalizes upward mobility, makes our health and retirement programs solvent, grows the economy, and importantly, avoids a debt crisis. These chapters focus on policy, and each author realizes that polices exist to promote human flourishing and human dignity.

A 21st-Century Tax Code

As Austin Smythe argues in his contribution, to maintain the strength of the US, "Washington needs to implement policies that sustain a healthy economy, slow the growth in federal spending, and maintain stable prices." The primary ingredient for any flourishing society is a growing economy. And a crucial component of a durable and growing economy is the tax code.

I consider the Tax Cuts and Jobs Act (TCJA) of 2017 one of the greatest achievements of my 20-year career in Congress. The TCJA made substantial, pro-growth improvements in our tax code, but there are major opportunities for even better reforms.

Kyle Pomerleau and Alex Brill propose "a set of reforms to the individual and business tax systems that would create a broader, more neutral, and simpler tax base and encourage economic growth by reducing marginal tax rates on investment."

The proposal for individuals would simplify the tax code while maintaining a progressive tax code with four rates: 10 percent, 20 percent, 30 percent, and 33 percent. This would streamline taxes on capital gains, interest, and dividends and dramatically broaden the tax base, improving incentives for work, family, and charity.

The proposal for businesses focuses on addressing the remaining problems with business taxation after the TCJA. This plan would eliminate the tax burden on new investment and reduce distortions across different types of investment, forms of financing, and legal forms of organization. It would also improve the tax treatment of US multinationals by reducing incentives to shift profits out of the United States while maintaining competitiveness.

As Pomerleau and Brill note, "Under this reform, all businesses would be subject to the same tax regime, no matter their form of organization." The present business tax system would be converted into a destination-based cash flow tax with a 15 percent rate on the business entity. This would dramatically simplify and improve the international competitiveness of US businesses while igniting faster economic growth, higher productivity, and wage gains. Building a tax code for faster economic growth and higher living standards is an essential component of our plan.

The proposal also makes a key compromise between our two parties on a matter of great importance in the 21st century: carbon. This proposal builds within the destination-based tax system a border-adjustment tax on carbon. This is the cleanest, simplest, and most economically advantageous way to address the global priority of decarbonizing the global economy.

By sending price signals on carbon through an efficient, pro-growth tax code, America can take a leading role in promoting innovative global decarbonization while staying focused on faster economic growth. The alternative—a poorly designed and ineffective crony capitalism policy of spending and tax subsidies for existing and dated technologies—would be a terrible mistake. In essence, the bargain we conservatives are offering our friends on the left, who are rightly focused on removing carbon from the atmosphere, is a better carbon policy in exchange for a pro-growth tax code.

We believe this tax proposal is best suited to the demands of this century, promoting growth, opportunity, global competitiveness, and healthy environmental stewardship.

Sound Money: A Central Bank Digital Currency

It is troubling enough that our present fiscal policy threatens the dollar's status as the world's reserve currency. This "exorbitant privilege" allows the US to finance its debts at low interest rates and settle international business transactions in our native currency, and it provides our government unparalleled tools to advance our national interests. As such, losing this status would inflict severe costs on the nation and the global economy. Today, an additional challenge (and opportunity) confronts our dollar dominance: digital currencies.

In his proposal for a central bank digital currency (CBDC), Hoover Institution scholar Kevin Warsh makes the case for a uniquely American-style CBDC. He proposes a digital dollar regime that is "most conducive to monetary soundness, sovereign control, financial innovation and competition, and individual privacy." Specifically, he proposes that the US create a new wholesale digital dollar framework to intermediate dollar payments between the US government and wholesale providers of banking services. This two-tier system maintains an important separation between the central bank money and commercial bank money. Unlike with the Chinese e-CNY (their CBDC), Warsh proposes that citizens continue to interface with the private retail banking sector for their digital dollar deposits and banking services as a way to encourage innovation and competition and guarantee privacy from government intrusion into citizens' financial lives.

A New Safety Net for Upward Mobility

Nicholas Eberstadt describes a "New Misery" spreading in America, where real net worth for the bottom half of households is distinctly lower than it was 30 years ago, income mobility has stalled, and more citizens than ever depend on poverty-conditioned, means-tested benefits. The duplicative, contradictory, and confusing programs that make up our social safety net desperately need repair. "If we are to redeem the promise of the American future," Eberstadt writes, "we need to be thinking right now about how to achieve escape velocity from a future of stagnation and dependence."

A great portion of this book focuses on rewiring our safety net to provide people the means to escape stagnation and dependence. As the CBO's forecast makes clear, a key to avoiding stagnation is a safety net focused on promoting work, family, and education.[4] The more people work and the better skills they attain, the faster the US economy grows and upward mobility rises. This "virtue cycle" of growth and opportunity can only come from rebuilding the key components of our social safety net. Fortunately, there is great promise in growing evidence-based solutions and new technologies that can assist in this rebuild.

To begin with, the digitization of money and benefits holds tremendous promise toward advancing breakthrough solutions. One challenge for safety-net programs is the ability to measure outcomes. For the most part, program budgets are allocated at a high level with crude qualifying criteria. As a result, it can be difficult to make adjustments based on real-time behaviors or customize programs to target specific circumstances.

Today, many commercial institutions such as banks, insurance companies, and health care organizations are using digital assets. They use these assets and the technology that underpins them (blockchain) to improve operational efficiency, reduce risk, remove expensive intermediaries, and allow for the creation of better business models.

Like with many other digital technologies, all parties using a digital asset platform can typically access their assets and data in real time. In addition, the transfer of value is clear, seamless, and immediate. Social safety-net programs can benefit significantly from these features as they will allow administrators to instantly measure program outcomes and make targeted improvements as necessary. A/B testing methodologies at all levels—federal, state, and local—could be applied to assess different initiatives even before their implementation, which will also result in higher levels of program efficacy.

Digital assets will also allow programs to apply conditions or criteria that ensure compliance with the program mandate and provide more immediate access to benefits for participants. For example, consider food stamps and the countless Government Accountability Office and inspector general reports of waste, fraud, and abuse that have plagued this important benefit. With programmable digital money, a food stamp dollar may be used only to buy food. Period. Or consider Temporary Assistance for Needy Families benefits with work requirements and time limits. Such criteria could be built into the programming of the money so that it performs as intended. Or consider the chronic problem known as "benefit cliffs" in which beneficiaries lose more in accumulated benefits than they gain as they attempt to rise out of poverty, thus discouraging their rise. This is no doubt the function of crude, across-the-board benefit designs that are incapable of customizing to a person's particular situation—until now. A coordinated digital asset platform could be designed to "smooth" such cliffs while maintaining the core program's intentions and designs.

As Warsh's CBDC proposal outlines, such programmable dollars, or benefits, would be disseminated to people via the private banking service provider chosen by the recipient. Rather than the Federal Reserve placing conditions on money—an impossibility under Warsh's proposal—a person would open their digital wallet, and the issuing agency or authority would add the appropriate conditions at that retail level for the benefit to commence. Imagine the endless possibilities for local, state, federal, philanthropic, and fintech entities to pilot and test these digital benefits to rid the system of the incredible amounts of waste, fraud, and abuse that have consistently plagued our national web of poverty programs.

In their proposal to reform the safety net for low-income families, Angela Rachidi, Matt Weidinger, and Scott Winship propose a comprehensive overhaul that builds "a safety net for the 21st century that better promotes work and strong families, strengthens the social contract, aligns federal and state incentives, and slows the growth in safety-net spending." The purpose of these reforms is to learn from clear evidence on what works and what doesn't, in order to build a safety net that leads families to upward mobility and long-term prosperity.

Specifically, Rachidi and Weidinger propose combining the earned income tax credit, the child tax credit, and the head-of-household filing status into one "working family credit," which would simplify and align the various programs rules, thereby providing one tax tool to address poverty and provide tax relief to offset child-rearing costs.

The authors propose a new framework in the role that states play to better align policies while encouraging state innovation. The purpose of this reformed safety-net system is to shift our emphasis from merely "accommodating poverty in the US to supporting the principles that will lead to family prosperity—more work, less government dependence, more marriage, and a larger stake in the results at the state level."

Another crucial component of the safety net is the child welfare system. To be blunt, it is failing. In her chapter, Naomi Schaefer Riley lays out a series of reforms based on clear evidence and a respect for the leading role that states, localities, and nonprofit groups play in protecting the welfare of the most vulnerable among us.

An additional component of a modernized safety net is a policy for paid parental leave. Abby M. McCloskey lays out a few policy options, such as advancing child tax credit payments or Social Security benefits and creating a stand-alone parental leave program that offers a limited benefit funded by repurposed government spending to blend pro-work and pro-family benefits for new parents as they begin their journey of working while raising a family.

And in one of the most vexing issues of our time, education, Max Eden, Frederick M. Hess, and Brent Orrell propose a specific agenda for family-centered early childhood education (Eden), K–12 schooling (Hess), and workforce training (Orrell). It is nearly impossible to overstate the importance of education, from early childhood to adulthood, and its direct impact on lifting people out of poverty.

Government, however, is not the only safety-net source. Civil society must also play a role, and Howard Husock proposes several ways to strengthen this sector, including tax preferences for charitable contributions and reinvigorating the federal government's volunteer service programs.

Given the status quo, much of the predicted stagnation derives from the assumption that millions of our fellow citizens continue to stay trapped in a welfare system that does not encourage work or teach the hard and soft skills needed to achieve self-reliance. If we break with this status quo, we can, to once again use Eberstadt's vivid words, "achieve escape velocity from a future of stagnation and dependence."

A Reformed and Solvent Social Contract

Along with interest on the debt, the greatest driver of our coming debt crisis is a collection of major entitlement programs that have come to define our basic social contract: health and retirement security. Specifically, spending on our major health care programs such as Medicare, Medicaid, and the Affordable Care Act, along with Social Security, are projected to consume 15.2 percent of GDP by 2052. By that year, interest payments on the national debt are projected to total 7.2 percent of GDP.[5]

In other words, spending on just three basic policies and functions of our federal government—health security, retirement security, and interest payments—together would consume 22.4 percent of GDP. To put that into perspective, the average costs of the entire federal government from 1972 to 2021 totaled 20.8 percent of GDP.[6]

It is obvious, but bears repeating, that the American people greatly value the mission of these programs. Health and retirement security are core components of the American social contract that have been counted on for generations. Unfortunately, these programs—particularly Medicare and Social Security—are the primary drivers of our coming debt crisis.

Fortunately, the best developed solutions are to be found in this book. We must maintain the mission of health and retirement security for all

Americans. Yet, to do so while avoiding a debt crisis will require reforming the way these programs deliver on their core missions.

By far the largest fiscal challenges lie in the Medicare program. James C. Capretta proposes a comprehensive set of reforms that offer the best chance of delivering on Medicare's core mission while bringing program cost growth under control. The key policy ingredient is bringing more choice and competition to Medicare so that beneficiaries can gain from the improvements in costs and quality of services that come with real competition.

The method for doing this is converting Medicare to a premium support system, which works like the Federal Employees Health Benefits Program. This effectively builds on the popular Medicare Advantage program that seniors enjoy today. By combining the hospital insurance and supplementary medical insurance trust funds into a single Medicare trust fund and adding a means-testing feature to the premium support, in which the wealthy shoulder more of the premium burden than low- and middle-income seniors do, these reforms would deliver substantial savings over the long term. This in turn would bring substantial relief to our fiscal burden.

Similarly, Thomas P. Miller proposes a series of reforms to the Medicaid and Affordable Care Act programs to bring costs down while improving the delivery of quality health coverage to millions of lower-income Americans. His suggested reforms, such as state per capita allotments and mega-waivers, would reinvigorate the benefits of federalism and state innovation while aligning the fiscal priorities of the state and federal governments.

The primary Social Security program is the Old-Age, Survivors, and Disability Insurance program. In his proposal to save Social Security from its pending insolvency, Andrew G. Biggs proposes reforms "modeled on systems in countries such as Australia, New Zealand, and the United Kingdom, [that] could pave the way for a more affordable Social Security program without sacrificing Americans' retirement income security."

A smaller, yet important part of the Social Security program is Social Security Disability Insurance. Richard Burkhauser examines various European disability programs and their attempts to continue to encourage work among the disabled community. He concludes:

> Efforts to shift to more work-first policies over the past two decades in Europe suggest that fundamental disability reforms,

> if done well, can lower projected long-term costs for taxpayers, make the job of disability administrators less difficult, and, importantly, improve the short- and long-run opportunities of people with disabilities.

A Great American Century

America has shown the world what self-determining people can achieve. We introduced democracy to the world. We built a society based on the consent of the governed that established a social contract to provide for the basic necessities of life and aid those most in need. Other democracies have done the same.

What is consistent among the policies discussed in this book is that they were mostly designed during the 20th century in ways that are proving unsustainable in the 21st century. Thankfully, and primarily due to advancements in the private sector, prudent reforms and policy changes taken soon can fulfill the promise of these programs sustainably. What's more, the economic dynamism that we came to enjoy in the 20th century can be repeated in the rest of the 21st—if we act.

The fiscal challenges addressed in this book have become a great test of American democracy. Ours is the first generation that runs the risk of leaving our children worse off than we are. The fiscal and economic calamities that await us if we do nothing should not come as a shock. And we can't say we weren't warned.

This plan represents a reconciliation with some of the great policy disputes of the 20th century. It is a viable path to a durable safety net and solvent social contract. We must break out of the economic malaise and forge a path for America to lead the free world in showing that democracy still has what it takes to solve its great problems.

The policy recommendations laid out in this book, taken together, will grow federal spending more predictably and sustainably, which will stabilize our national debt at levels we can afford, modernize the dollar, demonstrate that we can deliver a health and retirement system free from near-term insolvency, and make those systems more reliable to those who count on them. By harnessing new technologies, we can advance a solvent and effective social safety net. By reinvigorating federalism and strengthening civil society, we can rebuild our communities. With a modernized tax code wired for growth, we can make American businesses more competitive, raise living standards, and demonstrate to the world that we can advance both economic growth and responsible environmental stewardship.

The purpose of *American Renewal: A Conservative Plan to Strengthen the Social Contract and Save the Country's Finances* is to promote thoughtful and informed discussions, offer serious policy solutions, and demonstrate real reasons for hope.

In this enormous economic challenge lies an opportunity of renewal. If we stabilize our debt, revitalize our economy, and restore the promise of upward mobility, we will be the authors of a great new chapter in the remarkable American story.

Notes

1. Laurence J. Kotlikoff, "America's Hidden Credit Card Bill," *New York Times*, July 31, 2014, https://www.nytimes.com/2014/08/01/opinion/laurence-kotlikoff-on-fiscal-gap-accounting.html.
2. Congressional Budget Office, "The 2022 Long-Term Budget Outlook," July 2022, https://www.cbo.gov/publication/58340.
3. Congressional Budget Office, "The 2022 Long-Term Budget Outlook."
4. Congressional Budget Office, "The 2022 Long-Term Budget Outlook."
5. Congressional Budget Office, "The 2022 Long-Term Budget Outlook."
6. Congressional Budget Office, "The 2022 Long-Term Budget Outlook."

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Revitalizing America: The Arithmetic of Social and Economic Reform

NICHOLAS EBERSTADT

The COVID-19 pandemic, well into its third calendar year, has been America's greatest crisis since World War II.[1] In 2020 and 2021, according to the Centers for Disease Control and Prevention (CDC), nearly 850,000 Americans were killed by strains of this coronavirus—and by the summer of 2022, the CDC reported the death toll had exceeded one million.[2] This ongoing public heath disaster has placed our society, economy, and political system under extraordinary pressure.

That pressure resulted in some spectacular accomplishments. Months into the pandemic, crash programs by US and other Western researchers and pharmaceutical companies came up with highly effective coronavirus vaccines: a success many experts would have deemed impossible on the very eve of the crisis.

On the other hand, the strain of the pandemic exacerbated preexisting social and economic ills—including problems that had somehow largely escaped the notice of America's describers and deciders. And the unprecedented emergency pandemic measures the government implemented in the name of staving off an economic and financial collapse also entailed unintended consequences of a comparably vast scale, inadvertently constraining long-term growth and compromising prosperity.

On the eve of the COVID-19 pandemic, America's engines of material advance and personal success were already in serious need of repair. The US capacity to create wealth remains astonishing and unrivaled: By year-end 2021, private-sector net worth approached $150 *trillion*.[3] Yet at the same time, a creeping failure has been afoot for decades: a failure for our nation to generate and deliver its great benefits to all. The unvarnished truth is the American dream has not been working out for growing contingents of our fellow citizens. Far too many Americans have become familiar with faltering living standards or have found themselves mired in a "New Misery."[4]

The continuing spread of welfare dependence through the American population is one of the markers of this New Misery—both a cause and a consequence, organically linked to it. Never before has America been as rich as today; never before have so many Americans sought and accepted government benefits available only for those who see themselves as poor. In the pernicious new political economy on the rise since at least the end of the Cold War, government social programs—means-tested benefits, disability payments, and perhaps universal basic income (UBI) or other new entitlements yet to come—are dispensed to compensate Americans for the slowdown in popular gains from the market economy.

Slower economic growth and entitlement dependence are insidiously connected. And while self-styled conservatives tend to be alert to the proposition that explosive entitlement claims can impair national productivity, they are less attentive to the risk that prolonged subpar growth will whet the public appetite for entitlements.

Reviving dynamic, broad-based economic growth therefore lies at the heart of any strategy that aims, at one and the same time, to increase US living standards and reduce entitlement dependency. The arithmetic of reviving national productivity involves entitlement reform—but also much more. Social and economic revitalization can spark a dynamic upswing in progress—and prosperity for all—as COVID-19 subsides. But this will mean addressing the social and economic flaws that increasingly impaired our national performance even before the pandemic.

The Other COVID Crisis: Unintended Effects of Pandemic Policies

To prevent catastrophic collapse of the US economy and the American financial system from the nationwide COVID-19 lockdown in March 2020, Washington unleashed a tidal wave of public resources to float businesses and families through the emergency. Mindful of the policy mistakes that deepened and prolonged the Great Depression nearly a century earlier, Congress and the White House reacted rapidly, authorizing extraordinary fiscal and monetary interventions. Through several rounds of spending measures, many trillions of dollars in emergency COVID-19 benefits were dispensed from March 2020 until September 2021. The Federal Reserve was also permitted—in fact, encouraged—to flood the US economy and the international system with liquidity and venture into other territory our central bank had never before dared to enter.

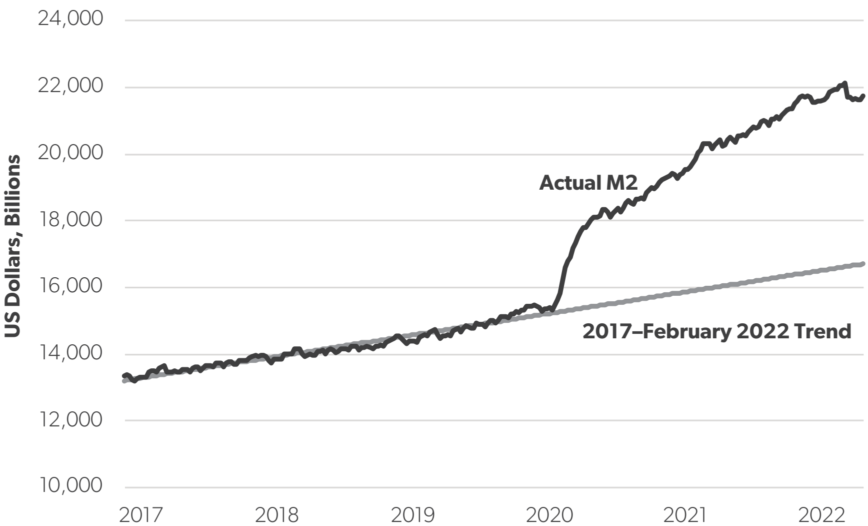
Washington can take credit for preventing a national (potentially global) economic and financial panic in 2020–21 through its actions. With the economy in free fall, the impulse to act urgently and "go big" was surely the right call at the outset of the emergency. Yet urgency also meant the largest single "state surge" in American history was necessarily improvised, characterized by not only immense intended consequences but perhaps even greater unintended ones.

Consider the Fed's all-in monetary interventions during the COVID-19 emergency.[5] With these measures, the US money supply and Fed security holdings suddenly spiked. Between January 2020 and January 2022, the former—for which America's money stock (M2) is a proxy—jumped by 40 percent (Figure 1). (The latter leaped by over 140 percent.)[6] Consequently, the "velocity" of money in circulation, which had been dropping since the turn of the century, suddenly plunged to unprecedented postwar lows[7]—levels suggestive of a widespread willingness to hoard money rather than spend it, despite near-zero interest levels, as would be expected perhaps in a "liquidity trap."

The Fed's actions took America into a monetary terra incognita: a terrain that the central bankers themselves patently lacked a map for charting, much less navigating. The thought that a sudden, radical expansion of the money supply might affect national price levels apparently did not occur. As inflationary pressures gathered in 2021, accelerated in early 2022, and continued to surge upward from there, US monetary authorities remained a step or two behind events, only finally recognizing the inflationary threat after it had assumed frightening proportions. Nor were they the only economists to get the new inflation wrong.[8]

There is greater clarity about the unintended consequences of emergency pandemic fiscal policies. Washington's deluge of spending during the COVID-19 emergency was mainly financed by deficit spending, with federal debt jumping by over $5 trillion between the end of 2019 and the fall of 2021.[9] That torrent of transfers did not simply stabilize disposable

Figure 1. US M2 Money Supply



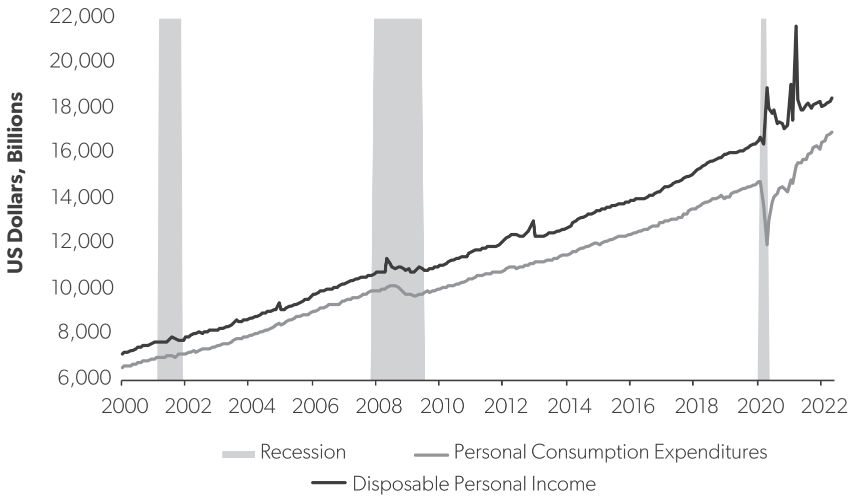
Source: Federal Reserve Economic Data, "M2," June 28, 2022, https://fred.stlouisfed.org/series/WM2NS.

income during the emergency. Rather, it propelled US household incomes to their highest levels in history—well above where they would have been had the expansion underway before the pandemic simply continued. (See Figure 2.)

The transfers were so immense that Americans did not end up spending them. Instead they banked much of the pandemic emergency windfall. In 2020 and 2021, the US private savings rate more than doubled, the upsurge in these personal assets mirrored by the ballooning government deficits. (See Figure 3.) Since the net national savings rate did not appreciably change from pre-pandemic levels during the emergency,[10] this means that government borrowing was in effect being banked into private accounts.

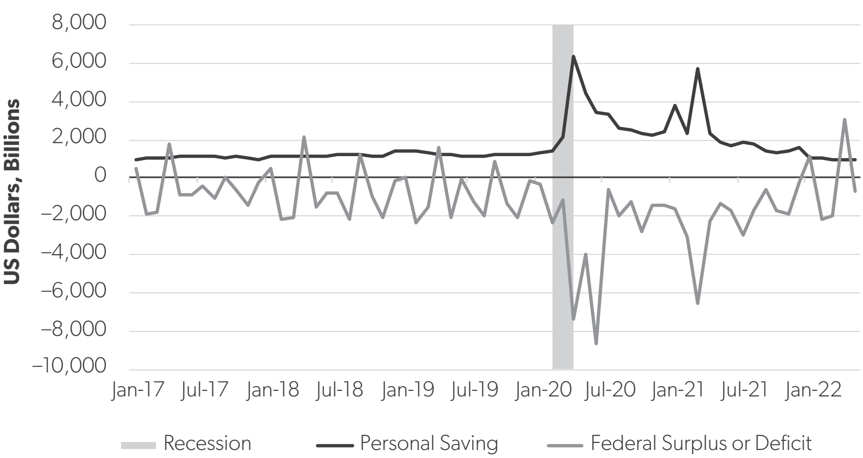
The emergency measures were rife with moral hazard, only the most familiar of which was the famous $600 a week "pandemic unemployment insurance" benefit. Individuals could obtain the initial $600 a week in additional unemployment benefits if they were not working, or were not working enough, almost regardless of the recipient's wealth or annual income. Those pandemic benefits, remember, came on top of benefits from the existing unemployment insurance system. When added to

Figure 2. US Personal Disposable Income vs. Personal Consumption Expenditures (January 2000–May 2022)



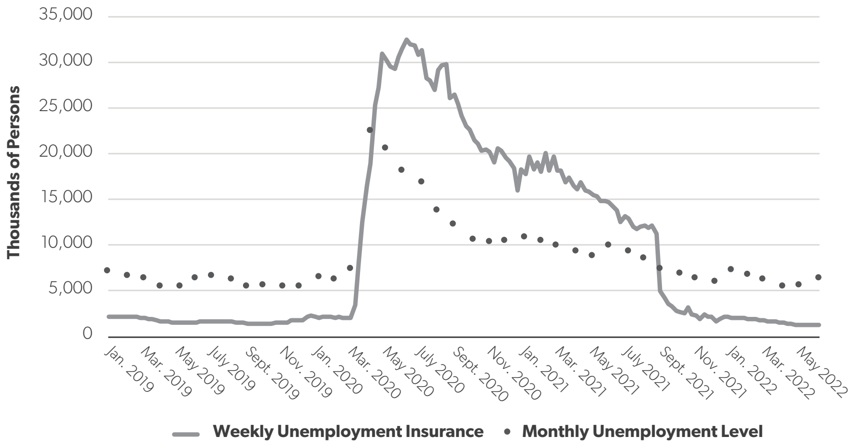
Source: Federal Reserve Economic Data, "Personal Consumption Expenditures," accessed July 12, 2022, https://fred.stlouisfed.org/series/PCE; and Federal Reserve Economic Data, "Disposable Personal Income," accessed July 12, 2022, https://fred.stlouisfed.org/series/DSPI.

Figure 3. US Personal Savings vs. Federal Deficit (January 2017–May 2022)



Source: Federal Reserve Economic Data, "Personal Saving," accessed July 12, 2022, https://fred.stlouisfed.org/series/PSAVE; and Federal Reserve Economic Data, "Federal Surplus or Deficit," accessed July 12, 2022, https://fred.stlouisfed.org/series/MTSDS133FMS.

Figure 4. US Monthly Unemployment Level and Weekly State Unemployment Insurance Claims (January 2019–June 2022)



Note: Data are not seasonally adjusted. US Bureau of Labor Statistics monthly job reports estimates for unemployment are dots for the week in which the monthly survey was conducted. The Department of Labor unemployment insurance claims total is for all individuals covered, including those covered by special pandemic benefit programs.

Source: Federal Reserve Economic Data, "Unemployment Level," accessed July 8, 2022, https://fred.stlouisfed.org/series/UNEMPLOY; and US Department of Labor, "Unemployment Insurance Weekly Claims," press release, July 2022, https://www.dol.gov/ui/data.pdf.

regular unemployment benefits, the pandemic benefits pushed payments for the jobless above the median wage level in 36 states, according to one analysis for the *New York Times*.[11]

Pandemic unemployment benefits, in other words, turned out to be a jackpot for many—and you did not actually have to be unemployed to take home the bonus. In July 2020, the national unemployment level was about 17 million, but more than 30 million Americans were reportedly collecting some form of unemployment insurance. For almost a year and a half, the number of unemployment insurance beneficiaries was larger—often much larger—than the number of Americans unemployed. (See Figure 4.)

Wittingly or not, COVID-19 America was toying with something like a UBI. Proponents of UBI may not be aware of exactly what they would be subsidizing by paying adults not to work. The patterns are clear enough when looking at pre-pandemic self-reported time-use trends of prime-age

Table 1. Self-Reported Time Use: Prime-Age (25–54) Men and Women by Employment Status 2015–19 (Average Minutes per Day)

Activity	Men Not in the Labor Force	Unemployed Men	Employed Men	Employed Women
Personal Care	619	588	538	567
Household Maintenance	96	125	73	110
Caring for Household Members	33	36	27	46
Work	12	65	361	299
Education	37	32	5	8
Eating or Drinking	56	60	65	60
Socializing, Relaxing, and Leisure	446	372	219	188
Screen Time	312	255	139	114
Observations	(852)	(341)	(10,316)	(10,161)

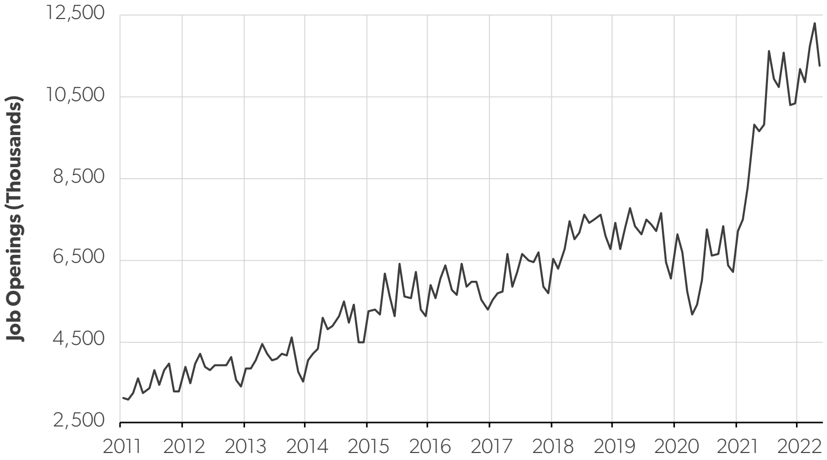
Source: US Bureau of Labor Statistics, US Census Bureau, American Time Use Survey, 2020, https://www.bls.gov/tus/database.htm.

men (age 25–54, ordinarily peak working years) who are *already* neither working nor looking for work. (See Table 1.)

The picture provided by Table 1 is not pretty. Today's unworking men while away their days in front of screens—television, internet, handheld devices, and the like—on average close to 2,000 hours a year. This is their full-time "job." And nearly half of pre-pandemic unworking prime-age men said they took pain pills every day.[12] Would any taxpayer really want to pay for more of this?

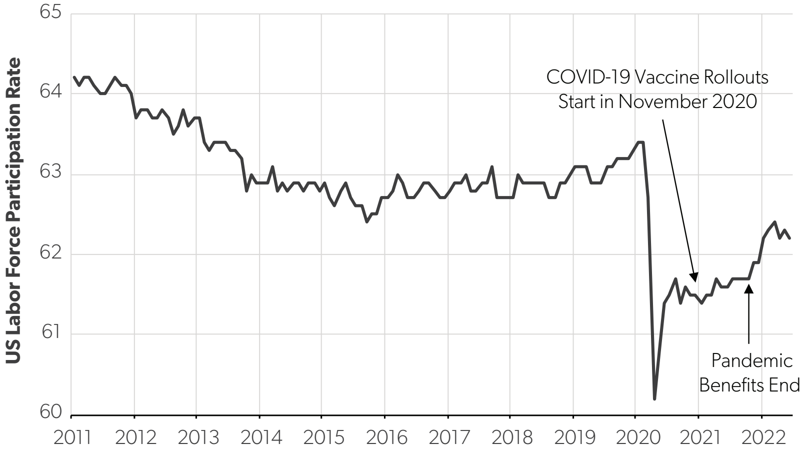
In any event, the de facto UBI experiment came to an end when the pandemic unemployment benefit ran out—but perverse paradoxes in the US labor market continued. Despite a roaring demand for workers—with over 11 million jobs going begging at the end of 2021 (Figure 5)—labor force participation rates (LFPRs) stagnated from the summer of 2020 through the end of 2021. In mid-2022 the US labor force was still slightly smaller than just before the pandemic—and millions short of where it would have been if pre-pandemic LFPRs were still obtained. (See Figure 6.)

Figure 5. US Job Openings (January 2011–May 2022)



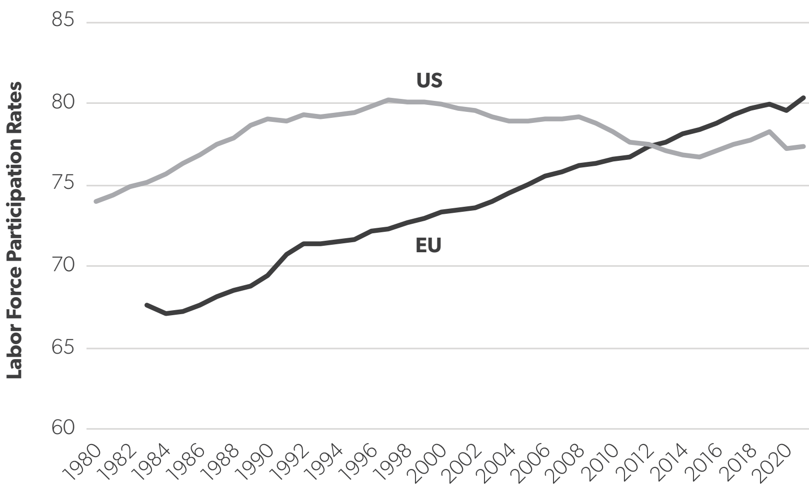
Note: Data are seasonally unadjusted. Since November 2020, empty workforce positions have increased by nearly five million.
Source: US Bureau of Labor Statistics, Job Openings and Labor Turnover Survey, 2022, https://www.bls.gov/jlt/data.htm#.

Figure 6. US Labor Force Participation Rates (January 2011–June 2022)



Note: Data are seasonally adjusted and include those age 16 and up.
Source: US Bureau of Labor Statistics, "Labor Force Statistics from the Current Population Survey," accessed July 12, 2022, https://data.bls.gov/timeseries/LNS11300000.

Figure 7. Labor Force Participation Rates for Adults Age 25–64, US vs. EU (1980–2021)



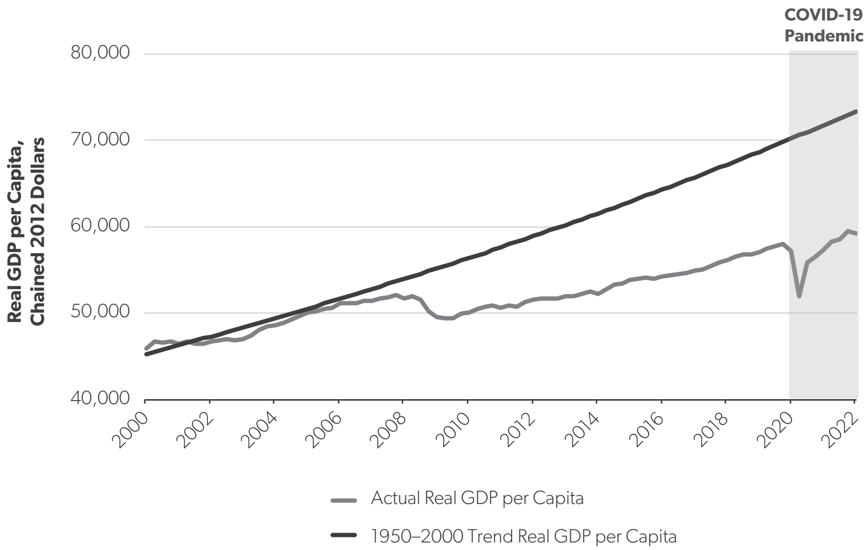
Source: Organisation for Economic Co-operation and Development Data, "Labour Force Participation Rate," https://data.oecd.org/emp/labour-force-participation-rate.htm#indicator-chart.

Low and stagnating LFPRs in the face of unprecedented peacetime job openings are all the more intriguing now that three-quarters of the US adult population is fully vaccinated.[13] The current extreme worker shortage likely has multiple causes, and unintended side effects of COVID-19 rescue policies are no doubt one of them. But US LFPRs have been faltering since the late 1990s—that is, for nearly a generation before the pandemic erupted. Ironically, by some metrics, US LFPRs are now lower than those of the European Union—a region Americans have long caricatured as a work-free zone with sclerosis-inducing welfare states. For example, the EU's LFPRs for the age 25–64 cohort surpassed America's almost a decade ago. (See Figure 7.)

Anemic work rates are just one of the worrisome new socioeconomic realities exacerbated by the pandemic (or the policy response to it). Another is the long-term slowdown in US economic growth and worker productivity.

If the US had managed to maintain its earlier (1950–2000) postwar growth rates into the 21st century, per capita output on the eve of the

Figure 8. Real 2012 GDP per Capita, Quarterly, January 2000–January 2022



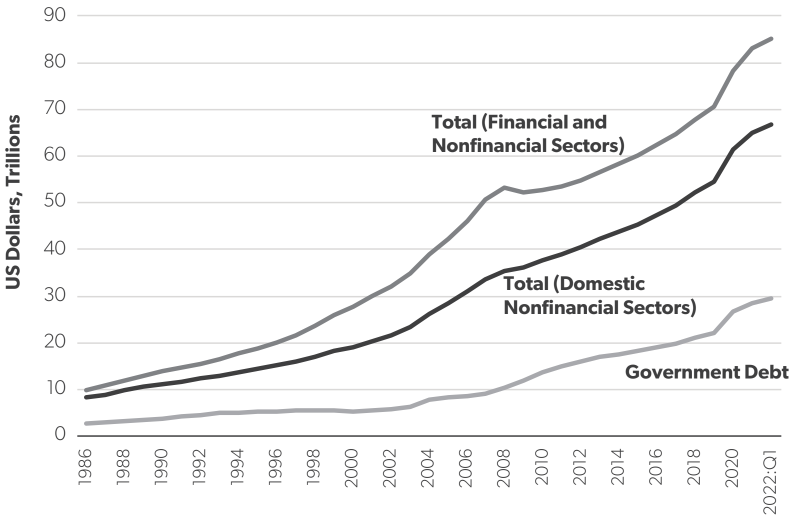
Note: Exponential trend line represents 1950–2000.
Source: Federal Reserve Economic Data, "Real Gross Domestic Product per Capita," June 29, 2022, https://fred.stlouisfed.org/series/A939RX0Q048SBEA.

pandemic would have been over 20 percent higher than the levels actually recorded—and the gap would be even greater today. (See Figure 8.)

Looking forward, the Congressional Budget Office (CBO) perhaps reflects the current consensus among leading economists: It envisions real gross domestic product (GDP) growth of under 1.7 percent per annum for 2024–32, with output per adult rising at less than 1.5 percent a year—an implied doubling time of about 48 years.[14] Sluggish as this prospect may seem, however, those projections do not take account of any coming recessions—even though recession may lie in store, possibly sooner rather than later. Thus far in the new century we have already experienced three of them—and our country's actual 21st-century per capita growth rate to date has averaged barely 1 percent a year, a tempo requiring almost 70 years for a doubling.

The US growth slowdown has been conjoined with another overarching trend bearing on American life: a seemingly insatiable desire to finance

Figure 9. US Debt: Total Credit vs. Government Debt, 1986–2022 First Quarter



Note: Data are shown annually from 1986 to 2015 and then quarterly (seasonally adjusted) from 2016 to 2020. Government debt is federal plus state and local.
Source: Board of Governors of the Federal Reserve System, "Financial Accounts of the United States—Z.1," September 23, 2021, https://www.federalreserve.gov/releases/z1/20210923/html/d3.htm.

federal spending—most of which is entitlement transfers—through government deficits, which is to say ever more public debt. Paradoxically, what may be most troubling about 21st-century federal-debt buildup is the relatively small share due to the COVID-19 emergency: The pandemic crisis of 2020–21 accounted for only about a quarter of the run-up from 2000 to 2021 and about 30 percent of the jump since 2007.[15] In fact, government debt has accounted for the majority of America's credit increase between 2000 and year-end 2021—and over 60 percent between 2007 and year-end 2021.[16] (See Figure 9.) Is this what the path to crowding out the private sector looks like?

The CBO, incidentally, now projects net federal debt will be about twice the size of the US economy in 2050—roughly two and a half times the pre-pandemic level—and further upward revisions may await.[17] Thanks to ultralow interest rates in force since the crash of 2008 and the Great Recession, the burden of debt finance has thus far been comparatively mild for this new mountain of taxpayer obligations.[18] America had already used much of the "fiscal space"—the difference between the debt limit and current debt—it enjoyed before the Great Recession by 2019, according to International Monetary Fund estimates,[19] and is on track to have used up much of the remainder by 2025, implying that future shocks or crises will be more difficult and painful to manage.

Slow growth, low and continuously declining velocity of money, super-high public debt, and super-low interest rates: All these formerly unfamiliar hallmarks of America's emerging new political economy are already quite familiar elsewhere—namely, in contemporary Japan, the home of the modern "lost decade" phenomenon. The specter of "Japanification" should not be cheering, nor should symptoms of that affliction be greeted with equanimity. There are reasons to fear that a Japanification with American characteristics could be more unpleasant—indeed, more miserable—than the original version that beset Japan.

Modern America's New Ills

From a distance, the summary record of America's performance over the past generation is a marvel to behold. No nation has ever been as powerful and rich as the United States is today. Thirty years ago, the US won the Cold War and became the planet's sole superpower—a title it still holds. Never before has the world seen a system that could generate so much national strength and prosperity.

But during our unipolar moment, a New Misery was also spreading in America. Symptoms of our new social and economic ailments abound. They might be called paradoxes of plenty, the unnatural pathologies of daily life in America's second Gilded Age. They are afflictions that predated the coronavirus pandemic but are now even more acute thanks to the crisis. Diagnosing them is essential to the effort to revitalize our nation.

Consider these symptoms of the New Misery:

- Although our nation has never been so rich, never have so many Americans been dependent on poverty-conditioned, means-tested benefits.

- Although survival odds for young and middle-aged parents are vastly more favorable than in earlier times, many more children today live as if orphaned: with just a mother, just a father, or sometimes just grandparents.

- Although we enjoyed a so-called "full-employment" economy on the eve of the pandemic, the 2019 work rate for prime-age American men mirrored the level in early 1940, at the tail end of the Great Depression.

- Although our national net worth has been soaring for decades, real net worth for the bottom half of households was barely higher on the eve of the pandemic than when the Berlin Wall fell 30 years earlier.

What accounts for these miserable contradictions?

The conventional answer is "structural economic changes" in our age of globalization and rapid technological advance. There is some truth in this explanation, of course—but it is not the whole story, nor even perhaps most of the story.

Family breakdown, rising welfare dependence, "deaths of despair," and the explosive growth of our ex-con population: Such features of the New Misery have their roots in other factors—social changes, changing mores, and changing political choices and priorities. Taken together, these other changes have ensnared our immensely wealthy and amazingly powerful country in a domestic "tangle of pathologies."

That fateful phrase was coined by Daniel Patrick Moynihan, in his 1965 report on the crisis of the black family in America.[20] Moynihan warned that family breakdown and its ramifications—illegitimacy, broken homes, absent fathers, welfare dependence, and more—were undermining social and economic progress for black Americans and would limit the gains that civil rights reforms seemed to promise.

What he could not have known back then was that the turmoil evident in black families in the 1960s would be a leading indicator for the rest of the population—a prefiguration of the trends that would lie in store for citizens with no such legacy of race-based mistreatment.

That same tangle of pathologies is rampant nowadays in 99 percent nonblack New Hampshire, where a third of births are out of wedlock, 26 percent of children live in single-parent homes, and 35 percent of children live in homes receiving at least one means-tested benefit. Even predominantly Mormon Utah, likewise 99 percent nonblack, is no longer immune from these pathologies: Nearly one baby in five in the Beehive State is born to an unwed mother, and a quarter of the state's children live in households that receive means-tested benefits. (See Figure 10.)

Worklessness and crime also figure in the modern American tangle. Back in 1965, one in eight prime-age black men was not holding down a job; in 2019, in a supposedly booming economy, the corresponding rate for American men of all ethnicities was even higher. By 2010, nearly 20 million Americans had a felony conviction in their past[21]: Every eighth man in America was an ex-con by then. And by 2018, over 110 million American adults—over two-fifths—had criminal-arrest records, according to figures from the Bureau of Justice Statistics.[22]

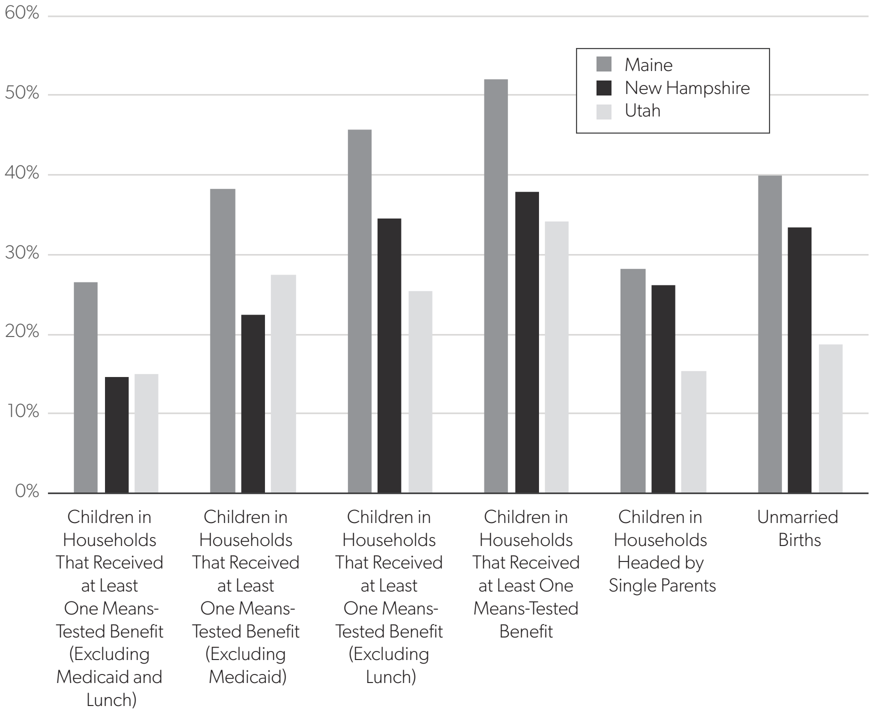
Politics has also played its role in this tangle. When postwar economic growth began its long slowdown, America in effect entered a new social compact with the poorer half of its people. We tried to buy social peace by underwriting further improvements in how the other half lives—but through welfare and debt. The truth is that this approach enjoyed deep bipartisan support; that fact accounts for its endurance.

Between 1985 and 2016, according to the Census Bureau's Survey of Income and Program Participation (SIPP), the share of Americans in homes depending on means-tested benefits more than doubled, vaulting from 15 percent to 36 percent. Over those decades, according to SIPP, America's means-tested population nearly tripled, shooting up by 79 million, even though total US population grew by just 85 million over those same years. And the SIPP figures may be underestimates.[23]

The relentless increase in social-welfare recipience also transformed the face of dependency in modern America. These programs are no longer just for struggling women and children. Grown men in the prime of life, ordinarily society's providers, are now a major constituency for need-based public aid.

According to the Census Bureau's Annual Social and Economic Supplement (ASEC) to the Current Population Survey, something like 30 percent

Figure 10. Comparison of Social and Economic Indicators: Maine, New Hampshire, and Utah, Pooled 2014–18



Source: Author's calculations using Sarah Flood et al., Integrated Public Use Microdata Series, Current Population Survey, Version 7.0, https://www.ipums.org/projects/ipums-cps/d030.v7.0; Joyce A. Martin et al., "Births: Final Data for 2018," *National Vital Statistics Reports* 68, no. 13 (November 2019): 1–47, https://pubmed.ncbi.nlm.nih.gov/32501202; Joyce A. Martin et al., "Births: Final Data for 2017," *National Vital Statistics Reports* 67, no. 8 (2018): 1–50, https://pubmed.ncbi.nlm.nih.gov/30707672; Joyce A. Martin et al., "Births: Final Data for 2016," *National Vital Statistics Reports* 67, no. 1 (January 2018): 1–55, https://pubmed.ncbi.nlm.nih.gov/29775434; Joyce A. Martin et al., "Births: Final Data for 2015," *National Vital Statistics Reports* 66, no. 1 (January 2017): 1, https://pubmed.ncbi.nlm.nih.gov/28135188; and Brady E. Hamilton et al., "Births: Final Data for 2014," *National Vital Statistics Reports* 64, no. 12 (December 2015): 1–64, https://pubmed.ncbi.nlm.nih.gov/26727629.

of America's prime-age men of the civilian noninstitutional population are now in homes that seek and accept disability payments, means-tested benefits, or both. And this high rate of dependency is not solely due to programs supporting the needs of children living under the same roof as the aforesaid men. In 2021, according to ASEC, nearly one in five households with prime-age men but no children was likewise dependent on disability, welfare, or both. And ASEC, remember, is notorious for its underreporting of such public benefits.[24] (See Figure 11.)

Yet curiously, in all the commentary on the factors threatening the American middle class, rising welfare dependence is almost never mentioned. Quite the contrary—to much of the commentariat, the unaddressed danger to the middle class is of the need for *even more* government benefits!

As the lower half of the income scale became increasingly dependent on means-tested public largesse (and such spending now averages around $6,000 per recipient), their personal finances also grew strangely precarious, as moral hazard theory might predict of government-welfare programs.

Nearly three in eight American homes today are rentals, and most renters find themselves all too near a hand-to-mouth existence. In 2019, on the eve of the COVID-19 pandemic, half of all renters had a net worth of under $6,500—and not because they were all newly minted PhDs awaiting their first big job.[25] Half of renters 55 and older had less than $7,000 to their name. An astonishing half of all female-headed renter families reportedly had barely $2,000 in net worth in 2019.[26]

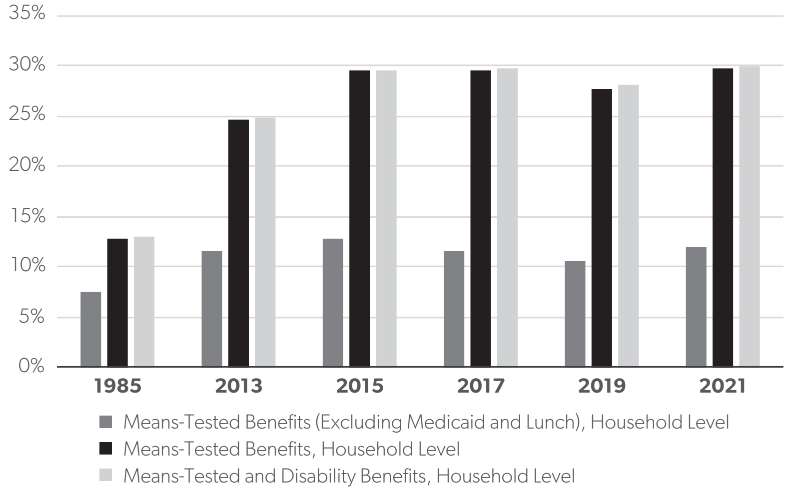
Moreover, the bottom half in America, renters and homeowners alike, saw their households' mean net worth fall sharply between 1989 and 2016—by at least 38 percent and perhaps even more, depending on which measure of inflation one prefers.[27] Over those years, personal debts and loans ate away the net worth of Americans in the lower half.[28] Not until late 2019 did real mean net worth for this group of Americans finally claw its way back to the level attained 30 years earlier—that is, just before the fall of the Berlin Wall and the end of the Cold War.[29]

But our social enervation and increasingly fragile finances (both private and public) also find an echo in our national economy, in which dynamism seems to be steadily ebbing. True: America's top corporations are world-beaters, still best in class and the envy of regulators in other lands. Our trillion-dollar gladiators cast a long shadow. Maybe that is why we don't always notice what is going on in the rest of the private-sector arena.

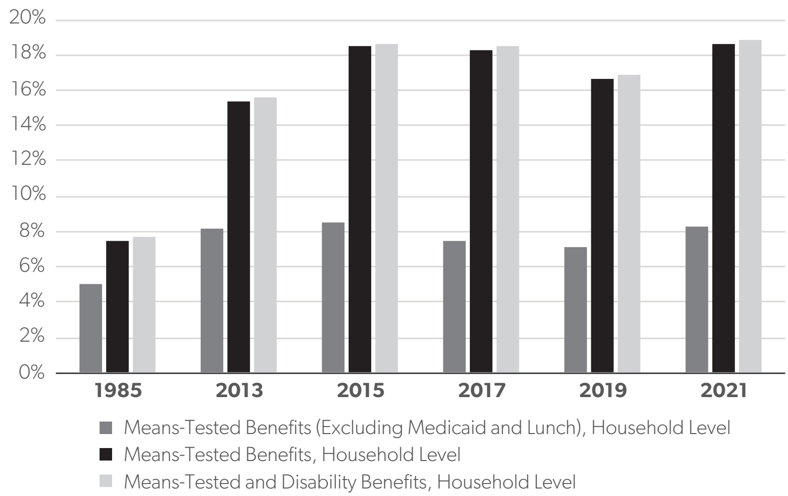
Simply put, there is less creative destruction, the lifeblood of free enterprise. The ratio of new startups to existing businesses has been falling for over 40 years—for as long as we have been keeping such records, in fact.[30]

Figure 11. Prime-Age Men Receiving Means-Tested Assistance

Panel A. Percentage of Prime-Age Men in Households Receiving Means-Tested Assistance: Census ASEC



Panel B. Percentage of Households with Zero Children and at Least One Prime-Age Man That Received Means-Tested Assistance: Census ASEC



Note: Means-tested programs included energy subsidies; Supplemental Nutrition Assistance Program; Special Supplemental Nutrition Program for Women, Infants, and Children; Temporary Assistance for Needy Families; rent subsidies; free lunches; Medicaid; and Supplemental Security Income. This figure accounts for ASEC-weighted individuals and households.
Source: Sarah Flood et al., Integrated Public Use Microdata Series, Current Population Survey, Version 9.0, 2021, https://doi.org/10.18128/D030.V9.0.

Accompanying the decline of American "garage entrepreneurialism" was a drop in labor market churn—switching jobs.[31] (Currently, with the so-called Great Resignation, we observe a pause in the downward trend in job churn; how long the hiatus will last remains to be seen.) Overall, residential mobility in America is at an all-time low: Americans today are less than half as likely to move as in the early 1980s[32]—yet another warning sign of gradual hardening in America's entrepreneurial arteries.

Structurally, American business is increasingly gray and top-heavy, dominated by larger, older corporations with easy access to capital at highly favorable rates that smaller businesses cannot obtain, aided by fixers and regulatory counsel smaller firms can't afford. By some important yardsticks, we see increasing market concentration and decreasing knowledge diffusion—more laggards falling behind on the learning curve.[33] This is not a recipe for healthy improvements in productivity. It should not be a surprise that the decade of recovery from the Great Recession was the weakest snapback ever recorded for the American economy.

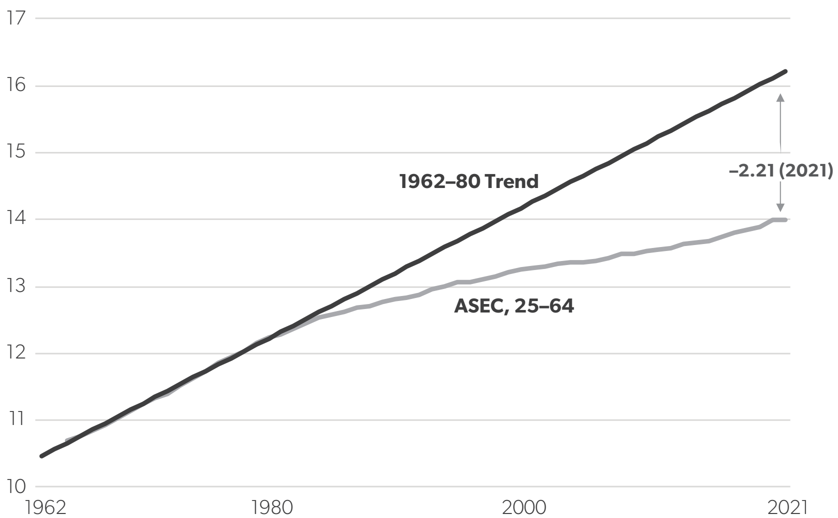
Thus, as we look beyond COVID-19, the arithmetic for US economic growth may be increasingly troublesome. The problem signs are both social and institutional.

Over the long run, economic progress in a modern economy depends greatly on human resources and business climate. Yet over the past generation, despite our unaccountably expensive health care system, health progress has been agonizingly slow: barely one extra year of life expectancy per decade. From 2014 through 2017, the US actually suffered slight, continuing declines in life expectancy,[34] partly because of white America's opioid crisis.[35] With the pandemic's impact, moreover, US life expectancy at birth fell sharply[36]—back to levels last seen in the previous century and roughly five years below other advanced Western democracies.[37]

After leading the world in educational advance for the century following the Civil War,[38] America's progress in attainment suddenly threw a gear; for more than a generation it has been limping along at barely a third of its historical pace, as others surpass us in mean years of education. (See Figure 12.)

And while some appreciate the tax cuts, it is hard to argue that America's business climate overall has improved thus far in the 21st century. To the contrary: Although subjective, such varied measures as the Cato

Figure 12. Mean Years of Schooling by Age Group: Americans Age 25–64, 1962–2021



Note: Fitted data are based on trends between 1962 (the first year for which census microdata are available from IPUMS) and 1980.
Source: Sarah Flood et al., Integrated Public Use Microdata Series, Current Population Survey, Version 8.0, 2020, https://www.ipums.org/projects/ipums-cps/d030.v8.0.

Institute's Economic Freedom in the World,[39] the Heritage Foundation's Index of Economic Freedom,[40] Transparency International's Corruption Perceptions Index,[41] and even the World Bank's Ease of Doing Business Index[42] all show some drop in US ratings and rankings for quality of institutions and policies over the past two decades.

These trends influence long-term economic performance. Unless they change, the US is in danger of an unexpectedly weak recovery from the COVID-19 crisis, followed by a run of much slower economic growth than Americans were long accustomed to. We could find ourselves drawn closer and closer to our own form of Japanification—a version, for reasons already mentioned, quite possibly much more unpleasant than the Japanese original. If we are to redeem the promise of the American future, we need to be thinking right now about how to achieve escape velocity from a future of stagnation and dependence.

Toward Prosperity and Self-Reliance for All

Revitalizing America requires a vision of where we want to take our nation tomorrow. We can describe that objective—and identify some of the tasks on the road before us—clearly enough today.

We can imagine a more dynamic, rapidly advancing, and self-reliant America: an America that can generate prosperity for all, one with more freedom and stronger families and communities, and one in which our people are less weighed down by government debt, less dependent on infantilizing state handouts, and more fully in charge of their own pursuit of happiness.

And we can identify the tasks before us in getting there.

The Arithmetic of Revitalization. The arithmetic of American revitalization depends, first and foremost, on a sustained upswing in national productivity. As we have seen, US economic performance has been ever anemic in the decades leading up to our current crisis.

We already know the main elements required for restoring rapid productivity growth in America. We need more and better research, both public and private. Like any resource, funds for research and development (R&D) can be squandered if they are not used wisely. But in a revitalizing America, we would be investing much more heavily in this aspect of America's future than we do today. Israel, South Korea, Taiwan, and even Sweden: All now devote more of their economies to R&D than America does.[43] We used to lead the world in this—and we should want to again.

We need more and better education and training for Americans from all backgrounds—again, much more. By "education and training," I mean actual knowledge and skills—not indoctrination or ideologized cant passing as learning. As noted already, over the past four decades, America has been stricken by a strangely unexamined slowdown in educational-attainment advance. If we had only maintained our previous tempo of long-term advance, our working-age population today would average about two additional years of schooling—even more for younger adults.

Rough rules of thumb suggest these educational shortfalls have lowered current US output by many trillions of dollars. And that slowdown in educational progress has not only depressed our national income but also skewed the distribution of opportunities unforgivingly. In what economists call America's "race between education and technology,"[44] lagging education makes for labor displacement, with flagging wages for the less skilled to boot. Should we really be surprised by what has happened to our nation's employment and earnings profiles since our great slowdown in educational progress set in? More and better education applied across the US population will help generate better wages, especially at the bottom; increased opportunity; and that welcome, vibrant churn once again.

Then there is America's other big innovation problem: the sclerosis, complacency, and rent-seeking in our private sector, especially in big business. America cannot succeed unless a lot of its firms fail—including some of its largest ones. Bankruptcy and reallocation of resources to more productive ends are the mother's milk of dynamic growth in a competitive market. There should be no room for corporate welfare in a revitalized America. Bring on the "zombie apocalypse" in our corporate sector. We will not only survive it; we will thrive by it. (Let's also save some creative destruction for those increasingly essential but bloated government-dominated sectors, health and education.)

Rolling Back Welfare Dependence. A revitalized America must offer a pathway from dependence back to self-reliance for individuals and families. This will of course be easiest with dynamic growth, but in any case, it will require rethinking our sprawling and largely dysfunctional social-welfare system.

To the fullest extent possible, American social-welfare arrangements should be reconfigured based on a work-first principle, with active employment or job seeking conditioning other benefits. The concept of a living wage for working families is worth exploring as well. Of course, a panoply of unintended consequences could attend subsidizing employment, so reorientation to a work-first principle bears careful consideration. This will unavoidably create problems of its own, but if we pursue this policy correctly, we will likely be trading a larger set of problems for a decidedly smaller set.

Demographic Revitalization. This brings us to demography, the vital factor that may spare us the plight of a shrinking, atomized society. Perhaps the two most important demographic questions for a revitalized America concern family and immigration.

Family is the basic building block of our society and our nation, so the health of our country depends on the health of our families. Without presuming the Solomonic acumen to judge any single family situation or circumstance, we can nonetheless confidently prefer more intact families to fewer of them; more rather than fewer lasting, committed marriages; more rather than fewer children born within marriages; and more time at home, not less, for parents with their children.

We also know that strong bonds of kinship are the very first safety net our species developed. Weak and fractured families spawn big national welfare systems. More than a century of modern social policy has demonstrated that the state is a highly imperfect substitute for the father and is even more misbegotten when attempting to step in as mother. Our public policies should reflect these realities.

Then there is immigration. Immigrants have been a great blessing for our country. Current and future immigrants should play an important role in revitalizing America. People who risk everything to come here to start a new life embody the American spirit; that is why immigrants generally make such great Americans. And the magic of the American ethos seems especially suited to making loyal and productive citizens out of these newcomers.

There is an argument for favoring highly skilled immigrants in the future, and it has merit. But the grit, drive, and family values of immigrants with little formal education should have a place in our country too. Such strivers and their children make us more dynamic, for talent and entrepreneurialism do not always come with academic credentials.

Yet we must not forget this important proviso: Globalization should work for Americans—not the other way around. That holds for immigration. Our national sovereignty is nonnegotiable. We get to choose who is invited to join in our American experiment—no one else. My own preference is for fairly high immigration quotas. But whatever the level, immigration to our country should be legal immigration.

Illegal immigration is not only an affront to our rule of law; it is an affront to our democracy because it circumvents the people's will. If our immigration process is badly broken, as almost all agree it is, we should fix it; that is what competent democracies do.

Wealth for All. A key indicator for our national revitalization will be wealth trends for the lower half in our society. We should want to see their net worth growing—in fact, growing a good deal faster than for the country as a whole.

And by wealth, we should mean private assets in their own immediate possession—things such as bank accounts, homes, college funds, and retirement accounts. A neoclassical economist can make the case that payouts from our national social-insurance system—Social Security—should be counted as wealth for these families, and the argument is theoretically unassailable. But some take this to mean we should not worry so much about tangible private assets for the less well-to-do. If we took this logic to its conclusion, we would be counting the net present value of expected future food-stamp use as wealth too. There is a world of difference between a monthly check from the government and a lump sum you put together through managing your own affairs. A free people deserve better than a life on allowance money and a debit card.

A revitalized America can provide the framework in which everyone can build their own wealth—with the help of more work, better wages, more two-parent families, and constantly improving opportunities and skills. But personal responsibility is the other element. Financial discipline, thrift, and other money habits determine a family's savings, and consistently accumulated savings are indispensable to personal wealth. And as a practical matter, family stability is terribly important to a household's wealth outlook. The struggle to save and get ahead is so much harder in homes with just one parent. Even in a revitalized America, that reality is not going to change.

The Macroeconomics of Revitalization. If America is to revitalize, then our government will need to adopt budget discipline. To be sure: There is a respectable Keynesian case for running big deficits in bad times and emergencies, just as there are special times when a family may need to live beyond its means. But unlike John Maynard Keynes, who said government should run surpluses in good times to balance out the deficits in bad times, we seem to find an excuse every year to spend more than we bring in. If we treat each and every new fiscal year as if it is an emergency, the prophecy will become self-fulfilling. The path to Japanification is paved with high budget deficits and unnaturally low interest rates.

If we revitalize America, ours will be a future of positive interest rates and low or negative net budget deficits. Taxes will have to be higher, too, for at least a generation, since in a revitalized America we will cease spending our children's inheritance. But future generations will thank us for this—and if we attain dynamic growth, then the tax bite shouldn't sting quite as much.

Concluding Observations

Lest it go unsaid: Revitalizing America will take more than a trustworthy policy playbook, essential as that ingredient may be. It will rely crucially on the fabric and integrity of our civil society and the moral sentiment of our population—essential qualities largely beyond the reach of the ameliorative state, and deliberately so in the case of our own American experiment in limited constitutional governance.

Lately our civil society and our nation's moral sentiments have been under strain. Confidence in our institutions has ebbed. Distrust of fellow Americans is on the rise. Elite circles wonder, increasingly aloud, whether our American civilization—traditions, ethos, ideals—are actually worthy of *them*. They might be better served wondering a bit more whether *they* are worthy of the remarkable system they have inherited. More often than not, it is ignorance of the US political tradition and our fellow citizens—not familiarity with them—that breeds such contempt.

A bright thread running throughout the American story—thanks in no small part to the genius in the political design of the US—is the nation's resilience in the face of setbacks and adversity. Again and again our country has demonstrated its capacity to mend its flaws, rebound, and flourish.

Yet another revitalization of our nation is within grasp now. All we need for it to unfold is for Americans to determine this will take place—and to resolve to bring it about, together.

Acknowledgments

Evan Abramsky and Peter Van Ness provided valuable research assistance for this chapter.

Notes

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3

Deficits, Debt, and America's Future

AUSTIN SMYTHE

The United States has the largest, strongest, and most dynamic economy in the world. The strength of the US economy has made the dollar the world's reserve currency, and the credit of the federal government is currently unquestioned. Even so, the United States should not take the reserve status of the dollar or the Treasury's credit for granted.[1]

The federal government seemingly has an unlimited ability to borrow with little concern about deficits, interest rates, or inflation.[2] While inflation has risen recently, markets believe inflation has peaked and the Federal Reserve will retreat from raising interest rates and return them to historically low levels.[3] That view, however, poses huge potential risks to both the US economy and the federal government's ability to carry out its functions. Fortunately, the strength of our country's economy, particularly relative to its peers, and recent experience suggest the nation has the time and fiscal space to get its fiscal house in order. However, according to the Congressional Budget Office (CBO), the longer Washington delays addressing the problem, the more difficult the task becomes.[4]

To ensure our country retains the benefits of having the world's reserve currency, the best credit on the globe, and strong, sustainable economic growth, Washington needs to implement policies that sustain a healthy economy, slow the growth in federal spending, and maintain stable prices.

Background and Outlook

At the country's founding, it was bankrupt after borrowing to finance the Revolutionary War and struggling with inflation, both of which produced an anemic economy.[5] The new Constitution gave Alexander Hamilton, the nation's first Treasury secretary, the tools to build a lasting financial foundation for the federal government and US economy.[6] Hamilton recognized the importance of a nation's ability to borrow, writing in 1781, "A national debt if it is not excessive will be to us a national blessing."[7]

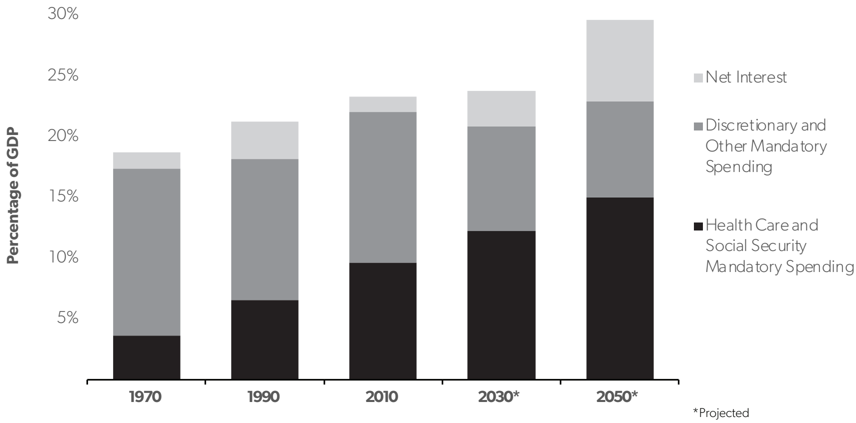
Throughout its history, the federal government has relied on its credit for numerous accomplishments, including to service the debt from the Revolutionary War and the Louisiana Purchase and to win the Civil War and World War II. In each instance, the surge in borrowing was temporary, and the government balanced its books and reduced its debt in relation to the economy afterward.

While entitlement programs date back to the nation's beginning, the New Deal, the Great Society, and subsequent additions to and expansions of entitlement programs have led to these programs dominating the federal budget. In a book on the history of US entitlement programs, John Cogan characterizes the New Deal as the "birth of the modern entitlement state" and notes that "since 1946, entitlement spending has grown at an annual average rate 33 percent faster than the growth in GDP [gross domestic product]."[8]

Beginning in the late 1960s, federal entitlement spending grew to dominate the federal budget. In 1962, the defense budget represented about half of federal spending (49.2 percent) and mandatory spending about a quarter of the total (26.1 percent). As a share of total spending, defense outlays declined steadily over the next 57 years as entitlement spending, particularly Social Security and health care spending, soared (Figure 1). By 2019, defense comprised 15.2 percent with mandatory spending, equaling 69.9 percent of total spending.[9] During this period, federal spending as a share of the economy—gross domestic product (GDP)—fluctuated but steadily rose from 18.2 percent of GDP in 1962 to 21 percent of GDP in 2019.[10]

With the enactment of the Great Society, the expansion of its entitlement programs, the creation of new ones, and a resistance to higher taxes to offset the growing spending, Washington no longer followed the historical norm to balance budgets during peacetime and economic expansions. Except for four years in the late 1990s and early 2000s, beginning in the 1960s, the federal government began to run a fiscal policy of sustained budget deficits, and the debt began a steady rise from its post–World War II nadir of 23.2 percent of GDP in 1974. By fiscal year (FY) 2008, federal debt stood at 39.2 percent of GDP.

Figure 1. Major Categories of Outlays as Percentages of GDP



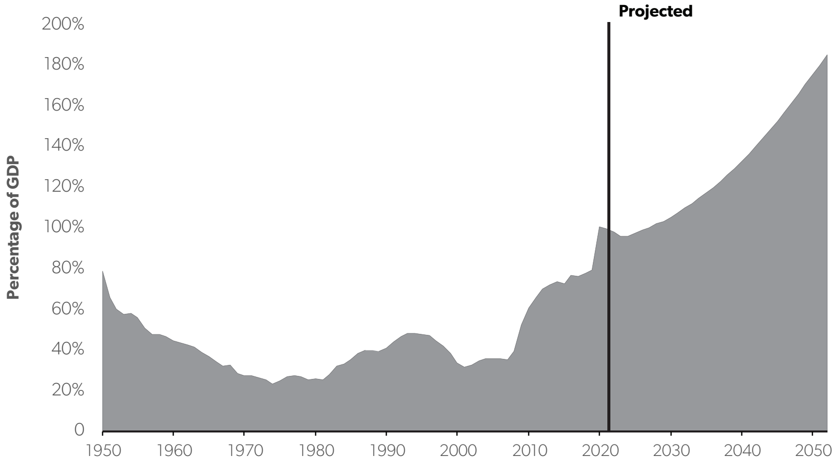
Source: Congressional Budget Office, "Budget and Economic Data," https://www.cbo.gov/data/budget-economic-data.

With the 2008–09 financial crisis and again with the COVID-19 pandemic that started in 2020, the federal government deployed an unprecedented fiscal and monetary response that was greatly expanded in response to the pandemic. Those two crises produced a huge surge in the federal debt of a magnitude not seen since World War II. Unlike past crises, in which debt receded as a burden on the economy, Figure 2 displays the CBO projection of a continued steady and steep rise in the debt, driven by higher mandatory spending—particularly for health care programs—joined by the growing interest expense to finance this debt.

Despite this enormous surge in the debt, the response in inflation and interest rates has been remarkably subdued. The federal debt soared from 39.2 percent of GDP in FY2008 to 100.3 percent of GDP in FY2020. During that same period, relative to the economy, the financing cost of that debt (i.e., net interest outlays) has remained below 2 percent of GDP. FY2020 best illustrates the huge benefits of lower interest rates to the federal government. Despite the federal debt rising by 25 percent that year alone, the Treasury's interest costs *declined* by 7.9 percent.

The Federal Reserve's actions contributed to this dichotomy. It used its traditional tool, the federal funds rate, to essentially reduce short-term interest rates to zero in 2008 and again in 2020. To provide additional

Figure 2. Debt as a Percentage of GDP, 1950–2052



Note: Federal debt held by the public is projected to increase in most years in the projection period, reaching 110 percent of GDP in 2032—higher than it has ever been. In the two decades that follow, deficits are projected to push federal debt higher still, to 185 percent in 2052.
Source: Congressional Budget Office, *The Budget and Economic Outlook: 2022 to 2032*, May 25, 2022, 19, Figure 1-8, https://www.cbo.gov/system/files?file=2022-05/57950-Outlook.pdf.

downward pressure, particularly on longer-term rates, it also engaged in "quantitative easing," the purchase of Treasury and other securities. With a dramatic deployment of quantitative easing, it increased its balance sheet tenfold (from nearly $900 billion in 2007 to nearly $9 trillion in 2022), with its holdings of Treasury securities representing the largest share (64 percent).[11] By the summer of 2022, the Fed had purchased a little over half the amount the federal debt has increased since the pandemic.[12]

Until recently, those policies appear to have been risk free, at least in the short term. That changed over the past year as interest rates rose more quickly than the CBO projected and with recent data demonstrating that inflation is accelerating more rapidly and running at higher levels than the Fed, the CBO, and many economists originally projected. The tremendous surge in debt and its projected future trajectory pose risks that are likely to aggravate the level of debt and stymie future economic growth and Americans' well-being.

Risk of Higher Interest Rates

The Office of Management and Budget, the CBO, and the Fed all continue to project interest rates that are low in historical terms.

Table 1 compares the average of the CBO's projection of interest rates on Treasury securities for 2021–30 to the average for the previous five decades. Taking the 10-year Treasury note as an example, in May 2022, the CBO projected that interest rates would average 3.17 percent for 2021–30. Looking back at the average interest rates for the past six decades, the projected 10-year average interest rate falls well below the average for all those decades except the most recent one (2011–20). The difference is not small relative to these five previous decades. For example, relative to 1991–2000, a period of strong economic growth, stable monetary policy, and shrinking deficits and debt, interest rates on average were twice as high in 2011–20 than the CBO is projecting for the next decade. The CBO is not alone in projecting that interest rates will remain low, but economists' projections tend to be closer to one another than what unfolds in the economy.[13]

The CBO has developed a workbook that models how alternative economic assumptions would affect the budget outlook. According to this CBO model, a 1 percent sustained increase in interest rates above its projections would increase the deficit by $2.9 trillion through 2032.[14] Such a scenario would still result in the 10-year Treasury rate averaging less than the average for four of the previous six decades.

Risk of Higher Inflation

The second risk to the US economy is inflation. Milton Friedman observed that inflation "is always and everywhere a monetary phenomenon."[15] Separate from the recent extraordinary fiscal and monetary stimulus, supply-chain bottlenecks, and the Russian invasion of Ukraine, Charles Goodhart and Manoj Pradhan conclude that a demographic reversal, particularly in China, will lead to higher inflation.[16]

The surge in inflation clearly caught the Fed by surprise, and it has begun raising rates and has initiated a reversal of quantitative easing. Even so, as

Table 1. The CBO's Projection of 10-Year Treasury Interest Rate for 2021–30 Compared to Previous Decade Averages

Decade	10-Year Treasury Note	Three-Month Treasury Bill	Federal Funds
Actual Averages			
1961–70	5.00	4.33	4.58
1971–80	7.91	6.80	7.72
1981–90	10.30	8.43	9.44
1991–2000	6.41	4.68	4.96
2001–10	4.18	2.13	2.35
2011–20	2.17	0.59	0.63
CBO Projection			
2021–30	3.17	1.98	2.08

Source: Congressional Budget Office, "Budget and Economic Data," https://www.cbo.gov/data/budget-economic-data.

inflation rises, the reduction in real interest rates increases the power of the Fed's ongoing monetary stimulus.[17]

If the detrimental economic consequences are not incorporated, higher inflation in isolation improves the fiscal picture by increasing nominal GDP and because many tax provisions are not indexed for inflation, pushing taxpayers into higher brackets and increasing revenues. While higher inflation might reduce deficits in the short run, the corrosive effects of inflation erode the economy's future potential, which is ultimately the source of revenue to the Treasury. In short, inflation in isolation may reduce deficits in the short run but at significant costs to the economy that raise deficits in the long run.[18]

The CBO generally assumes higher inflation results in higher interest rates, and the net effect is to increase deficits and debt even in the short run. Using the CBO's workbook provides estimates of the budget impact if interest rates and inflation are higher than its May 2022 budget and economic projections. Assuming inflation and interest rates are 1 percent higher than what the CBO projected in May 2022 increases federal deficits by $2.6 trillion over the next 10 years.[19]

Risk of Additional Fiscal Policy Expansions

As alarming as the CBO's projections are for the federal debt's future path, Congress and the White House will likely worsen the situation. Fiscal policy is increasingly haphazard. Presidents since 2015 have failed to submit their proposed budgets by the statutory deadline, and the congressional budget process is increasingly used as a means to generate partisan reconciliation legislation instead of implementing and enforcing a fiscal framework. There is no bipartisan consensus on a set of budget rules. Further, existing budget rules are rarely enforced. As just one example, the Statutory Pay-as-You-Go Act of 2010 has never been enforced.[20]

Congress frequently sunsets provisions of legislation to meet budget rules or limit the apparent cost of the legislation, only to extend those provisions when the expiration date arrives without offsetting the cost. The CBO does not include the cost of future extensions of these provisions in its budget projections.

The recent Inflation Reduction Act is a good example. While a preliminary estimate showed a 10-year deficit reduction of $305 billion, the bill includes a three-year extension of a temporary emergency expansion of Affordable Care Act health insurance subsidies enacted during the pandemic. If those subsidies were permanently extended, the deficit reduction in that preliminary estimate of the bill would fall to $156 billion.

In addition to existing provisions of law that are scheduled to expire, President Joe Biden has recently signed two more bills into law with hefty price tags: Legislation to support the semiconductor industry (the CHIPS and Science Act) would increase the deficit by $79 billion over 10 years, and legislation to expand veterans benefits (the Honoring Our Promise to Address Comprehensive Toxics Act) would increase the deficit by $667 billion over 10 years.[21] And, on August 24, 2022, the president announced a plan to forgive up to $20,000 in student loan debt per qualified borrower with an estimated cost of $400–$600 billion.[22]

Finally, in the past 21 years, the country has suffered the worst terrorist attack in its history, the worst economic recession since the Great Depression, and the worst pandemic since 1918, along with hurricanes and wildfires. Congress responded with deficit-increasing legislation to address these emergencies. Importantly, the CBO's current debt projections do not include the likely cost of legislation to address future emergencies.[23]

Risk to the Economy

While the enormous increase in the debt has cost the federal government and the US economy little to date, if it continues to grow as a burden on the economy, it will eventually sap economic growth and could hinder the federal government's ability to finance the already-legislated growth in federal spending and responses to future crises. As the debt grows, it will reduce domestic savings, require a greater reliance on foreign borrowing, and increase the risk of a future fiscal crisis, as the CBO warned in March 2021:

> Debt that is high and rising as a percentage of GDP boosts federal and private borrowing costs, slows the growth of economic output, and increases interest payments abroad. A growing debt burden could increase the risk of a fiscal crisis and higher inflation as well as undermine confidence in the U.S. dollar, making it more costly to finance public and private activity in international markets.[24]

It is becoming increasingly clear that excessive debt-financed economic stimulus to counter the pandemic's economic downturn significantly contributed to the recent rise in inflation.[25] Inflation has produced large increases in prices, particularly for gasoline, other energy bills, and food, adding $450 a month to household bills.[26] Inflation imposes a cost on all households but imposes a disproportionate burden on lower-income families.[27] In 2020, the CBO estimated that if debt were reduced to its pre-pandemic level of 79 percent of GDP by 2050, it would boost GDP per person by $4,600 in today's dollars.[28]

A Path Forward

The best way to address our grim long-term fiscal outlook is to maintain a strong and growing economy while slowing the growth in federal spending. Federal-spending growth is driven by mandatory spending, particularly for non-means-tested entitlement programs, such as Social Security, and health care mandatory spending.

Despite the recent surge in borrowing, the federal government's financing costs remain low. Abrupt and large changes in fiscal policy are politically difficult to make and may harm the economy in the short run. Phasing in changes can demonstrate to financial markets that the US is on the case to get its fiscal house in order, and the savings from those changes, particularly in mandatory programs, compound powerfully over time. In addition, it gives individuals and organizations the time to adjust to those changes.

With a stronger economic recovery than anticipated, FY2021 federal revenues grew by $626 billion, or 18 percent, and reached a level of 18.1 percent of the GDP, well above what the CBO projected and the 50-year historical average of 17.3 percent of GDP.[29] Even without tax increases, the CBO projects revenues will remain above their historical average. That is not the case with spending, which was above the historical average of 20.8 percent of GDP the year before the pandemic; that gap is projected to widen dramatically in the future.

Congress has shown reluctance to tackle the major drivers of spending—Medicare, Medicaid, and Social Security. Moreover, any implemented long-term mandatory reforms are more likely to be sustained if enacted with bipartisan support that likely will require revenue increases to be part of the equation. Before revenues are raised through legislation, however, budget enforcement tools or demonstrated success in spending restraint are needed. Otherwise, spending reforms could be reversed, higher revenues could be spent, and the drivers of deficit and debt could remain in place or be expanded. If revenues are pursued, the focus also should be on revenue raisers that are the least detrimental to economic growth.

If Washington pursues policies that slow the growth of federal spending, promote economic growth, and bring down the federal debt burden, it reduces the risk of one of two potential bad outcomes. In the less pessimistic case, inflation and interest rates rise, hampering economic growth and Americans' well-being. The more troubling scenario is a fiscal crisis in which the federal government has trouble financing its debt at reasonable interest rates.

Reforms to entitlement programs are usually cast as harming the beneficiaries. However, if properly structured and implemented, putting these programs on sound financial footing can preserve the safety net and ensure future generations can continue to benefit from these programs. Most importantly, those same beneficiaries who are frequently cast as victims of reforms tend to be the ones hardest hit by the consequences of doing nothing—rising inflation, rising interest rates, and slower economic growth. And in the event of a fiscal crisis in which the federal government's ability to borrow is limited by financial markets, addressing it will require drastic and immediate actions that probably would impose the greatest harm on those who rely on government assistance the most.

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HEALTH AND RETIREMENT SECURITY

4

Medicare as a Catalyst for Competitive Reforms

JAMES C. CAPRETTA

The US is an outlier among advanced economies in that its national government does not fully control, through regulation and budgeting, health insurance coverage and the provision of medical care. The government is a major force, of course, but there is more room than in other countries for private enterprise and initiative, and many transactions take place beyond the government's reach.

Even so, the nation's health system is hardly an "anything goes" free market, despite frequent claims to the contrary by those wishing to blame today's dysfunctions on market ideology. Even with boundaries, the federal and state governments are far and away the most decisive forces directing the allocation of resources in the health system. What now exists in the US is not a market-driven health system but rather a complex interplay between the public and private sectors that does not fall neatly on one side or the other of the government-market divide.

For most Americans, the arrangements now in place, unplanned and fragmented as they are, are generally good enough and often excellent. The combination of public insurance for the elderly (Medicare) and the poor (Medicaid) and privately purchased insurance for the working-age population and their families (mostly by employers) gives the vast majority of citizens and legal residents ready access to health services from a large network of hospitals and physician practices that have the skill and resources to deliver world-class care.

The major challenge in the current system is the absence of an organized and intentional regimen of cost and quality discipline. The government is not fully in control, and the markets for both insurance and medical care are highly compromised, by both government interventions and inherent limitations. The result is runaway costs. The rise in unchecked expenses, often for care that provides little value to patients or is vastly overpriced, is forcing aside other priorities, such as spending by households on educational expenses or improved housing. Rising health system costs are also the most important contributor to current forecasts of ever-widening annual deficits for the federal government. Left unchecked, the predictable result of continued rapid health cost inflation will be runaway debt, followed by higher taxes and premiums for all consumers.

Medicare is central to all of this, both good and bad. The program is understandably popular among the elderly because of the access to essential services it provides. At the same time, Medicare's rules for paying hospitals, physicians, and other service providers are the single most important factors influencing how care is delivered to all patients, not just those enrolled in Medicare. In other words, as Medicare changes, the ripple effects throughout the health system are substantial.

And therein lies an opportunity. For advocates of a market-driven health system, Medicare reform is essential because of its influence. Critics contend the elderly will never serve as effective consumers, but existing evidence already says otherwise. Several studies have shown that when Medicare beneficiaries enroll in Medigap insurance, their use of services increases because they no longer pay out-of-pocket for many services.[1] Congress needs only to modify the program to give its enrollees the right tools and incentives to benefit directly from making cost-reducing choices.

A Structured Market

Over the past half century, market advocates have advanced some successful reforms to the health care system, such as creating health savings accounts in 2003, but the overall direction of change has been toward tighter government control rather than vigorous competition and consumer choice. One impediment has been confusion over what is required for a market to function properly. As Kenneth Arrow articulated in 1963, the market for medical services will sputter without some regulation because of the nature of what is being consumed.[2]

Patients must entrust their well-being to trained clinicians because they lack sufficient expertise to make decisions on their own. This alters the normal supplier-consumer dynamic that allows other markets to operate efficiently. It also follows that the public expects physicians and others who largely determine what services patients will receive to apply ethical principles to their professional decisions irrespective of the financial consequences. This is not an expectation that applies in most other sectors.

Further, the probability of needing medical care is skewed toward those with high risks, which makes it difficult for an unregulated insurance market to provide acceptable access to all patients, including those with limited resources. Without some restraint, insurers would set premiums for those at the highest risk well above what healthy consumers pay. As just one example, cancer survivors would face a lifetime of high premiums. Most Americans would see this as unfair.

These tendencies, however, do not mean markets can never work or are not worth attempting in this slice of the American economy. The potential remains for incentives to deliver better results for consumers, measured by cost efficiency, innovation, and ever-improving quality and convenience. Rather, the predictable failings of a fully unregulated market point to the need for establishing structure around consumer decisions, so that patients and insurance enrollees can readily see meaningful price differences among their options.

Building an effective health care market will require helping consumers, including those enrolled in Medicare, see value differences when choosing among their coverage options—plan-focused competition—and when deciding from whom to get individual medical services when circumstances are conducive to consumer discretion.

Plan-Focused Competition. The value proposition of managed care insurance plans, especially health maintenance organizations (HMOs), is that they can control costs for their enrollees better than unmanaged fee-for-service (FFS) insurance can. With plan-level competition, consumers would hire agents—HMOs and other types of managed care—to control costs on their behalf. Health plans that successfully keep expenses in check could charge lower premiums than their competitors do and thus attract more enrollees.

Strong competition among plans is essential for spending discipline because overall costs are concentrated in a relatively small number of expensive cases, and only experts who fully understand the care process can use clinical data to identify opportunities for greater efficiency. Spending on patients in the top 10 percent of per capita expenses accounts for two-thirds of all medical care spending.[3] Competing health coverage plans, including those affiliated with service providers, would separate themselves by getting better at managing total costs.

Government policy is essential to making the market for managed care insurance work as intended. Insurers must offer standardized benefits to ensure premium differences are due entirely to varying levels of efficiency and not indecipherable coverage details.

Further, the sponsor of the coverage—which, in the case of Medicare, is the federal government but could also be employers or states—must provide its support in the form of a fixed contribution that does not vary based on the costs of the plans enrollees select. As an example, the level of premium support could be tied to the costs of the average plan; enrollees selecting more expensive coverage would pay the added premium out of pocket. With fixed contributions, the participants would have strong incentives to seek out high-value options, which is crucial for sending the right signals to the insurers running the plans.

Provider-Focused Competition. Consumers can drive efficiency and cost reduction when shopping for individual services and not just their insurance plans, which was the motivation for creating health savings accounts. Not all medical care is amenable to consumer discretion (for instance, emergency care usually is not), but some services allow for scheduling and comparison shopping. When the conditions are right, putting structure around the choices will intensify competition and lower costs.

The first step is meaningful price transparency. For decades, the pricing for individual services has been opaque and overly complex. That is beginning to change with new transparency regulations on hospitals and insurers, implemented across administrations and on a bipartisan basis. The new rules will flood the market in the coming years with pricing data that were previously invisible even to large payers, such as employers. The shift, aided by information technology, may begin to help consumers navigate the market in ways that were not possible previously.

However, the steps taken so far are unlikely to solve the whole problem, most especially in the context of Medicare. For price shopping to become a reality in the program, two further changes are necessary.

First, Medicare's administrators must issue rules standardizing what is being priced. Patients will never be able to shop for services if what one clinician is offering differs in important ways from what a competitor is offering.

Second, consumers must share in the savings when picking low-priced options, even when they have already satisfied their deductibles and have full insurance protection. Without an incentive for consumers to choose lower-priced but comparable options, service providers will never feel compelled to compete vigorously based on what they charge.

Key Reforms

Bringing market discipline to Medicare will require several steps, starting with rationalizing its benefit structure to reduce complexity and allow for more straightforward premium comparisons among coverage options.

Rationalizing Benefits, Coverage Options, and the Enrollment Process. Medicare's origin and evolution have made the program difficult for beneficiaries to navigate.

At enactment, Medicare was modeled on the prevailing private-sector insurance plans of the day: not-for-profit Blue Cross Blue Shield coverage for hospitalizations and physician services. In Medicare, Part A is for hospitalizations and other facility-based services, and Part B is for physician and ambulatory care. Prescription drug coverage (called Part D) was added in 2006 and is housed within Part B.

The hospital insurance (HI) trust fund is used to track Part A receipts and spending and is constructed like Social Security, with payroll taxes collected from current workers and their employers paying benefits for current retirees (so-called pay-as-you-go financing). Workers "earn" their Part A coverage for themselves and their spouses by paying employment taxes for a specified number of years (usually 10).

When eligible persons enroll in Part A, typically at age 65, they also can voluntarily enroll in Parts B (for physician and ambulatory care) and D (for prescriptions filled at retail pharmacies) by agreeing to monthly premiums covering a portion of their total costs. The balance of Parts B and D expenses, which are tracked in the supplementary medical insurance (SMI) trust fund, is financed by transfers from the general fund of the Treasury—that is, taxpayers. At enactment, premiums collected from enrolled beneficiaries were expected to cover 50 percent of total SMI expenses.[4] However, as health inflation escalated in the program's first decade, Congress limited the rate of growth of beneficiary premiums below that of total expenses, which meant a higher burden on taxpayers. Eventually, Congress settled on a new target, pegging beneficiary premiums at levels sufficient to cover 25 percent of total costs, which was written into permanent Medicare law in 1997.[5]

Medicare's benefit design, which may have made sense at enactment, is now out of step with industry standards. Most private coverage involves a single set of cost-sharing rules across all benefit categories. In Medicare, though, beneficiaries must satisfy separate deductibles and coinsurance requirements for all three benefit components.

In Part A, they must pay a deductible for inpatient hospital stays ($1,556 in 2022), a copayment per day ($389 in 2022) for stays that last between 61 and 90 days, and a higher copayment per day ($778 in 2022) beyond 90 days. Further, there is a lifetime limit of 60 days for inpatient stays lasting beyond 90 days; when those have been exhausted, the beneficiary is responsible for the full cost of inpatient care.

In Part B, the beneficiary must pay out of pocket for a deductible before coverage begins ($233 in 2022) and then 20 percent of the cost of each service received.[6]

Part D has a standard benefit with a $480 deductible in 2022 and a 25 percent beneficiary copayment for all costs above $480 and below $10,690. Above $10,690, the beneficiary pays 5 percent of costs.[7] Prescription drug plans participating in Part D are authorized to alter the standard cost sharing so long as the total actuarial value of what they are offering is equivalent to the benefit defined by the law.

Medicare is now a confusing mix of mandatory participation (for Part A) and voluntary enrollment (for Parts B and D), with further options to enroll in privately administered Medicare Advantage (MA) or Medigap plans. In addition, some beneficiaries are placed into accountable care organizations (ACOs)—provider-led entities that get paid for services rendered but that also can get bonuses for controlling costs with managed care practices—without their knowledge. (This general pattern has some exceptions.)

Adding to this complexity is the lack of a system of enrollment that makes price comparisons straightforward. Under current processes, it is not a simple matter for beneficiaries to compare the all-in financial implications of the various combinations of coverage available to them. Many beneficiaries end up relying on brokers to steer them through the process, even though brokers are under no obligation to treat all options equally.

Reform should begin with modernization and simplification of the benefit structure and enrollment process. Beneficiaries should be presented with the full range of their benefit options through one government-administered enrollment portal that makes it less necessary for beneficiaries to rely on outside parties to help them make their choices. Through it, they should be able to compare competing approaches for delivering covered services on an apples-to-apples basis and across the three main benefit components, as shown in Table 1.

Parts A and B should be combined into a single insurance plan, with one deductible and cost-sharing structure designed to encourage cost-effective use of care. There should be no cost sharing required for inpatient hospital stays, and beneficiaries should be protected against high annual out-of-pocket costs through a "catastrophic cap." The actuarial value of this redesigned benefit should equal what is required for covered benefits in current Medicare law. (This ensures no increase in federal costs.)

This redesign, with one deductible and simplified cost sharing for service use, will necessarily require a larger upfront deductible than applies to Part B today to ensure total federal costs do not increase. For instance, the Congressional Budget Office (CBO) has estimated that applying a $700 upfront deductible for both Parts A and B, along with 20 percent coinsurance on all expenses above that level and an out-of-pocket limit of $7,000 annually, would approximate the insurance value of current law (although changing the benefit design in this way would produce a relatively small amount of budgetary savings).[8] The distribution of spending across

Table 1. Restructured Choices for Medicare Beneficiaries

Required Medicare-Covered Services	Prescription Drug Coverage	Supplemental Coverage
Traditional FFS	Stand-Alone Part D Plans	Reformed Medigap Options
ACOs	Stand-Alone Part D Plans	ACO-Affiliated Medigap
MA Plans	MA-Affiliated Part D Coverage (MA-PD)	MA-Sponsored Optional Supplements

Source: Author.

beneficiaries would shift, however, with the sickest beneficiaries getting relief from elimination of expenses for hospital stays and the new limits on their annual out-of-pocket expenses. Total costs would fall slightly from reduced use of some services due to the larger upfront deductible.

While combining Parts A and B makes sense, Part D should remain a separate benefit initially because of its unique role and reliance on competing private plans. Over time, it could be integrated into the combined Parts A and B insurance plan as premium support (discussed below) is implemented across all of Medicare.

There should be three basic options for getting Medicare coverage that conforms to this redesigned benefit.

FFS, as administered by the federal government, would remain an enrollment option for all beneficiaries in all regions of the country. FFS is the traditional option in Medicare, for which the government has written extensive and complex payment rules for hospitals, physician practices, and other providers of medical services. About 60 percent of Medicare beneficiaries are enrolled in FFS.

ACOs—now a subpart of FFS—should become a coverage option that is distinct from both FFS and MA. ACOs differ from MA plans because they are organized and run by the hospitals and physicians providing care to patients, not insurance companies. Some Medicare beneficiaries may be comforted by this distinction. ACOs also are not traditional FFS because they are expected to implement some managed care techniques to control costs for their assigned beneficiaries.

Medicare's rules should be modified to require ACOs to offer the full range of Medicare-covered services for a fixed monthly premium and to demonstrate some capacity for managing costs without harming the quality of care provided to patients. The hospitals and physician groups now participating in the various ACO demonstration models should be given time to transition into entities capable of taking on insurance risk and providing organized care to an enrolled patient population. They could contract with other insurance plans to perform functions outside their core competencies. They also could pay their affiliated providers on any basis they determine is effective, but, at their discretion, they would be free to continue using Medicare's FFS payment rules.

MA plans would be required to offer all enrollees a package of benefits actuarially equivalent to coverage under Parts A and B, without supplemental benefits (which would be offered separately, as discussed below).

The next component of the benefit scheme would be for prescription drugs. Here, the Part D program would operate much as it does today, with private plans competing for enrollment (and no government-administered option). The Part D benefit package should be updated to lessen the incentive for using rebates for price discounts by requiring the plans to cover more of the expenses above the catastrophic threshold. Beneficiaries opting for enrollment into FFS or an ACO would choose from stand-alone Part D plans, while MA enrollees could accept their MA plan's drug coverage option (which the MA plans would be required to offer) or decline enrollment into Part D.

Finally, Medicare beneficiaries should be allowed to buy supplemental benefits that they self-finance with premium payments. Enrollees in FFS should be allowed to purchase Medigap coverage—but in modified form to make sense in the context of unmanaged care. With FFS insurance, cost sharing at the point of care is an important tool for moderating use of services. Medigap plans sold to FFS enrollees should not fully eliminate cost sharing when patients are using more discretionary services in an ambulatory setting.

ACO enrollees could purchase Medigap coverage, too, but the ACOs would be required to work with private Medigap plans to provide coverage that works with the plan's managed care practices. In particular, the Medigap plans should provide preferential cost sharing only when enrollees use ACO-affiliated providers and not for out-of-network care.

MA plans attract enrollment today by offering supplemental coverage beyond the benefits required under current Medicare law. With these reforms, they could continue to offer these benefits, but they would be separated from statutorily required Medicare benefits and financed from beneficiary premiums. On a net basis, the effect likely would be an approximation of what occurs today, albeit with more transparency and beneficiary participation. Many MA plans would be able to deliver premium savings relative to FFS, with the savings available for use by the beneficiaries to purchase supplemental benefits.

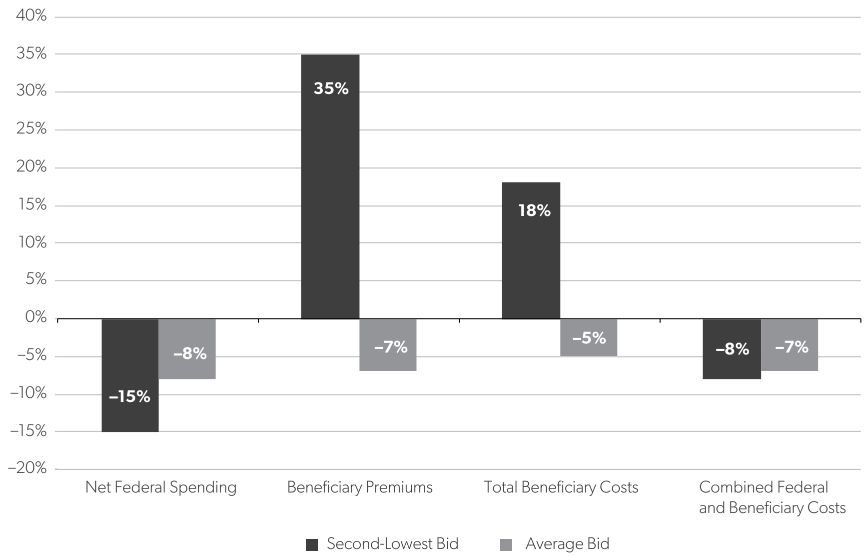
This reformed benefit structure, along with a streamlined and improved enrollment portal, would allow Medicare beneficiaries to see their options more clearly than they do today. They could compare the premiums charged by FFS, ACOs, and MA plans when deciding how to secure their benefits under Parts A and B. They also could see what their premiums would be when combining options for Parts A and B coverage with those for Part D and supplemental benefits. Structuring the enrollment process in this way would intensify the premium competition and lower overall costs.

Ensuring Fair Premium Competition Among the Coverage Options. The crucial second piece of an effective reform is implementation of strong price competition among the various coverage options. As noted, the Part D benefit was designed to promote such competition, through a premium support construct. Modest premium growth in the program has validated the model.

The next step is to implement premium support in Parts A and B. MA plans already submit competitive bids under current law, but those bids are considered in relation to benchmarks tied to historical cost rates that may not accurately reflect what spending would be with efficient care provision. Further, FFS does not participate in the competitive bidding process, which means its enrollees are held harmless even when FFS is much more expensive than the MA options in a market area. The exemption of FFS from competition has been a major impediment to stricter cost discipline.

Fair competition requires submission of bids from FFS, ACOs, and MA plans for the same set of redesigned and actuarially equivalent benefits.

Figure 1. Premium Support Effects on Program and Enrollee Costs



Source: Congressional Budget Office, "A Premium Support System for Medicare: Updated Analysis of Illustrative Options," October 2017, https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53077-premiumsupport.pdf.

FFS's bid would be a calculation by the government of the per-beneficiary costs in each market. The government should continue to refine its risk adjustment methodology to ensure the competition is based on efficient care delivery and not differences in the underlying health status of the enrollees joining the various coverage options.

The government's contribution toward coverage (its "premium support") should be based on the submitted bids. One option for setting the government's payment would be to tie it to the second-lowest bid in every market area (as defined in law or regulation). An alternative would be the average bid (weighted by enrollment) in each market.

The CBO has analyzed the budgetary effects of both approaches, as shown in Figure 1. (The government contribution would be net of the beneficiary premium, set at what is required for enrollment into Part B under current law.)

With the second-lowest bid, overall costs for the federal government would fall by 15 percent, but net beneficiary expenses would rise by

18 percent, partly because FFS enrollees in high-cost markets would pay higher premiums. Using the average bid to set the government's contribution would still lower the federal government's costs (by 8 percent), but it would also reduce out-of-pocket spending by beneficiaries, by an average of 5 percent annually.

The CBO's assessment of premium support confirms that competition would lower costs by encouraging migration toward more efficient coverage options. It also suggests that the competition likely would slow program spending growth in future years by encouraging development and adoption of cost-reducing technologies that improve the efficiency of care delivery.[9]

MA plans have an advantage over FFS because they can build selective networks without paying substantially higher rates for inpatient services. The law prohibits balance billing by facilities even when treating non-FFS Medicare patients, which means hospitals have little incentive to resist the contract terms of MA plans.

To improve the functioning of the marketplace, this requirement should be revisited, especially as premium support would increase the pressure on MA plans to achieve cost reductions through more efficient arrangements.

The savings from more intensive premium competition among the coverage options can be shared with Medicare enrollees to make the reform more attractive politically. One approach would be to expand Medicare-covered benefits and increase the government's contribution toward the coverage. For instance, expanding Medicare benefits to include an annual out-of-pocket cost limit (so-called catastrophic protection) might be done as an add-on (rather than in an actuarially neutral manner). Medicare might also cover some benefits that fall outside what is provided in current law today (such as some dental services). These added benefits would lessen the savings from reform but might diminish the political opposition that has made advancing the premium support concept so difficult in the past.[10]

Competition and Price Shopping in FFS. Premium support is not the only means by which stronger market discipline can be introduced into Medicare. Enrollees in FFS can be encouraged to select lower-priced service providers too.

Medicare should become a leader in using standardized pricing to foster strong competition. Hospitals and physicians today have weak incentives to post clear pricing for their services, and the complexity of medical care makes price comparisons difficult for patients when multiple line items are billed for a full episode of care.

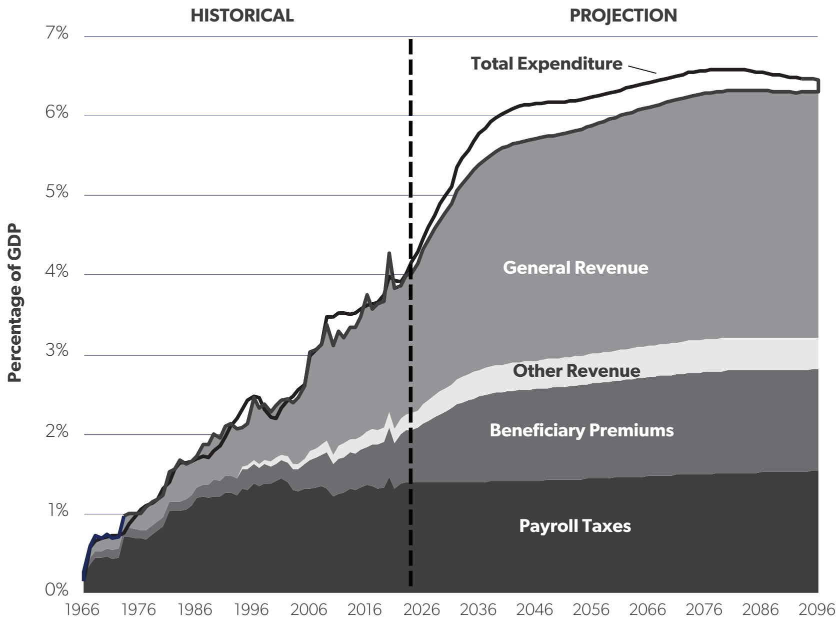
The Centers for Medicare & Medicaid Services could promote strong price competition by requiring participating providers to disclose pricing for standardized services covering common procedures. The key is to ensure a coordinated, all-in price from all the practitioners and facilities involved in delivering care to a patient. For instance, the government could require all providers involved in common surgeries to provide a combined all-in price for these services.

An essential next step is to incentivize the Medicare enrollees to shop for lower-priced options. Medicare could do this by calculating benchmarks in every market (based on prevailing FFS rates) for a list of standardized interventions. Beneficiaries opting for providers that post prices below the benchmarks should keep some of the savings (perhaps 50 percent). In some cases, for expensive care, the payment to the Medicare beneficiaries could be thousands of dollars, which would create strong incentives for the providers to price their services more aggressively and for the beneficiaries to migrate to the lowest-priced options. For beneficiaries in rural areas, the savings from lower-priced options in more urban settings might be sufficient to make the cost of travel worthwhile. And there is strong evidence that the overall effect would be to deliver substantial savings, for both Medicare as a program and the program's enrollees.[11]

Modernizing the Trust Fund Structure. Medicare's trust funds attract considerable political attention, for understandable reasons. HI relies entirely on tax collections, not subsidies, to meet its obligations, which means it could run short of funds and thus force Congress to take up corrective legislation. In 2022, the CBO projected that the HI trust fund would be depleted of reserves in 2030, after which it could not cover 100 percent of benefit claims.[12]

While the impending insolvency of HI can be a powerful motivator and, under the right circumstances, propel sensible reforms forward, it has not always worked that way. Congress's interest is in ensuring Medicare

Figure 2. Total Medicare Spending and Sources of Financing



Source: Medicare Trustees, *The 2022 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, Centers for Medicare & Medicaid Services, June 2022, https://www.cms.gov/files/document/2022-medicare-trustees-report.pdf.

beneficiaries receive coverage of their medical expenses. The path of least political resistance might be to replenish the HI trust fund with changes that cause minimal controversy, even if that means ignoring the fundamental sources of the program's financial challenges.

Figure 2 exposes why papering over HI's shortfall would leave the real financial problem unresolved. Because the SMI trust fund is financed mainly with transfers from the Treasury, it is perceived as perpetually solvent even though its burden on taxpayers is already immense and will become overwhelming in the coming decades. The 2022 Medicare Trustees report on the program's financial outlook estimated that general fund transfers to SMI will total $6.0 trillion over the next decade alone. By 2050, the annual transfer will equal 2.8 percent of gross domestic product (GDP), up from 0.7 percent in 2000.[13]

The core problem is rapid growth of total Medicare spending, driven by an aging population and escalating costs for services. In 1990, total program spending equaled 1.9 percent of GDP; three decades later, it had reached 4.0 percent of GDP. Medicare's trustees expect costs will reach 5.0 percent of GDP in 2030 and 6.2 percent in 2050.[14]

Medicare's trust funds need updating to mirror the changes recommended for the program's insurance design. With Parts A and B benefits combined into a single insurance plan, their receipts and expenses should be tracked through a single trust fund too. For this reform to work as intended, general fund payments to the new account must be limited in some fashion, which would then force Congress to consider reforms to keep program spending within available receipts.

One option would be to tie the government's general fund contribution to Medicare to the amount paid for Parts B and D in a reference year and then to index that amount in subsequent years to the rate of growth in the national economy. This approach would ensure that current and future taxpayers contributed the same percentage of their combined incomes toward sustaining Medicare.

Changing the basis of general fund support for Medicare will not by itself ensure an appropriate political response, as Congress could avoid serious reforms with budget gimmicks that inject funds into Medicare without raising taxes or cutting expenditures.

Nonetheless, it remains important to change how the Medicare trust funds operate because the status quo creates an unhealthy and misguided focus on HI solvency, even as SMI spending becomes an ever-larger burden on taxpayers. A reformed trust fund mechanism could change the tenor of the political conversation around Medicare solvency and is thus worth pursuing.

Cost Estimates and Further Reforms

The reforms suggested here, if approved, would be among the most consequential entitlement changes ever enacted by Congress, although estimating the full extent of the savings will be difficult because the suggested adjustments interact with each other. The two changes with the most notable effects are implementing premium support and limiting the growth rate of general fund payments to the Medicare trust fund.

As noted previously, the CBO has estimated that premium support, with the government contribution tied to the average premium bid in each market, would reduce federal program spending by 8 percent. In the agency's most recent long-term forecast, Medicare spending (net of premiums) is projected to rise from 2.9 percent of GDP in 2022 to 5.9 percent in 2052.[15] Cutting the program's cost in 2052 by 8 percent would lower the burden to 5.4 percent of GDP.

While certainly substantial (and likely a conservative estimate of the potential savings), allowing Medicare spending to rise to 5.4 percent of GDP in 2052 would still entail too much pressure for further tax hikes and non-Medicare spending cuts. More savings in Medicare will be necessary. For instance, one goal might be to limit the amount of overall Medicare spending in 2050 to about 5 percent of GDP, which implies that reforms would need to deliver another 14 percent reduction in program expenses.

Combining HI and SMI into a single Medicare trust fund will not, by itself, deliver such savings, but it might help. The intention is to force Congress to take up additional program adjustments to prevent trust fund insolvency.

Among the ideas that should be considered is further means testing the program. One option would be to keep in place a level of subsidization for all Medicare participants but to ask those with above-average lifetime earnings to pay for more of the total costs of their coverage. Medicare would remain a highly valued program for these beneficiaries because it is a community-rated insurance plan; enrollees with higher risks do not pay higher premiums. But some enrollees would be expected to pay higher premiums out of their retirement savings. Low- and moderate-income elderly enrollees would lose none of their current support.

Changing Medicare in this way would be controversial, of course, and could only be implemented gradually, as workers approaching retirement would need time to plan for the additional expenses. Even so, the immensity of the government's financial challenges requires that this and other ideas (such as raising the age of eligibility) remain firmly on the table for consideration.

Still, the first step should be to modernize the program and bring more discipline to it by allowing its participants to steer resources toward more efficient ways of receiving services. These changes are controversial, too, but not because they would impose higher costs on beneficiaries. Medicare's participants would see substantial savings, as would the government. Opposition will come from those who distrust using market incentives in health care. Their concern with these ideas is that they would work as planned and thus undermine the argument that Medicare as it exists today, with its heavy reliance on government-administered payment rules, should be the insurance plan for all Americans.

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5

A Path to Better Health Beyond Medicaid

THOMAS P. MILLER

Most right-of-center criticism of Medicaid comprises a mix of the following: The program's spending incentives stimulate demand while restricting supply. They encourage state officials to maximize their capture of federal matching dollars rather than focus on a better balance of efficient, effective, and equitable health care services for their most vulnerable populations. When the states eventually must economize on the margins, they primarily resort to underpaying health care providers to even greater degrees. This hollows out seemingly generous benefit promises in their Medicaid programs.

Expansion in enrollment equates to dilution in value delivered to the neediest. The push-pull dynamic between overstimulated demand and constrained supply encourages wasteful practices, delivers lower-quality care, and polices fraud poorly (even while driving up administrative burdens on providers).[1] It crowds out private-market alternatives and discourages work. Medicaid coverage also fails to be integrated effectively with other coverage, which disrupts ongoing relationships with physicians and care coordination during transitions in beneficiaries' eligibility status.

Medicaid in practice is far less about maintaining and producing better health and much more about delivering superficially higher coverage numbers in the cheapest and most expedient ways, or at least enough to overlook what is actually happening to beneficiaries over the long term.

There is a long and daunting to-do list of substantial repairs that are sometimes desired but rarely delivered. It's not a new one, either. This chapter could try to recount a host of past, and likely future, attempts to chip away at those chronic problems (and it does, briefly), but their track record and future prospects remain bounded by the political, economic, and social pressures that have sustained a dissatisfactory status quo across our health care system despite its outcomes. More of the same, more or less, remains likely to produce . . . more of the same.

A Different Mix of Initial and Slower Developing Structural Reforms

Where to begin again? Perhaps somewhere else, to demonstrate different initial routes for planting the seeds of more dynamic change over a longer time horizon. Most notably over the past decade, passage of the Affordable Care Act (ACA) in March 2010 further propelled decades of inefficiencies and disappointments in the Medicaid program for low-income Americans into a new era of rapid growth. Although an unexpected Supreme Court ruling in *National Federation of Independent Business v. Sebelius* in 2012 provided states with choices over whether to agree to the ACA's Medicaid expansion terms, various right-of-center efforts to resist or revise the terms of those federally prescribed changes fell short or short-circuited by the end of 2020. In the meantime, the COVID-19 pandemic triggered an even more rapid expansion of Medicaid over the past two years, primarily as the most readily available platform to dispense new layers of care quickly, if not effectively, for a health care system under extraordinary stress.

These facts on the ground have altered the political window for policy reform. Medicaid has grown larger than ever and captured a greater share of the health care market. These latest layers of Medicaid spending have been financed even more disproportionately by federal taxpayers and federal government debt.

However, the fiscal effects are symptoms that reflect deeper distortions than budgetary imbalances per se. Before succumbing to the lazy political temptation to rinse and repeat with another dose of rewarmed rhetorical stances, we should reexamine other options. They may begin with another round of modified, incremental policy steps but need a much bolder reframing of key issues, particularly for a post-pandemic policy landscape ahead.

Without preempting others' efforts to try to succeed finally with approaches that have often failed to be adopted in the past, let alone implemented successfully, here are several different approaches to pursue.

First, in the short term, stop the misdirected bleeding of resources through pandemic-related mis-incentives of enhanced federal matching rate subsidies combined with mandatory maintenance of effort restrictions on state Medicaid policies and practices.

Second, reopen some different windows for state, local, or even beneficiary-driven innovation, primarily through reconfigured combinations of Medicaid Section 1115 waivers that work in closer coordination with ACA Section 1332 individual market waivers. These so-called mega-waivers could provide better timelines, tools, and incentives to produce actionable and measurable results.

Third, reframe trade-offs more transparently to prioritize what must be done better, and what might have to be done less, to move in that direction. Medicaid habitually promises to do far more than it can, and it achieves even less as a result. Opportunistic expansion, driven by funding flows and political ambitions, overshoots the sustainable runway. It leaves victims and debris behind even well before it risks crashing more spectacularly. We won't change that until we first acknowledge a number of constraints that narrow the path for more conventional "reforms." This still could leave open some other less-explored doors for structural, slower-developing change.

Assembling an effective coalition in favor of more market-based alternatives to expansion of an unreformed Medicaid program will require more than a recitation of budget projections that suggest "it costs too much" and "we can't afford it." Those statements may contain accurate mathematical projections, but they fail to offer better, realistic alternatives that can address low-income Americans' health care needs more effectively, without preempting their opportunities to achieve other important life goals too. If we want better answers, we first will have to ask better questions from perspectives beyond the confines of the Medicaid program alone.

The more far-reaching reforms posited here still must first start on a smaller, proof-of-concept basis. Over time, they then can redirect the demands of current and future beneficiaries and voters to insist on higher-valued uses of resources in other ways to improve their overall lives as well. For these reasons, federal-state mega-waiver mechanisms that combine more of the individual health insurance market with the recent Medicaid expansion cohort could help unlock current commitments and invest more productively in producing improved health outcomes, upward mobility, and more self-sufficient Americans.

Recent Factors Inflating the Medicaid Bubble

Before fleshing out these alternative pathways, I pause for the obligatory, abbreviated review of recent Medicaid history from the spending-side perspective, even though that is not really where results-driven reform should begin or end. A further caveat is that many studies and statistics for the program tend to be incomplete, not fully comparable, subject to revision later, and often lagging significantly behind real-time overviews.[2]

The most recent estimates of Medicaid enrollment available from the Centers for Medicare & Medicaid Services (CMS) report that 81.9 million individuals were enrolled in Medicaid in May 2022. Another 7.1 million were enrolled in the Children's Health Insurance Program (CHIP), which somewhat complements Medicaid in covering many lower-income individuals below age 18.[3] If one uses the combined Medicaid and CHIP enrollment figures, those covered by the two income-related insurance programs increased by 18.3 million individuals (25.9 percent) from pre-pandemic February 2020.[4] However, Medicaid enrollment grew far more rapidly, increasing by 17.94 million individuals (28.0 percent) from February 2020 to May 2022. CHIP enrollment increased by only 347,900 individuals (5.2 percent) during that period. This rapid enrollment expansion actually followed combined enrollment declines in 2018 and 2019 and relatively flat enrollment growth in early 2020.[5]

Total Medicaid spending similarly increased by over 9 percent in 2020, to $649 billion.[6] By one recent historical yardstick, Medicaid spending grew by over 50 percent since 2013, compared to overall national health care spending growth of 44 percent during that same period. (This is contrary to a longer-term trend, in which annual Medicaid spending grew slower than the average annual national rate by about 0.5 percent each year from 1971 to 2010.) The ACA's Medicaid expansion was implemented primarily in 2014 and 2015, and the pandemic-related surge in Medicaid enrollment began mostly in the second half of 2020. These spending increases were driven more by periodic surges in Medicaid enrollment (up 16.5 million individuals, or about 28 percent, since 2013) than by increased spending per enrollee (up 18 percent).[7]

This frame of reference highlights the primary source of "recent" spending growth. It remains true overall that a smaller share of total Medicaid beneficiaries in other eligibility categories—the "dual-eligible aged" and the disabled of all ages—are much more expensive to finance on a per capita basis, whether or not the care they receive is delivered in adequate quality and quantity.[8] However, both the fiscal and qualitative problems in those portions of the Medicaid program are even more persistent and resistant to market-oriented reform efforts. They offer meager prospects for structural change over the foreseeable horizon (as explained further below).

The federal government's share of overall Medicaid spending also increased, to 67 percent, in fiscal year (FY) 2020. Before the ACA's Medicaid expansion, the average federal share was around 57 percent.[9] However, the ACA provided a much higher federal matching rate for individuals enrolled under its expanded eligibility provisions (starting at 100 percent in 2014 and declining over several years to 90 percent). A special enhanced matching rate boost of 6.2 percent in the Family First Coronavirus Response Act (FFCRA) in 2020 drove the federal share of Medicaid spending higher again.

In short, Medicaid grew significantly over the past decade, and federal taxpayers picked up more of those costs. The two developments are not unrelated. They happened despite various right-of-center critiques of the program's design and operations and lingering resistance to the ACA Medicaid expansion in a (shrinking) number of Republican-governed states. The combination of enhanced levels of "free" federal money for state officials, private-insurance losses during economic downturns, and short-term emphasis on Medicaid coverage as the quickest fix during the COVID-19 pandemic seems to have overpowered those concerns.

Spending mis-incentives produced by Medicaid's open-ended Federal Medical Assistance Percentage (FMAP), in which each dollar of state Medicaid spending is matched by at least one dollar (and usually more) from federal taxpayers, are not new. They undoubtedly discouraged previous state efforts to control spending more effectively in previous decades, but they only grew stronger due to enhanced rates under the ACA expansion and the FFCRA.

Proposals to cap federal funding levels through block grants or per capita allotments were rejected on Capitol Hill in 2017 (following resistance from several Republican governors).[10] Trump administration efforts to encourage state waiver applications to pursue similar objectives failed to produce significant responses or results. Lesser initiatives to experiment with increased cost sharing and account-based savings incentives for Medicaid beneficiaries were hemmed in by statutory restrictions, funding limits, and administrative challenges.

Secondary Effects from Fiscal Pressure

At some point, most states still manage to exhaust creative ways to maximize federal funds beyond their nominal percentage levels and run up against their own budget constraints. Then, their most common policy response has been to lower payments to Medicaid providers, even further below their actual costs to supply such services and products. Cutbacks in optional Medicaid benefits and limits on eligibility offer less-immediate savings to state policymakers. They also are more transparent to voters and Medicaid beneficiaries and hence less politically attractive.

Decrying state Medicaid programs for inadequate reimbursement levels, by itself, is more of a facile political talking point, absent any indication of new political willingness to pay more to improve access to quality care in better ways.[11] Although higher spending by itself does not ensure better-quality care, below-market payments certainly can reduce physician participation in the program and aggravate gaps in timely access to necessary care.[12]

Limited data indicate a mixed picture. By several older measures, Medicaid may pay most physicians a little over 60 percent of private insurance rates and about 75 percent of Medicare rates.[13] However, the payment gap between Medicaid and Medicare appears to be far less, if any, for hospital payments, once supplemental Medicaid payments are included.[14] Physicians are less likely to accept new patients insured by Medicaid (71 percent) than those with Medicare (85 percent) or private insurance (90 percent).[15]

Although Medicaid acceptance rates remain highly sensitive to the level of reimbursement, they do not appear to have been affected by ACA implementation or by a state's decision to accept the Medicaid expansion. Moreover, a July 2015 Government Accountability Office report concluded that "Medicaid enrollees report access to care that is generally comparable to that of privately insured individuals and better than that of uninsured individuals."[16]

Rinse and Repeat?

The overall effect of Medicaid's conflicting financial incentives is to increase demands on a program that already struggles to do more with less—and often fails at both goals. Making exaggerated benefit promises to more beneficiaries while trying to deliver them below their actual costs merely produces less value per taxpayer dollar.

The political course of least resistance for would-be Medicaid reformers on the right has been to rinse and repeat some of these familiar formulas and hope for different results than seen thus far. However, a few concessions to harder realities plus more nuanced modifications would appear to be advisable, even if the current political balance of power changes enough to make new substantive legislation somewhat more viable.

Assuming a Solution: Much Easier Than Implementing and Producing One. Formulaic block grants and capped budgetary allotments are part of the conventional Medicaid reform tool kit on the right. They look much better as budget gimmicks that are "scorable" on paper than as enduring commitments in political practice. At best, they require more substantial front-loaded spending inducements along with the discipline to enforce often mythical out-years' savings. Spending-rate reductions by formula also generate anecdotal anomalies and mis-targeted side effects that erode any initial base of political support. They often lack more-resilient rationales that extend beyond the short-term goal of claiming to reach aggregate numerical targets.

Broader federalist swaps between Washington and state governments of larger components of the Medicaid program (such as splitting off long-term care for the elderly from responsibilities to assist low-income individuals below age 65) have an even longer history of unwilling buyers.[17]

State officials remain far more innovative (and energetic) in finding new ways to extract more dollars from Washington than in developing more efficient and effective systems of care for their low-income residents.

The Limits of Contractual Outsourcing. Further efficiency gains from state government contracting with private managed-care insurers also face diminishing returns. As of FY2019, roughly 70 percent of all Medicaid beneficiaries were enrolled in comprehensive managed-care arrangements, including more than 80 percent of the newer ACA expansion group for adults under age 65.[18] However, applying private-sector managed-care techniques to more complex and expensive population groups such as disabled, institutionalized, or elderly Medicaid enrollees has proven far more difficult. Moreover, budgetary savings through increased managed-care contracting appear to be limited to the smaller number of states in which previous fee-for-service Medicaid reimbursement levels already were comparable to those paid by private insurers.[19]

In any case, managed care for an increased share of Medicaid beneficiaries is far from a simple cure-all. Its effects on costs and quality depend on how well it is executed in practice and the setting in which it occurs.[20] The standard tool kit for reducing Medicaid costs on the health care delivery side (besides paying providers less) is well-known in theory but more difficult to implement consistently:

- Move more health care treatment encounters to less-sophisticated settings and lower-cost providers.

- Keep beneficiaries out of higher-cost hospitals, emergency rooms, and nursing homes as much as possible.

- Catch potential health problems sooner through preventive care, early diagnoses, and better coordination across multiple health care providers.

- Ensure that Medicaid funding follows the beneficiary across the multiple settings where they need and choose care, rather than locking them into more siloed care-delivery processes.

Can these be done better by well-motivated and adequately staffed state administrators pushing the envelope of competitive bidding incentives for private Medicaid managed-care contractors? In some cases, yes, but further gains look less substantial, at best.

What Did Not Work and Why

Medicaid work requirements used to provide another rhetorically comfortable resting place for right-of-center reformers. However, they were attempted far too clumsily in various states during the Trump administration. They needed to be targeted to a much smaller portion of the ACA expansion population—as part of agreements with holdout states to open such Medicaid eligibility—and implemented with far more advanced administrative planning and better support services to facilitate realistic pathways to employment and economic independence. Instead, they often looked like expedient mechanisms to either trim eligibility or provide political cover for yielding to older terms of Medicaid expansion.

These work-requirement provisions were usually tied to critiques of Medicaid for increasing disincentives to work. At the official income margins for program eligibility (when enforced), beneficiaries risk losing all their coverage benefits if they begin to earn too much money. This common trait of welfare programs whose eligibility is pegged to specific income cliffs usually can be dampened, but not eliminated, either by setting income-eligibility tiers much lower or phasing them out more gradually at much higher income levels.

Instead, the Trump administration overinvested in encouraging states to pursue Medicaid waivers with broad work-requirement provisions. The near-term results were legal and administrative fiascos. Federal courts ruled consistently (except for one late-developing federal district court ruling in the 11th Circuit on August 19, 2022,[21] as discussed below) that those waivers failed to match up with Medicaid's statutory authority and were approved arbitrarily and capriciously. In practice, early state government adopters failed to target the waivers more narrowly and then implement them with sufficient administrative resources. Hence, by the early months of 2021, none of the approved waivers remained in active operation.

Older Chronic Problems: Still Resistant to Uncomfortable Solutions. The most expensive Medicaid beneficiaries are those with long-term disabilities and health impairments needing near-constant care, sooner or later accompanied by severe limits on their ability to generate and maintain self-supporting income. Hypothetical policy approaches to incentivize advance planning through private-insurance protection and reduce future claims on Medicaid as the eventual payer of last resort for long-term care services have found relatively few supporters for multiple reasons. Although substituting more use of private resources to safeguard against larger claims on the program's funding is a worthy goal, finding workable and sustainable policies to accomplish that objective remains elusive.[22]

Tighter eligibility standards are unpopular and difficult to enforce. Mandating the equivalent of prepaid protection even for those who can afford it more, such as through a tax or deductible pegged to one's lifetime income near the age of retirement eligibility in the absence of such pre-committed resources, remains far more theoretical than practical. Instead, the vast majority of young and middle-aged Americans will wish for better luck ahead or new magic medicines to stave off the more debilitating ailments of longer lives. Medicaid's long-standing role as the payer of last resort, in theory, also ensures that it increasingly is the payer of first resort for these services, in practice.[23]

Elderly dual eligibles comprise the most expensive cohort of the Medicare program. Efforts to better integrate the Medicaid and Medicare portions of care for this population have languished, and more-limited programs to provide coordinated care have made minor inroads, at best. In theory, designating either the federal government's Medicare program or state Medicaid programs to take the primary, if not exclusive, role in administering such care makes sense, but structural change remains tangled up in financing and turf quagmires.

Competing Differently to Succeed Politically. Decades of failed Medicare and Medicaid reforms attempted by conservatives, along with occasional signs of modest progress, suggest several lessons. It remains hard to beat Medicaid advocates at their own fiscal game, which is delivering the lowest-quality care at the cheapest per capita cost to the most people. Administered prices and hollow delivery of promised benefits consistently trump the mostly formulaic fiscal tools standardly offered by right-of-center proponents. It also remains far easier to redirect taxpayer subsidies to newer benefits packages than to reduce them in older ones. Even then, long-term reforms cost more upfront. (See, for example, the Medicare Advantage program on both points.)

Reforming long-standing health care entitlement programs requires the treacherous advancement and implementation of structural reform well before any sustainable savings can be expected. Focusing more on reshaping the size and nature of future demands on such programs, and then facilitating new modes of supply to better address those demands, still extends the eventual payoff beyond conventional budgetary scoring windows.

Stepping Up Incremental Reforms Another Notch. What might the next round of improved incremental policy reforms involve? One initial step would be to end the enhanced Medicaid matching rates under FFCRA as soon as possible, as part of phasing out related maintenance of effort requirements on states that have frozen redeterminations of eligibility and encouraged even higher levels of Medicaid fraud.[24]

Although nominally tied to renewed findings of a federal public health emergency (PHE) dating back to early 2020, both provisions have been exploited as political levers to keep more money and enrollees flowing into the Medicaid program. President Joe Biden has renewed these findings a number of times for 90-day intervals, most recently on October 13, 2022, to extend the PHE until at least January 11, 2023. Further extensions remain likely, but cutting such an artificial cord to the federal government's borrowing capacity and winding down the related Medicaid maintenance of eligibility requirements on states as soon as possible are minimal first steps.

If policymakers return to more-nuanced caps on future federal funding, they could consider several different layers of annual per capita allotments for distinct categories of Medicaid beneficiaries (such as children, working-age adults, the elderly, and the disabled) whose average annual costs and spending patterns differ significantly. Even then, the shaky political sustainability of any such budgetary "deals" could be destabilized if their underlying assumptions prove inadequate to provide promised levels of Medicaid services and health care quality.

Allowing for too many, or too few, adjustments in setting per capita block grants ex ante (or in later years) within and across states poses uncertain trade-offs between need-based payment accuracy and administrative and political feasibility. However, simply transferring large, predetermined amounts of revenue from one level of government responsible for collecting it to another level of government left relatively free to spend it and then hoping for the best also dilutes political accountability for balancing tax decisions with spending ones.

Hence, greater emphasis on federalism in health policy instead should travel a two-way street that focuses more on outcomes than inputs. Each state Medicaid program seeking greater operational flexibility should be accountable for achieving intermediate performance metrics, rather than just for close compliance with remaining federal rules and regulations.

The federal government's primary role should extend beyond serving as the least-constrained source of other people's money. It should ensure true accountability and responsibility for producing results by those states given greater freedom in spending federal dollars—in other words, reviewing and rewarding "what" is achieved instead of dictating "how" it is supposed to be accomplished.

The federal government should offer every state the opportunity to enter into a simplified compact that sets outcome measures and benchmarks and then requires a participating state to report periodically (perhaps quarterly) on its performance toward meeting them. Federal oversight would be triggered when there is a significant deviation in the reported versus projected performance. The number of measures should be limited to no more than 10 key indicators of health care, including cost, quality, and access. This will simplify or eliminate the state plan approval process, allowing states and their constituents to concentrate more on what matters most: better health outcomes, better value, and lower costs.

The federal government should allow states adopting this option to:

- Determine their own eligibility categories and income threshold levels for Medicaid;

- Establish rates and service delivery options;

- Design benefit packages that best meet each state's or region's demographic, public health, and cultural needs (whether that involves adding, deleting, or modifying benefits); and

- Use cost sharing to promote individual responsibility for personal health and wellness.

To enhance such executive branch offers, Congress also should consider providing bonus payments for each state that achieves appropriate benchmarks and holding some of the base allotment "at risk" in the event of poor performance.

Going Further with Reality-Bounded, Direct-to-Consumer Medical Empowerment. Even the best versions of block-grant-style Medicaid reform essentially hand off many important Medicaid decisions concerning health benefit levels[25] from one set of federal government officials to other state-level policymakers. Individual beneficiaries remain largely on the sidelines instead of becoming more engaged and empowered.

A more consumer-focused Medicaid reform would develop a defined-contribution alternative for Medicaid financing and coverage at the individual level. This personalized mechanism could help hold taxpayer costs and program-eligibility rules relatively more constant, by allowing the nature, level, and quality of Medicaid's health benefits to become more variable and more freely selected by Medicaid enrollees.

Defined-contribution payments are made more directly and transparently to beneficiaries than traditional financing that diverts the amount and nature of defined-benefit promises through other third-party intermediaries. The overall goals are to empower and encourage consumers and patients to make better health care choices while stimulating more innovative and accountable competition by health care providers. One can pay more for health care when it delivers more value but redirect resources to other investments in well-being when it delivers less.

Although defined-contribution public dollars from taxpayers to support such coverage would be limited, the spending of additional private dollars to enhance or expand coverage would not be restricted. Supplemental benefits (paid for exclusively with private dollars) could vary widely, beyond a baseline definition of core coverage (and its actuarial equivalents) that would be supported wholly or partly through taxpayers' defined contributions.

The better version of defined-contribution health benefits must go beyond the simple fiscal mathematics of placing initial control of how to spend those taxpayer subsidies in the hands of beneficiaries. It also would provide an enhanced infrastructure of health information and connections to intermediary agents to assist those beneficiaries in making their health care choices more actionable and effective. This approach would reward insurers, health care providers, and state policymakers for raising the quality of health care, the value of health benefits, and the satisfaction of Medicaid patients instead of just for keeping the apparent costs of the program lower (or hidden).

States pursuing more market-based, consumer-choice reforms also should acknowledge that executing these ambitions can be more expensive and require different types of oversight. They may have to decide to cover fewer people and leave more details of health-spending decisions to those beneficiaries who are ready and eager to make them while paying participating health care providers for the full costs of care and measuring quality of delivered care more accurately.

Reconciling the wildly theoretical with the practical, however, also means presenting this as an opt-in alternative for interested beneficiaries and ensuring alternative access to more conventional Medicaid benefits (particularly for higher-risk cohorts). Of course, implementing this sort of straddle complicates financing assumptions and adjustments and the pace of change substantially.[26]

These policy reform paths will have to overcome preexisting hurdles in current law. Comprehensive legislation theoretically could clear them away, but that involves assuming one's solution in advance.

Going Bigger Instead of Going Home

A slower, incremental path to similar reforms also could be attempted via more-comprehensive Medicaid and ACA mega-waivers for states willing to step forward earlier and experiment with integrating their healthier Medicaid expansion populations with their predominantly ACA-subsidized individual market health exchange enrollees. This policy option could be transformative over time, but it would be bounded initially by a substantial number of technical, financial, and political hurdles. They would include redefining budgetary baselines, extending timelines for evaluation, gaining buy-in from states willing to be accountable for overcoming implementation challenges and delivering measurable results, powering through executive branch resistance by career staff, dampening risk-pool distortions, guaranteeing access to statutorily mandated Medicaid benefits, overcoming opposition from influential health care providers, and managing the political optics of disruptive change. Coordinating the sequencing of parallel Medicaid and individual market reform waivers to maximize resource reallocations and optimize budgetary projections will remain a necessary cost of doing business. Aside from all of the above, it would be mostly a piece of cake.

The best places to start for an initial mega-waiver would involve states that have not agreed to the ACA's Medicaid expansion terms for their lower-income, childless, adult population. More precise targeting also would focus on states with less of a differential in reimbursement rates for providers in the state's Medicaid program and those in its commercial individual insurance market. Attempting to restructure and merge other Medicaid program populations into a state's reformed (and expanded) individual market would be far more complex and unwise. Initial objectives should emphasize attracting potentially eligible Medicaid enrollees who can be rewarded for becoming more economically independent in stages, as opposed to disrupting legally mandated specialized services to the most at-risk current Medicaid beneficiaries.

Revival of a more carefully constructed mega-waiver mechanism would allow at least one state (and perhaps more over time) and a dedicated president's executive branch to get this process started and incentivized in more targeted directions. Even under better circumstances, several recent executive branch rules would need to be altered to expand the policy reform playing field. An unnecessarily restrictive interpretation of "budget neutrality" that originated in the Obama administration in 2015 guidance[27] and was echoed by the Trump administration in 2018 guidance precludes combining budget savings from related non-Medicaid waivers for the ACA-regulated individual market with Medicaid waiver-funding reallocations as part of a single reform package.[28] Moreover, a new administration would have to reverse some of the Biden administration rule finalized in September 2021, which rescinded the Trump administration's interpretation of statutory guardrail enforcement for Section 1332 waivers and restored the previous interpretation of the Obama administration.[29] (Yes, this does operate somewhat like a regulatory yo-yo, depending on who sets the latest "rules." But it also demonstrates the malleability and impermanence of such administrative practices.)

Recent limits on the duration for which past waiver-related budget savings can be accumulated should also be reconsidered. The recent Medicaid and ACA individual market policies noted here, particularly those involving definitions of "budget neutrality," are discretionary creations of CMS administrators and not required by statutory law. A new White House regime would have the authority to change them if it decided to do so.[30]

Maneuvering around current legal interpretations of Medicaid's statutory purposes[31] plus embedded political expectations of maintaining current insurance coverage levels adds other constraints on the pace and scale of such reform. The most feasible path requires keeping up nominal coverage numbers while changing what a reconfigured individual market covers and how it does so. As long as total coverage (as redefined) remains approximately similar and health outcome gains are demonstrated, other trade-offs in "how" this is done can be lost in the wash, provided that most of the earlier Trump administration rules for Section 1332 waivers are reinstated.[32]

Why Bother to Build a Better Political Narrative for Medicaid Reform?

A new round of successful Medicaid reform also must transcend the current political mindset accentuated by the COVID-19 pandemic. Medicaid became a catch-all mechanism for targeting new funding for care and coverage as an available expedient while fiscal constraints evaporated. If the overriding political goals remain simply to cover as many people as cheaply as possible, regardless of their needs or the health outcomes produced, then the current Medicaid program will face few challenges from potential alternatives. Getting beyond this dead end will require a better story that inspires hope for improved lives, not just expedient and illusory savings.

The political case for Medicaid reform needs to reflect the core values of the political constituencies that will support it. Hence, it should combine firm commitments to provide financial assistance to the most vulnerable Americans with greater reliance on more decentralized, market-based choice and competition to carry out those goals more effectively and efficiently. The ultimate test is whether such interventions improve the health outcomes of the poor. Spreading more health care services across a wider base of new beneficiaries further up the income ladder, as the ACA and Biden administration enhancements envision, is more likely to dilute their value.

The political forks in the road involve several trade-offs:

- Addressing substantial medical needs versus closing income-related difficulties in paying for care;

- Choosing between Medicaid assistance that focuses on improving the health of low-income populations versus serving as an all-purpose vehicle to pursue broader objectives such as reduced societal disparities, more-extensive income redistribution, and greater federal government control of health care resources and practices; and

- Recognizing that changing the structure of Medicaid incentives and decision-making, with higher upfront investment costs, is a prerequisite for any lasting opportunities for long-term budgetary savings.

Better targeting of Medicaid assistance toward disabled, very low-income, and medically impoverished populations is overdue. Able-bodied adults without the resources to pay for basic medical bills may merit short-term financial relief while in extreme duress, but public policy interventions need to be far more focused on helping them regain independence and self-sufficiency. Taxpayer-subsidized health coverage should be aimed at establishing a politically acceptable floor below which no one should be allowed to fall.

However, individuals subject to short-term economic dislocations or uncomfortable circumstances need to know that their access to better health care in the future is tied to how well they fare eventually in the overall economy. Better jobs and higher incomes, stable families, enhanced educational opportunities, and improved health habits, rather than larger taxpayer-subsidized transfer payments, must remain their primary ticket out of unmet medical needs and less-satisfactory health care.

This sort of reframing of priorities and commitments runs counter to conventional political incentives to serve other, more numerous, less needy constituents on a less expensive, wider, and thinner basis. The temptations remain strong to use changes in Medicaid eligibility and subsidy levels to reward one's most favored constituencies, when not simply propping up the bottom lines of local health care providers. But not everyone can win at this political auction, and the most vulnerable populations tend to lose the most.

Even the most optimistic vision of improvements in the efficiency and quality of Medicaid's health care delivery should regain some broader perspective, by reconsidering the effects of slow or stagnant economic growth, rising levels of disabling health conditions, and lack of improvement in the ratio between working taxpayers and beneficiaries dependent on publicly financed health entitlement programs. Hence, health policy should support broader economic policy incentives to work, save, and invest more effectively to protect the most vulnerable Americans without increasing their numbers. One of the strongest arguments for limiting, or redirecting, the future growth of Medicaid spending should be how it will free up public and private resources to more effectively improve the lives of all Americans, particularly poorer ones.

The lower bounds of necessary reform certainly should include realistic limits on taxpayers' commitments to finance necessary health care services for low-income Americans. But they also should allow more flexible trade-offs in better targeting of scarce resources. Those objectives are accomplished best through decentralized decision-making, market-based delivery mechanisms, and more transparent accountability.

The upper bounds of Medicaid reform suggest that the program would perform better by concentrating more on its core mission of ensuring improved health outcomes for those most in need, rather than aiming at covering as many people as imaginable as thinly and cheaply as possible. These bounded Medicaid goals should open fiscal and political space for a broader focus on other areas of public policy that could reshape the magnitude and nature of the demand for its assistance and the likelihood of the program's success—in short, policies that produce fewer poor people with persistent and expensive medical conditions.

Starting points with the best returns include investing far more in early childhood interventions, targeting the roots of the most costly and persistent medical conditions before they take hold, and executing basic practices before attempting more elaborate ones. Medicaid needs to be far more of a partner with other contributors to building health and human capital, rather than expanding its already-overstretched domain of disappointing performance in paying higher medical costs on the back end. It should join with larger health reform efforts to engage other policy instruments that promote healthier behavior and improve the capabilities of individuals over their entire life cycle of health, such as those improving education, nutrition, family, culture, and early childhood development.

We cannot afford the long-term consequences of habitually trying to do even more of the same badly. Results-driven reorganizing of the many tools to achieve those goals, while improving the overall ratio between independently productive citizens and those who must depend on them, offers the best insurance policy of all.

Keeping Score in Washington

The better versions of Medicaid reform do not deliver early savings or simplify into a handful of bullet points for future legislation. They will take longer to mature and involve layers of interconnected uncertainties that resist standard budgetary estimates or procedural shortcuts.

The main structural reforms recommended here include short-term termination of the pandemic "emergency" increase in the FMAP rate for Medicaid and its interconnected continuous enrollment mandate (part of state maintenance of effort requirements) that preclude changes in state Medicaid eligibility rules and effective enforcement of current ones. Because this policy operates under short-term, though recurring, presidential declarations of a PHE under Section 6008 of the FFCRA, it appears that such higher spending is not embedded in the Congressional Budget Office (CBO) budget baseline. Thus, ending it through either executive or new legislative action is unlikely to produce any "scorable" budget savings.

The other primary policy change recommended here involves redeveloping mega-waiver options for states. Because they would be voluntary, slower to develop even under a new presidential administration, contingent on several moving parts coming together closer in time, not yet fully delineated in terms until fully approved, and more likely to deliver measurable savings beyond even an initial five-year waiver period, any potential CBO-scored budgetary gains would not yet be measurable through standard processes.

The Best Case for Renewed Pursuit of Mega-Waiver Tools: Means to More-Transformative Ends

State policy innovation in the most malleable and actionable portions of the Medicaid program needs to extend beyond new ways to extract more federal dollars. It should aim higher. Waivers combining reforms of the ACA expansion portion of Medicaid with individual market reforms within willing states can provide larger scale, more resources, better-integrated tools, and sufficient stakes to pursue more-consequential reforms that include at-risk accountability for outcomes.

Several technical challenges remain but are not insurmountable if the larger political case can be made for greater interest in overcoming them. This can enable a more market-oriented state to try to do something better, with accountability for producing it. An evolutionary approach means opening doors to states and their constituents that are receptive to change, rather than forcing it on those more wedded to the status quo.

Related spillover benefits from more-dynamic incentives include new opportunities to redirect the operating rules and taxpayer subsidy distributions for the individual insurance market and ACA exchanges in interested states. The ability to move Medicaid savings into a more consolidated, restructured individual market would ensure more continuity and integration of insurance coverage and health care arrangements for enrollees as their income and health status change.

More fundamentally, creative uses of federal-state waiver paths could unlock long-standing program silos and resource commitments to expand the playing field for reform, by facilitating different metrics, incentives, and feedback loops that redefine "success" in health policy. It might even make receiving less in health insurance subsidies more politically appealing, if those resources can be unlocked and redirected to serve other, higher-valued preferences of current Medicaid and ACA exchange enrollees.[33] Of course, the key political ingredients for accomplishing such calibrated but sweeping change involve purpose, patience, and persistence—commodities in scarce supply during our current era of rhetorical theatrics.

Winning the political battle for future market share in how health care resources are deployed and shaped—subordinate to centralized, politicized means or more responsive to competitively accountable and patient-centered signals—will require more aspirational goals and deliverable results best pursued by the latter, particularly for lower-income Americans. Despite many problems across the health policy and social mobility landscape, this one needs to move up in agenda-setting priorities.

Notes

1. See, for example, Abe Dunn et al., "A Denial a Day Keeps the Doctor Away" (working paper, National Bureau of Economic Research, Cambridge, MA, July 2021), https://www.nber.org/papers/w29010. "Physicians lose 16% of Medicaid revenue to billing problems, compared with 7% for Medicare and 4% for commercial payers."

2. The last annual report on the financial outlook for Medicaid by federal government actuaries available is for fiscal year 2018. US Department of Health and Human Services, Centers for Medicare & Medicaid Services, Office of the Actuary, *2018 Actuarial Report on the Financial Outlook for Medicaid*, https://www.cms.gov/files/document/2018-report.pdf.

3. Center for Medicaid and CHIP Services, "May 2022 Medicaid and CHIP Enrollment Trends Snapshot" (PowerPoint presentation, Centers for Medicare & Medicaid Services, May 2022), https://www.medicaid.gov/medicaid/national-medicaid-chip-program-information/downloads/may-2022-medicaid-chip-enrollment-trend-snapshot.pdf.

4. The Kaiser Family Foundation (KFF) more recently also has used another

measure of Medicaid and Children's Health Insurance Program (CHIP) enrollment. Performance Indicator Project (PIP) data from the Centers for Medicare & Medicaid Services incorporate updated enrollment reports from states. They differ somewhat from the Enrollment Trends snapshot data and are available only through March 2022. KFF's most recent analysis of this PIP data, on August 3, 2022, which also added the April 2022 snapshot data, tells a similar story as the snapshot data analysis alone does: Total Medicaid and CHIP enrollment grew to 88.3 million, an increase of 17.0 million from enrollment in February 2020 (23.9 percent). Bradley Corallo and Sophia Moreno, "Analysis of Recent National Trends in Medicaid and CHIP Enrollment," Kaiser Family Foundation, August 3, 2022, https://www.kff.org/coronavirus-covid-19/issue-brief/analysis-of-recent-national-trends-in-medicaid-and-chip-enrollment.

5. Corallo and Moreno, "Analysis of Recent National Trends in Medicaid and CHIP Enrollment." The enrollment declines from December 2017 to February 2020 appear to be relatively similar for adults enrolled in Medicaid and children enrolled in Medicaid or CHIP. Kaiser Family Foundation, "Analysis of Recent Declines in Medicaid and CHIP Enrollment, November 25, 2019, https://www.kff.org/medicaid/fact-sheet/analysis-of-recent-declines-in-medicaid-and-chip-enrollment.

6. US Department of Health and Human Services, Centers for Medicare & Medicaid Services, "National Health Expenditure Data," https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsHistorical.

7. See Jonathan Skinner, Eli Cahan, and Victor R. Fuchs, "Stabilizing Health Care's Share of the GDP," *New England Journal of Medicine* 386 (February 24, 2022): 709–11, https://www.nejm.org/doi/full/10.1056/NEJMp2114227. "Medicaid has had stable per-enrollee inflation-adjusted spending during the past several decades."

8. In fiscal year 2018, individuals eligible based on disability and enrollees age 65 and older accounted for about 21 percent of Medicaid enrollees but about 57 percent of program spending. Many of these individuals were users of long-term services and supports (LTSS). LTSS users accounted for only 5.5 percent of Medicaid enrollees but almost one-third of all Medicaid spending. Medicaid and CHIP Payment and Access Commission, *MACStats: Medicaid and CHIP Data Book*, December 2019, 38–61, Exhibits 14, 20, and 21, https://www.macpac.gov/wp-content/uploads/2015/12/MACStats-Medicaid-and-CHIP-Data-Book-December-2019.pdf.

9. Alison Mitchell, Evelyne P. Baumrucker, and Kirsten J. Colello, *Medicaid: An Overview*, Congressional Research Service, February 22, 2021, https://crsreports.congress.gov/product/pdf/R/R43357.

10. Nick Castele, "Meet the Republican Governors Who Don't Want to Repeal All of Obamacare," NPR Morning Edition, January 23, 2017, https://www.npr.org/2017/01/23/510823789/meet-the-republican-governors-who-dont-want-to-repeal-all-of-obamacare; Jennifer Haberkorn, "4 GOP Senators Demand to Keep Obamacare Medicaid Expansion," *Politico*, March 6, 2017, https://www.politico.com/story/2017/03/obamacare-medicaid-repeal-republicans-235736; and Todd Spangler, "Four Republican Governors Come Out Against Obamacare Repeal Plan," *USA Today*, March 17, 2017, https://www.usatoday.com/story/news/politics/2017/03/17/four-republican-governors-come-out-against-obamacare-repeal-plan/99301698.

11. There is some evidence that increases in state contracting for private managed-care delivery of Medicaid services does improve their quality, but only if it also improves political willingness to increase reimbursement levels. Timothy Layton et al., "Private vs. Public Provision of Social Insurance: Evidence from Medicaid" (working paper, National Bureau of Economic Research, Cambridge, MA, July 2019), http://www.nber.org/papers/w26042.

12. See American Medical Association, Advocacy Research Center, "Summary of Research: Medicaid Physician Payment and Access to Care," 2020, https://www.ama-assn.org/system/files/2020-10/research-summary-medicaid-physician-payment.pdf.

13. See, for example, Adam I. Biener and Thomas M. Selden, "Public and Private Payments for Physician Office Visits," *Health Affairs* 36, no. 12 (December 2017): 2160–64, https://www.healthaffairs.org/doi/10.1377/hlthaff.2017.0749.

14. Medicaid and CHIP Payment and Access Commission, "Medicaid Hospital Payment: A Comparison Across States and to Medicare," April 2017, https://www.macpac.gov/wp-content/uploads/2017/04/Medicaid-Hospital-Payment-A-Comparison-across-States-and-to-Medicare.pdf.

15. Kayla Holgash and Martha Heberlein, "Physician Acceptance of New Medicaid Patients" (PowerPoint presentation, Medicaid and CHIP Payment and Access Commission, January 24, 2019), https://www.macpac.gov/wp-content/uploads/2019/01/Physician-Acceptance-of-New-Medicaid-Patients.pdf; and Centers for Medicare & Medicaid Services, "2020 Estimated Improper Payment Rates for Centers for Medicare and Medicaid Services (CMS) Programs," November 16, 2020, https://www.cms.gov/newsroom/fact-sheets/2020-estimated-improper-payment-rates-centers-medicare-medicaid-services-cms-programs.

16. US Government Accountability Office, *Medicaid: Key Issues Facing the Program*, July 2015, https://www.gao.gov/assets/gao-15-677.pdf.

17. See, for example, John Holahan, "Restructuring Medicaid Through a Swap: An Alternative to a Block Grant," Urban Institute, April 2011, https://www.urban.org/sites/default/files/publication/27261/412327-Restructuring-Medicaid-through-a-Swap-An-Alternative-to-a-Block-Grant.PDF. The key stumbling block here is usually either getting states that are likely fiscal losers in the potential swap to participate nevertheless or subsidizing them even more, negating projected budget savings for federal taxpayers. One unavoidable political reality is that neither the federal nor state governments are eager to absorb full responsibility for the uncharted fiscal future of our current long-term-care health programs. For a different earlier potential menu of program swaps between the federal government and the states, see also Steven R. Weisman, "Reagan and 'New Federalism' Are Ready to Go on the Road," *New York Times*, February 7, 1982, https://www.nytimes.com/1982/02/07/weekinreview/reagan-and-new-federalism-are-ready-to-go-on-the.html.

18. Medicaid and CHIP Payment and Access Commission, *MACStats: Medicaid and CHIP Data Book*, December 2021, Exhibit 30, https://www.macpac.gov/wp-content/uploads/2021/12/MACStats-Medicaid-and-CHIP-Data-Book-December-2021.pdf.

19. See Mark Duggan and Tamara Hayford, "Has the Shift to Managed Care Reduced Medicaid Expenditures? Evidence from State and Local-Level Mandates," *Journal of Policy Analysis and Management* 32, no. 3 (2013): 505–35, https://pubmed.ncbi.nlm.nih.gov/23814802.

20. Other important factors that vary from state to state include the competitiveness of the market for Medicaid services, the degree of risk-based reimbursement required, and the manner in which bidding for Medicaid managed care contracts and setting capitation rates is conducted. Neil McCray, "Rent-Seeking in Medicaid Managed Care," in *Institutions and Incentives in Public Policy: An Analytical Assessment of Non-Market Decision-Making*, ed. Rosolina A. Candela, Rosemarie Fike, and Robert Herzberg (Lanham, MD: Rowman & Littlefield, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4102121.

21. Maya Goldman, "Judge Revives Georgia's Medicaid Work Requirements Policy," *Modern Healthcare*, August 19, 2022.

22. For example, past efforts to enforce income and asset limits on eligibility for long-term care subsidies, as a precondition to fostering broader and sustainable private-insurance markets and reducing dependence on Medicaid coverage as a fallback, have failed miserably. See, for example, Medicaid and CHIP Payment and Access Commission, *Report to Congress on Medicaid and CHIP*, March 2021, 71–122, https://www.macpac.gov/wp-content/uploads/2021/03/March-2021-Report-to-Congress-on-Medicaid-and-CHIP.pdf. Compare that with Mark J. Warshawsky, "Specific Steps to Improve the Fairness and Sustainability of Medicaid's Financing of Long-Term Services and Supports for Older Americans," American Enterprise Institute, January 5, 2022, https://www.aei.org/research-products/working-paper/specific-steps-to-improve-the-fairness-and-sustainability-of-medicaids-financing-of-long-term-services-and-supports-for-older-americans.

23. Jeffrey R. Brown, Norma B. Coe, and Amy Finkelstein, "Medicaid Crowd-Out of Private Long-Term Care Insurance Demand: Evidence from the Health and Retirement Survey," *Tax Policy and the Economy* 21 (2007): 1–34, https://www.journals.uchicago.edu/doi/10.1086/tpe.21.20061913.

24. See, for example, Brian C. Blase and Aaron Yelowitz, *The ACA's Medicaid Expansion: A Review of Ineligible Enrollees and Improper Payments*, George Mason University, Mercatus Center, November 2019, https://www.mercatus.org/system/files/blase-medicaid-expansion-mercatus-research-v2_2.pdf; and Centers for Medicare & Medicaid Services, "2020 Estimated Improper Payment Rates for Centers for Medicare and Medicaid Services (CMS) Programs."

25. For example, how comprehensive will benefits be? With how much cost sharing? What degree of medical management will be applied to them?

26. This would include more-ambitious proposals to offer defined-contribution opt-in terms to interested individuals at a "discount" from existing benefit levels.

27. US Department of the Treasury and US Department of Health and Human Services, "Waivers for State Innovation," *Federal Register* 80, no. 241 (December 16, 2015): 78131–35, https://www.govinfo.gov/content/pkg/FR-2015-12-16/pdf/2015-31563.pdf.

28. See, for example, Timothy B. Hill, letter to state Medicaid director, August 22, 2018, https://www.medicaid.gov/federal-policy-guidance/downloads/smd18009.pdf. New Hampshire ended its initial waiver experiment from 2016 to 2018, which covered Affordable Care Act Medicaid expansion eligibles through its state Affordable Care Act individual market exchange, once it could no longer use Medicaid funding for those purposes within budget-neutrality interpretations by the Trump administration.

See also Louise Norris, "New Hampshire and the ACA's Medicaid Expansion," Healthinsurance.org, November 17, 2021, https://www.healthinsurance.org/medicaid/new-hampshire.

29. US Department of the Treasury and US Department of Health and Human Services, "Patient Protection and Affordable Care Act; Updating Payment Parameters, Section 1332 Waiver Implementing Regulations, and Improving Health Insurance Markets for 2022 and Beyond," September 17, 2021, https://www.cms.gov/files/document/cms-9906-f-nbpp-webposting-version.pdf.

30. See Matthew B. Lawrence, "Fiscal Waivers and State 'Innovation' in Health Care," *William & Mary Law Review* 62, no. 5 (2021): 1477–556, https://scholarship.law.wm.edu/wmlr/vol62/iss5/3.

31. Litigation continues over proposed Medicaid work requirements, after the Supreme Court declined, on April 5, 2022, to rule directly on an appeal of a lower court decision involving Arkansas and New Hampshire. Georgia has succeeded most recently, on August 19, 2022, in getting a federal district court to overturn the Biden Centers for Medicare & Medicaid Services decision in 2021 to rescind its Medicaid waiver. *State of Georgia and Georgia Department of Community Health v. Lasure*, 2:22-CV-6 (S.D. Ga. 2022), https://storage.courtlistener.com/recap/gov.uscourts.gasd.86202/gov.uscourts.gasd.86202.52.0.pdf.

32. A more creative and ambitious approach for a state wishing to improve the calculations of how its current law baseline compares to its projected mega-waiver effects could involve tilting the current law baseline in advance, such as by imposing similar burdens on its current Medicaid program as those faced by a proposed post-waiver program (for example, reimbursing providers at higher rates, imposing tighter quality of care standards, and ensuring more transparency and accountability).

33. This intriguing potential is further reinforced by recent research findings suggesting that Medicaid recipients would not be willing to cover much of the government's cost of Medicaid, given other alternatives. The baseline estimates of the cited working paper indicate that the welfare benefits to recipients per dollar of government spending are between $0.20 and $0.40, depending on the framework used. These estimates are noticeably less than the full valuation approach used by the Congressional Budget Office. Amy Finkelstein, Nathaniel Hendren, and Erzo F. P. Luttmer, "The Value of Medicaid: Interpreting Results from the Oregon Health Insurance Experiment" (working paper, National Bureau of Economic Research, Cambridge, MA, June 2015), https://www.nber.org/system/files/working_papers/w21308/w21308.pdf.

6

Rethinking Social Security in the Face of Economic Threats

ANDREW G. BIGGS

The chief actuary of the Social Security Administration has declared that Social Security, which is the federal government's largest spending program, most workers' largest tax expense, and most retirees' largest income source, is "not in close actuarial balance."[1] That declaration came not today but in 1990, more than three decades ago. In 1991, the program's trustees first called for action to address Social Security's long-term finances. By 1997, the trustees' calls became more pressing:

> It is important to address both the OASI [Old-Age and Survivors Insurance] and DI [Disability Insurance] problems soon to allow time for phasing in any necessary changes and for workers to adjust their retirement plans to take account of those changes.[2]

Since then, Congress and various presidential administrations have accomplished precisely nothing to make the Social Security program fiscally sustainable and more responsive to 21st-century Americans' needs. Today, Social Security faces a long-term funding shortfall approaching $18 trillion, and the program's combined trust funds are projected to run out in the early 2030s.[3]

The only active Social Security reform legislation under consideration is from congressional progressives, who argue that due to the failures of the US private retirement saving system, the only alternative to a future retirement crisis is to expand Social Security benefits for rich and poor alike, financed by higher taxes on rich and poor alike. By phasing out the current $147,000 ceiling on wages subject to Social Security taxes, the Social Security 2100 Act, cosponsored by nearly nine in 10 House Democrats, would raise the effective top marginal tax rate on earned income by 12 percentage points, giving the United States one of the highest top marginal tax rates in the developed world.[4]

Since the failure of President George W. Bush's 2005 Social Security reform, Republicans and conservatives have been adrift on how to address the program's looming insolvency. Many right-leaning officials have reverted to denial: wishing neither to increase Social Security taxes nor to reduce benefits, but not yet internalizing that those are the only two options available.

In this chapter, I discuss how Social Security is financed and how changing demographics increase the program's costs and make it a poorer deal for current and future Americans. But I also discuss some good news: During a period when nothing has been done to fix Social Security, Americans' own private retirement savings have skyrocketed, and retirement incomes have reached new highs. In combination, these two trends point to solutions that make Social Security more affordable and effective: reforms to truly guarantee against poverty in old age while gradually scaling down Social Security retirement benefits for middle and high earners, building a more limited but more robust safety net.

In conjunction, private retirement saving would be scaled up by making on-the-job retirement plans accessible to all workers and using incentives, nudges, and potentially a mandate to ensure that all US employees save some minimum amount for retirement. This approach, modeled on systems in countries such as Australia, New Zealand, and the United Kingdom, could pave the way for a more affordable Social Security program without sacrificing Americans' retirement income security.

Understanding Social Security

Social Security provides a retirement income base on which most Americans must build with personal savings, employer-sponsored retirement plans, and earnings in retirement. The Social Security program was created in the 1930s under the Franklin D. Roosevelt administration. "We can never insure one hundred percent of the population against one hundred percent of the hazards and vicissitudes of life," Roosevelt said, "but we have tried to frame a law which will give some measure of protection to the average citizen and to his family against the loss of a job and against poverty-ridden old age."[5]

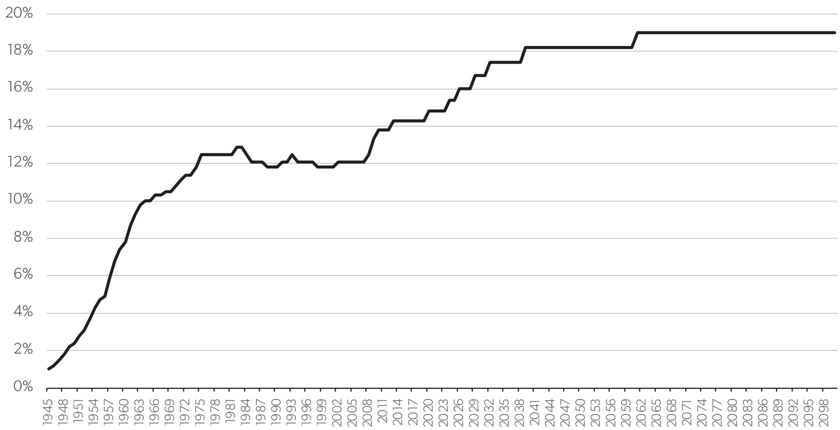
The Social Security program has several defining features that were introduced in 1935 and continue to this day. First, it is a contributory social insurance program, meaning that employees pay into Social Security from their wages. Roosevelt saw the worker contribution as generating earned benefits, not mere welfare to those who failed to provide for themselves. In 1935, the Social Security payroll tax was 2 percent of the first $3,000 in earnings, split evenly between employers and employees. In 2022, employees and employers pay a combined 12.4 percent of employee wages to Social Security, with the tax levied up to a maximum of $147,000 in annual earnings.

Second, while Social Security is contributory, it is also progressive. Benefits rise with wages in dollar terms. However, retirement benefits as a percentage of preretirement earnings—the so-called replacement rate provided by Social Security—are highest for low-earning workers and decline as earnings increase. The Congressional Budget Office calculates that for retirees who were born in the 1960s, Social Security benefits will replace 78 percent of the career-average inflation-adjusted earnings of individuals in the lowest fifth (quintile) of the lifetime earnings distribution, 49 percent for retirees in the middle quintile, and 31 percent for retirees in the highest earnings quintile.[6] Financial planners often recommend a retirement income equal to 70 percent of preretirement earnings. Many low earners approach or even exceed that replacement rate through Social Security alone, while high earners must save substantial amounts on top of Social Security to get there.

Third, Social Security is funded on a pay-as-you-go basis, meaning that current taxes fund current benefits. Pay-as-you-go financing allowed the program to pay benefits soon after it was established, rather than waiting a full working generation before full benefits could be paid.

Over time, however, pay-as-you-go funding entails two significant downsides, which lie at the root of the financial problems that Social Security faces. First, a pay-as-you-go system pays huge windfalls to early generations of retirees, who receive full retirement benefits after contributing for only a few years. As late as the 1960s, retirees received over seven times more in Social Security benefits than they had paid in taxes over

Figure 1. Cost (as a Percentage of Wages) of Providing a Social Security Benefit Equal to 40 Percent of the Current Average Wage



Source: Author's calculations from figures in Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, *The 2022 Annual Report of the Board of Trustees of the Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, US Social Security Administration, June 2, 2022, https://www.ssa.gov/oact/TR/2022/tr2022.pdf.

their working lifetimes.[7] It's no surprise that Social Security was extremely popular for many decades: Early program participants received a truly fantastic deal.

Yet this created a seesaw effect: Since Social Security is a pay-as-you-go program, the benefits paid out ultimately must equal the taxes paid in. If early generations of retirees received far more in benefits than they paid in taxes, later generations must pay more in taxes than they will receive in benefits. This explains why Social Security's rate of return has fallen, such that many future retirees will get less from the system than they paid into it. In fact, every penny of Social Security's nearly $18 trillion funding shortfall is a function of early generations of retirees receiving windfalls from the system. However Social Security's funding gap is fixed, whether through tax increases or benefit reductions, it will never again be as good a deal for Americans as it was in its early decades of existence.

Pay-as-you-go funding creates an additional financing issue for Social Security. In a program that simply transfers money from workers to beneficiaries, the ratio of workers to beneficiaries is crucial. The math is not complex.

The average Social Security benefit is equal to about 40 percent of the average wage that workers receive in the economy. If there are 16 workers per beneficiary, as in 1950, we divide 40 percent by 16 to find that each worker must pay only about 2.5 percent of their wages into the program.[8] If there are five workers per beneficiary, as in 1960, then the required payroll tax rate will rise to 8 percent of employee pay. And if there are only two workers per beneficiary, as there will be in coming decades, then the system's cost will approach 20 percent of employee wages. (See Figure 1.)

This doesn't necessarily mean the payroll tax rate must be set at 20 percent of pay; there are other ways to finance Social Security benefits, and of course benefits can be reduced. But even these simple illustrations show the powerful role of demographics in pushing Social Security's costs upward.

In reality, Social Security has promised more in benefits than it will have the financial capacity to pay. Benefits must be adjusted downward or revenues adjusted upward.

The Blank-Slate Approach to Social Security Reform

Most Social Security reform proposals start with the current program's tax and benefit formulas and then tweak these formulas based on a menu of common reform options to make the program financially sustainable in the long term. Different proposals place different weights on increasing taxes versus reducing benefits, but most reforms give little thought to Social Security as a program rather than a funding problem: They assume Social Security basically works well, except that it lacks sufficient funds.

The federal government treats almost no other program this way. Medicare and Medicaid are adjusted to produce better outcomes at lower costs. Welfare programs are reformed to improve social protections while reducing downsides, such as disincentives to work and marry. Education policy is continually reevaluated to improve outcomes. Yet Social Security is often treated as if its tax and benefit formulas were handed down on tablets from on high.

But there is another approach. Instead of thinking about where we would like the current system to evolve in coming years, we could ask what kind of retirement system we would like to give Americans who will retire, say, 50 years from now. These Americans have not paid a penny into Social Security, nor does the system owe them a penny.

This viewpoint allows policymakers to ask much broader questions. What protections should Social Security offer to future retirees? What should we demand that working Americans pay in return for those protections? How many retirement benefits should be mandated, encouraged, and simply left to individuals' preferences?

Different people will describe that ideal Social Security program differently. Yet those who honestly perform this thought experiment are unlikely to answer, "Exactly like the current Social Security program," because the world has changed dramatically in the 85 years since Social Security was designed. When Social Security was originally contemplated, widespread individual-level participation in capital markets for retirement saving was difficult to foresee. Practically no mutual funds were available, and those that existed were costly. No internet helped manage administration and investment choices. Americans were not merely financially illiterate but in many cases had difficulty even reading.[9] Social Security was constructed as it was largely because there was little other option.

In the 21st century, however, many Americans would likely agree with the following framework: The government should protect against penury in old age, and it should do that job well. Gaps in the existing safety net should be filled. But to generate income on top of that government-provided protection, Americans should adopt greater responsibility to save for retirement on their own. After all, if every American saved assiduously for retirement, Social Security's role could understandably be more limited.

Government policy should at the least facilitate household retirement saving; it might go further to automatically enroll workers in retirement plans, or it could take the final step and mandate personal retirement saving, as it effectively does today via Social Security. But dividing the labor between government-sponsored poverty protection and household-managed personal retirement saving allows each sector to operate at its best.

It is worth illustrating how this framework might play out by examining the retirement systems of similar countries, including Australia, Canada, New Zealand, and the United Kingdom. This exercise demonstrates how much might be accomplished by modeling policy after countries that share the United States' tradition of social protections for the poor coupled with robust private financial markets.

Australia combines a means-tested minimum retirement pension, provided by the government and funded through general tax revenues, with a requirement that all full-time private-sector employees participate in an employer-provided retirement plan with a minimum contribution level. Australia's Age Pension provides a retired couple with no assets or other income sources a benefit equal to about USD 1,900 per month. However, that government-provided minimum benefit decreases by 50 cents with each dollar the couple earns over about USD 450 per month. Benefits also decrease based on retirees' assets, including their home value.

This means test acts as an implicit tax on personal saving for retirement, but Australia seeks to overcome that disincentive to save by requiring all full-time workers to participate in a retirement plan. Each employee is enrolled in a retirement plan funded by an amount equal to 9.5 percent of employee wages, contributed to by their employer. The contribution rate is scheduled to increase to 12 percent by 2025. About half of Australian retirees receive the full means-tested benefit, about one-quarter receive a reduced benefit, and about one-quarter lose their benefit via the means test.[10] The 2020 cost of the means-tested benefit in Australia was 2.5 percent of gross domestic product (GDP). Over time, as savings grow in employer-sponsored retirement plans, government outlays on the means-tested benefit are projected to decline to about 2.3 percent of GDP in 2060, despite a decline in Australia's ratio of workers to beneficiaries.[11] Over that same period, US government expenditures on Social Security are projected to increase from 5.3 percent to 6.05 percent of GDP.[12]

New Zealand offers a universal, non-means-tested, flat-dollar benefit to nearly all retirees, regardless of past earnings or years in the labor force. For a retired couple, the New Zealand Superannuation benefit is equal to about USD 1,800 per month. That flat-dollar benefit is not reduced based on other retirement savings, though it is subject to taxes. The lack of a means test makes New Zealand's Superannuation benefit more expensive than a means-tested program such as Australia's Age Pension, but it also reduces the need to mandate personal retirement saving on top of what the government provides. New Zealand's supplemental KiwiSaver accounts, introduced in 2007, feature automatic enrollment and a government and employer match but no requirement to save.

The United Kingdom's reformed State Pension offers benefits based on years in the labor market, not average lifetime earnings, in contrast to US Social Security. A couple who have both spent at least 35 years in the labor force would each receive the full new State Pension benefit of about USD 1,800 per month. The State Pension is not means-tested, though it is subject to income taxes.

Additionally, in 2012, the United Kingdom introduced the National Employment Savings Trust, which automatically enrolls all employees who earn a minimum of about USD 10,000 per year in a defined contribution retirement account if they are not already offered a retirement plan at work. Participation is voluntary, but if the employee continues in the plan, their employer must contribute at least 3 percent of their pay, and the employee must contribute at least 5 percent of their salary. Most employees, however, receive a government credit that reduces their cost to about 4 percent of their salary.

Canada's government retirement system has two tiers. Canada's Old Age Security (OAS) benefit is a buffer to prevent poverty and is means-tested based on additional retirement income. The OAS benefit is paid on a flat-dollar basis and prorated based on years of residency in the country. The benefit and means-testing formulas are complex, but a retired couple with no other income sources would receive about USD 910 per month in OAS benefits. However, the OAS benefit can decrease if a retiree has other income sources, including from the Canada Pension Plan (CPP).

The CPP provides benefits on top of the OAS, but unlike US Social Security, the CPP benefit formula is not progressive. Each retiree receives a benefit equal to 33 percent of their average preretirement earnings, whereas Social Security can replace up to 90 percent of preretirement earnings for very low-earning individuals. The relatively low level of earnings that are subject to CPP taxes limits CPP benefits' dollar value.

In the US, Social Security payroll taxes are levied on earnings up to $147,000 in 2022, while in Canada, taxes are levied and benefits calculated based only on earnings up through about $65,000 per year. Thus, the average new Canadian retiree in 2021 received a CPP benefit of about $562 per month versus over $1,600 in US Social Security benefits for an average new retiree that year. On top of the OAS and CPP, Canadians may participate in employer-sponsored retirement plans similar to those offered in the US.[13]

The point of this review is that however politically sacrosanct US policymakers might consider Social Security's tax and benefit formulas to be, there are other ways to attain retirement income security that are compatible with the United States' basic political and economic traditions. Australia, Canada, New Zealand, and the United Kingdom each have fully functioning economies and democracies and provide well for their retirees while structuring their retirement systems differently from the US Social Security program.

How Social Security Reform Might Look

I construct a Social Security reform plan built on the general philosophies of retirement programs in the four countries discussed above. The reform plan most closely resembles Australia's retirement savings model while allowing policymakers to make several significant choices regarding the plan's ultimate structure.

In this reformed Social Security program, retirees would be guaranteed a government-provided benefit equal to 28 percent of the national average wage for single retirees and 41 percent of the average wage for couples, as is done in Australia. For 2022, given that the Social Security Administration projects the average wage will be $61,600, this would produce a benefit of $27,720 for single retirees and $33,880 for couples.[14] In each case, these benefits are slightly over twice the federal poverty threshold.[15]

Using 2022 parameters, in which approximately 55 percent of retiree households are married, 45 percent are single, and there are 2.7 workers for each beneficiary, these benefits would cost approximately 8.8 percent of employee wages. On top of this cost would be expenditures for Social Security's disability and survivor's insurance benefits. Moreover, the 2022 cost terms would rise to about 11.4 percent of employee wages as the changing demographics gradually reduce the worker-to-beneficiary ratio to two-to-one.[16]

Policymakers must face two important questions. First, would this base benefit be means-tested? In Australia, the government-provided benefit is subject to a means test that eliminates benefits for roughly the richest quarter of the retiree population, reduces them for another quarter, and leaves them unchanged for approximately half of retirees. A similar means test in the United States would reduce the cost of the minimum benefit by approximately 38 percent, reducing the long-term cost from 11.1 percent of wages to about 7.1 percent.[17]

However, a means test acts as an effective tax on retirement savings. For that reason, Australia mandates that all employers offer a retirement plan and that all employees must participate, with contributions funded by employers alone at an amount equal to 12 percent of employee wages, up to a maximum annual wage of about USD 178,000. Together, mandatory personal retirement savings and a means-tested government benefit reduce the cost of Australia's government retirement system.

An alternative approach would not means-test the reformed Social Security benefit, which would increase its cost but reduce the need to mandate personal retirement saving. New Zealand's flat-dollar retirement benefit is not means-tested. While employees are automatically enrolled in workplace retirement plans, they are free to withdraw if they choose. Thus, whether to means-test the reformed Social Security benefit involves a trade-off between financial costs to the taxpayer and individuals' personal autonomy to prepare (or not prepare) for retirement as they choose.

Policymakers must also choose how to finance the government-provided benefit. A tax on wages currently funds Social Security. Although there is no explicit link between taxes paid and the benefits to which a person becomes entitled, payroll tax financing was designed to make Social Security more closely resemble a private retirement savings plan. But if policymakers shifted Social Security's focus toward preventing old-age poverty, they might also consider altering how benefits are financed.

In Australia, Canada, and New Zealand, general tax revenues fund government retirement benefits focused on poverty prevention. In the US, individual income taxes generate most general tax revenues. The United Kingdom, by contrast, continues to fund its flat benefit with an explicit tax on earnings, similar to Social Security's payroll tax. Congress would more likely choose to fund a poverty-oriented Social Security benefit with general tax revenues if that benefit were means-tested, while it would probably retain a payroll tax if no means test were applied to benefits.

A means-tested benefit coupled with general revenue financing would be far more progressive than the current program, leaving low earners better off on both the tax and benefit sides of the program. But this would also shift more costs to higher-earning households. Since Social Security is underfunded, payroll tax and general revenue financing could conceivably be combined to help fill the funding gap. For instance, general revenues might initially be employed to ensure that no retirees received less than promised under the new benefit formula, even if they had worked most of their lives under the current benefit formula. Over time, as the maximum benefit payable by Social Security is phased down, the costs of the minimum benefit borne by general revenues might be increased and the payroll tax rate reduced when Social Security's financial health allows.

I here outline a specific policy proposal for budgetary analysis purposes. Implementing this proposal would make Social Security solvent and fix shortfalls that the current pay-as-you-go structure created. Emulating Australia's retirement system, the federal government would provide all seniors with a benefit equal to 28 percent of the national average wage for single retirees and 41 percent of the average wage for couples. Each employee must be offered and enrolled in a workplace retirement plan, which could be either an employer-sponsored plan or a government-sponsored defined contribution plan similar to the Thrift Savings Plan offered to federal government employees. As in Australia, contributions would be set at 12 percent of employee wages. Unlike in Australia, however, employers, employees, and the federal government would split the contributions.

Employers and employees would each contribute an amount equal to 5 percent of employee wages. The federal government would contribute an amount equal to 2 percent of employee wages, up to the national average wage. This federal contribution would be funded by reductions in the tax preference for private retirement savings, with a focus on reducing the net preference for the highest-income fifth of taxpayers. Universal retirement-plan coverage and participation would reduce the need for the federal tax preference. Moreover, higher-income households have demonstrated little difficulty in saving for retirement on their own.

All these provisions would be phased in, including introducing the minimum benefit, scaling down the maximum benefit that Social Security pays, introducing mandatory retirement-plan coverage and participation, and scaling up the contribution rate, perhaps by starting at 1 percent of employee wages and increasing each year until the 5 percent ultimate contribution rate is reached. Other provisions would also need to be filled out, such as whether and to what degree retirement-plan balances must be converted to annuities rather than being available as lump sums.

Conclusion

The United States needs innovative thinking on a range of public policy issues, including Social Security and retirement savings. Unfortunately, anyone advocating a more focused Social Security program and increased private retirement savings will likely be accused of wishing to "privatize" the program. But Australia, Canada, New Zealand, and the United Kingdom clearly demonstrate ways to address retirement security that reduce budgetary costs and increase private retirement savings while agreeing with our political and economic traditions.

Reforming Social Security to focus on low-earning Americans could eradicate old-age poverty while making the program financially sustainable. The nation should reform its private retirement savings system to close coverage gaps and automatically enroll employees in retirement plans. Compared to other public policy challenges facing the United States, such as health care and education, Social Security and retirement savings are eminently solvable—but only if policymakers willingly step up with creative solutions to politically difficult issues.

Notes

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9. In 1930, 11 percent of foreign-born Americans and over 16 percent of black and other non-white Americans were judged illiterate. See Thomas D. Snyder, ed., *120 Years of American Education: A Statistical Portrait*, US Department of Education, Office of Educational Research and Improvement, National Center for Education Statistics, January 19, 1993, https://nces.ed.gov/pubsearch/pubsinfo.asp?pubid=93442.

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7

Empowering Adults with Disabilities with a Work-First Approach to Social Security Disability Insurance Reforms

RICHARD BURKHAUSER

The number of people receiving Social Security Disability Insurance (DI) benefits as disabled workers increased from 1.0 million in 1965 to 9.0 million in 2014, and beginning in 2009, the DI program began paying out more in annual benefits than it received in taxes and interest from its trust fund.[1] In light of this growth, as early as 2012, the DI Trust Fund was projected to be depleted in 2016.[2] This event was eventually postponed by the passage of the Bipartisan Budget Act of 2015, which in 2016 allowed the DI Trust Fund to borrow from the Social Security Old-Age and Survivors Insurance (OASI) Trust Fund.[3] But no DI program reforms were initiated as part of this law.

The encouraging news is that based on Office of the Actuary projections reported in the 2022 Old Age, Survivors, and Disability Insurance (OASDI) trustees report, the DI Trust Fund is no longer borrowing such funds, and for the first time since the 1983 trustees report, its reserves do not become depleted within the 75-year long-range projection period.[4] Furthermore, the recipience rate (i.e., the number of disabled-worker beneficiaries per insured worker through normal retirement age), which had been rising steadily since 1990, peaked in 2014 and has since fallen. Based on the latest Office of the Actuary projections, it will remain at approximately its current level over the next 10 years.[5]

A major reason for this turnaround in the fortunes of the DI Trust Fund was the substantial improvement in the United States economy, its impact on the employment prospects of working-age people with disabilities, their decisions to apply for DI benefits, and the unexpected impact this has had on the DI recipience rate since 2014. As Leila Bengali, Mary C. Daly, Olivia

Lofton, and Robert G. Valletta document, in contrast to the business cycle of the 1990s, thanks partly to the longest National Bureau of Economic Research–recorded peak-to-peak business cycle (2007–20), the employment rate of working-age people (age 25–61) with disabilities increased over this period, as did their mean real wage earnings and household income.[6]

With coauthors Kevin Corinth and Douglas Holtz-Eakin, I showed in a 2021 article in the *Annals of the American Academy of Political and Social Science* that economic growth between the peaks of the 2007–20 business cycle lifted all Americans' economic well-being.[7] Consistent with conservative principles, we argued that the key lesson from the Great Recession is that strong economic growth and a hot labor market do more to improve the economic well-being of the working class and historically disadvantaged groups, including working-age people with disabilities, than does a slow recovery that relies on safety-net policies to help replace lost earnings.

Thus, we argue that the best way to prevent a "K-shaped" recovery out of the COVID-19-induced recession of 2020–21 is to ensure that safety-net policies do not interfere with a return to the strong pre-pandemic economy once the health risk subsides and pro-growth policies that incentivize business investment and hiring are maintained. This must be combined with a work-first approach to working-age people with disabilities—one that only provides benefits based on an "inability to work" once efforts to return those workers to the workforce have failed.

The less encouraging news with respect to the financial status of the DI Trust Funds comes in two parts. First, despite the legal separation of DI and OASI Trust Funds, in practice Congress has, when necessary, temporarily changed that law to allow inter-fund borrowing to maintain "technical solvency" of the borrowing fund. This is less encouraging, especially for those concerned with maintaining the joint long-term financial integrity of the two programs that comprise OASDI and the public's trust in them, since the combined OASDI Trust Fund is in far worse financial shape.

This is best seen in Congress's behavior in the process leading up to the 1983 amendments to the Social Security Act. Coming within months of having insufficient funds to fully pay its beneficiaries, Congress authorized the OASI Trust Fund to borrow DI Trust Fund money.[8] This may occur again in 12 years (2034), when—based on Office of the Actuary intermediate assumptions—OASI Trust Funds will be depleted. Without a major change in the OASI system, either through increases in taxes or reductions in benefits, such inter-fund borrowing would quickly deplete the combined OASDI Trust Funds sometime in 2035 despite the "counterfactual world" of a DI depletion not occurring for the next 75 years without such borrowing.[9]

Second, it is unclear exactly what is driving the long-run improvements in the fortunes of the DI Trust Funds. However, it is more than likely to be the aging out of the baby-boom population from DI coverage and onto the OASI rolls rather than a substantial return to pre-1990 disability recipience rates, which in 2020 were still twice their level in 1990.[10] This suggests that the United States can learn from disability policy reforms initiated in other Organisation of Economic Co-operation and Development (OECD) countries that, in response to similar increases in their recipience rates, managed to not only slow the pace of those increases but substantially reduce them over time through various work-first strategies.

The first section of this chapter provides a brief fiscal history of the OASDI system, focusing on the difficulty Congress faces in coming to a bipartisan compromise necessary to assure the long-term fiscal stability of the OASDI system.

The second section focuses on the unintended consequences of the 1983 amendments of the Social Security Act that disproportionately reduced the future benefits of workers transitioning out of the labor force as OASI beneficiaries relative to workers who did so as DI beneficiaries.

The third section describes efforts in other OECD countries to reduce their disability program recipience rates through work-first reforms, offering four lessons for the US to bring the OASDI system into long-term fiscal stability via disability policy reforms: Disability does not mean incapacity, incentives affect behavior, early intervention reduces flows into disability benefits programs, and hurdles to reform in the US are surmountable.

The Difficulty of Creating a Bipartisan Compromise

The difficulty of reaching the most recent great bipartisan compromise—the Social Security Act of 1983—offers a cautionary tale for reaching one more consistent with conservative principles of limiting unintended consequences, promoting work, and ensuring fiscal solvency. Despite warnings from the actuaries that the flow of taxes into the combined OASDI programs were insufficient to offset the outflow of benefits and, in 1974, that trust fund bonds would have to be sold to meet current costs, Congress failed to act decisively during that time. The National Commission on Social Security was finally appointed in December 1981.[11] But a solution was not found until after the November 1982 election, with the certainty that the trust fund would be exhausted in 1983.

The commission's pragmatic political "solution" was to advance already-scheduled payroll tax increases and postpone the time in the year when inflation adjustments would be made together with other minor adjustments. Collectively, this provided a patch on the system that would have allowed a few decades of fiscal relief but did little to resolve the long-term demographic challenges to the system. It was only later that an additional bipartisan change was made in the House along these lines by gradually increasing the normal OASI retirement age from 65 to 67 for succeeding cohorts of workers as they reached age 62 beginning in 2001 and ending in 2022. As of January 2022, all future OASI-eligible workers who reach age 62 and retire will receive only 70 percent of the OASI benefits they would receive at the new normal retirement age of 67.[12]

None of these changes directly challenged Social Security's fundamental structure. These changes simply postponed the day of reckoning when younger cohorts more familiar with private defined contribution programs might refuse to continue to accept the "pragmatic compromises" necessary to sustain Social Security's defined benefit structure and its complicated, out-of-date, within-cohort redistributive features.

For instance, issues related to OASDI's long-term financial stability in 1983 crowded out necessary reforms of its differential treatment of one- and two-earner couples that were unjustified on either actuarial or redistributive grounds.[13] Forty years later, two-earner couples across the wage distribution continue to have much lower benefits-to-taxes-paid ratios compared to one-earner households.[14]

Table 1 shows the consequences of inaction since 1983 in resolving the long-term funding of both the individual OASI and DI Trust Funds and the combined OASDI Trust Fund. Each year, the Social Security board of trustees must report on the long-term financial health of the OASDI system. If the system is in balance over the next 75 years, the “actuarial balance” (i.e., the amount that tax rates must be raised today to meet promised benefits) is zero.

In 1982, a 1.82 percentage point permanent payroll tax rate increase was necessary to keep the combined OASDI system in actuarial balance. But more importantly for Congress, it had to act by 1983, or there would be insufficient funds to fully pay current beneficiaries, even assuming inter-fund borrowing.

The Social Security Act of 1983 made current revenues again exceed current costs by immediately moving forward already-scheduled payroll tax increases, postponing when inflation adjustments were made, and, subsequently, gradually increasing normal retirement age. This growth in the combined trust fund increased continuously through 2020, and according to the 2022 trustees report, at the end of 2021, the trust fund was only slightly below its 2020 peak in terms of reserves.[15]

However, the growth in trust fund reserves belies that the shortfall in actuarial balances also began to grow almost immediately after the 1983 reforms and is now substantially larger than it was in 1982—3.42 percentage points.[16] At current tax rates, while DI Trust Fund balances are not expected to be depleted again for the next 75 years, OASI Trust Fund balances are expected to be depleted in 2034, and even with inter-fund borrowing, combined trust fund balances are expected to fall again in 2022 and continue to do so until they are completely depleted in 2035.[17]

In 1986, the combined trust fund was not expected to be depleted until 2051, 65 years in the future. In 2001, two years after Sylvester J. Schieber and John B. Shoven urged congressional action, the expected depletion date was 2038, 37 years in the future.[18] In the most recent trustees report, the depletion date is now 2035, 13 years away, thanks partly to the substantial increase in unemployment and the increased likelihood of a recession stemming from COVID-19 and the public health efforts to combat its spread, which have slowed economic growth.

Why hasn’t Congress acted in the face of the ever-shortening time before depletion of the combined trust fund? Most likely for the same reason that the 1983 amendments were not enacted until the trust fund was on the verge of exhaustion and current taxes would not cover current benefits. Any bipartisan agreement to bring Social Security into long-term balance

Table 1. Current Year OASDI Combined Trust Fund Reserves and Long-Range Estimates of Actuarial Balances, Projected Year of Trust Fund Depletion, and Years Left Before Depletion (1982–2022)

Year of Report	Trust Fund Reserves (US Dollars, Billions)	Actuarial Balance (Increase in Payroll Tax)	Year of Depletion			Years Remaining
	OASDI	OASDI	DI	OASI	OASDI	OASDI
1982	25	1.82	1988*	1983	1983*	1
1986	42	0.44	2026	2054	2051	65
1991	225	1.08	2015	2045	2041	50
1996	496	2.19	2015	2031	2029	33
2001	1,049	1.86	2026	2040	2038	37
2006	1,859	2.02	2025	2042	2040	34
2007	2,048	1.95	2026	2042	2041	34
2008	2,239	1.70	2025	2042	2041	33
2009	2,419	2.00	2020	2039	2037	28
2010	2,540	1.92	2018	2040	2037	27
2011	2,609	2.22	2018	2038	2036	25
2012	2,678	2.67	2016	2035	2033	21
2013	2,732	2.72	2016	2035	2033	20
2014	2,764	2.88	2016	2034	2033	19
2015	2,789	2.68	2016	2035	2034	19
2016	2,813	2.66	2023**	2035	2034	18
2017	2,848	2.83	2028	2035	2034	17
2018	2,892	2.84	2032	2034	2034	16
2019	2,895	2.78	2052	2034	2035	16
2020	2,897	3.21	2065	2034	2035	15
2021	2,908	3.54	2057	2033	2034	13
2022	2,852	3.42	Solvent***	2034	2035	13

Note: To illustrate the actuarial status of the Social Security program as a whole, the operations of the OASI and DI Trust Funds are often shown on a combined basis as OASDI. However, by law, the two funds are separate entities, and therefore the combined fund operations and reserves are hypothetical.
* The estimated years of depletion for DI and OASDI in the 1982 report were calculated assuming the absence of inter-fund borrowing. However, in November 1982, funds were borrowed from both the DI and the Health Insurance Trust Funds to allow all OASI beneficiaries to receive their benefits from the

OASI Trust Fund. ** The estimated years of depletion for DI in the 2016 report are based on borrowing from the OASI Trust Fund, which in turn is based on the Bipartisan Budget Act of 2015. *** For the first time since the 1983 trustees report, the DI reserves in the 2022 report do not become depleted within the 75-year long-range projection period and hence were declared solvent.
Source: US Social Security Administration, *The 2022 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, June 2, 2022, 165–67, Table VI.A3, 171, Table VI.B1, https://www.ssa.gov/OACT/TR/2022/tr2022.pdf; and author's calculations from previous trustees reports.

will require some combination of tax increases and benefit decreases, a difficult task politically: the exact opposite of the compromises Congress made when the beneficiary-to-worker ratio was falling and average benefits were falling relative to average wage earnings.

While President Bill Clinton urged a long-term Social Security solution as early as 1998, President George W. Bush's Commission to Strengthen Social Security in 2001 proposed the only major attempt at a long-term solution.[19] Its key proposal held harmless all current old-age beneficiaries and focused solely on current workers.[20] It would have reduced current workers' future benefits by using a price-based rather than a wage-based index to determine a worker's average indexed monthly earnings. This change alone would have reduced future promised benefits sufficiently to cover the entire shortfall in actuarial balances with enough left over to provide real increases in the minimum old-age benefit.

The commission also proposed a cost-neutral way for current workers to borrow from their future benefits to invest in personal accounts. While this offered workers a potentially higher return, it also required them to assume the downside risk inherent in private, defined contribution–style approaches to savings and was a deal breaker for Democrats. No further serious efforts to reform OASDI followed the failure to act on the 2001 commission's recommendations, and little has changed since then regarding a bipartisan solution.[21]

Unintended Consequences of Raising the OASI Normal Retirement Age on DI

Increasing normal retirement age as part of the 1983 Social Security Act was meant to offset built-in future increases in OASI liabilities due to increases in longevity that would increase the number of years future OASI recipients would spend as beneficiaries and, hence, overall program costs. Rather than permanently linking increases in normal retirement age to increases in life expectancy as the Swedish social security system did, the increase from age 65 to age 67 was phased in over almost 40 years, with insured workers still allowed to take early retirement benefits at age 62, but at only 70 percent of the monthly benefits. This additional decrease in the yearly flow of OASI benefits at age 62 was intended to encourage workers to work longer (both increasing overall output in the economy and OASI tax revenues) as their life expectancy increased rather than continue to retire at the same age their parents did and increase their years receiving OASI benefits.

However, an unintended consequence of not increasing the early retirement age in tandem with the normal retirement age (i.e., from 62 to 64 as the normal retirement age increased from 65 to 67) was to further widen the potential reward for workers with some disabilities of gaining entrance to "early retirement" benefits via the DI program, rather than continuing to work until they were eligible for normal retirement-age OASI benefits.

The reason is that DI benefits are still pegged to the normal retirement age; that is, DI beneficiaries are entitled to a monthly benefit based on their full primary insurance amount (PIA) regardless of the age they received this non-actuarially reduced monthly benefit.[22] This increased the difference in monthly benefits between two workers with the same PIA at age 62.

The OASI beneficiary now receives only 70 percent of the monthly benefit of a DI beneficiary with the same earnings history. This differential in benefits could increase applications for DI benefits, increase DI recipience rates, reduce employment of people with disabilities who might otherwise continue working rather than take reduced OASI benefits, and increase overall costs to the combined system.

The most straightforward solution to this unintended consequence is to phase in increases in the earliest retirement age for OASI to 64 and further increase the earliest retirement age in tandem with any future increases in the normal retirement age. An alternative, which would also reduce DI expenditures even more and increase employment, is to consider

DI benefits more explicitly as a form of "early retirement" and hence, like OASI benefits, reduce them to 70 percent of PIA if taken at the new normal retirement age of 67 for those who become DI beneficiaries at or before age 62. The German disability system used this approach in 1996 as a means of reducing growth in its disability rolls.[23]

Since life expectancy is predicted to continue to grow, any further increases in normal retirement age as part of a future bipartisan compromise without one of these corrections will only further exacerbate this unintended consequence of encouraging DI receipt. To protect DI beneficiaries in low-income families from reductions in income that result from either solution, Congress could use the other program administered by the Social Security Administration (SSA)—Supplemental Security Income (SSI)—to provide an income floor for such workers making the transition onto the DI rolls. This has the advantage of explicitly making such income transfer payments for those not expected to work via a program funded by general revenues rather than the OASDI payroll tax.

More generally, policymakers should consider using general-revenue SSI funding to offset income losses to low-income families of workers affected by reductions in currently promised OASDI benefits or increases in OASDI payroll tax.[24] For instance, as discussed above, rather than continuing to peg early retirement at age 62 when the normal retirement age increases, policymakers could lower the age of eligibility for SSI old-age benefits to 62 as they raised the OASI earliest retirement age.

Such approaches, which limit access to actuarially reduced OASI benefits to ages above 62 or reduce the DI monthly benefits of those who take DI benefits at or before age 62, have the additional value of protecting a feature of OASI and DI, which makes them almost unique among annuity plans. Both guarantee that once taken, future benefit payments will be protected against inflation. This feature makes OASI and DI annuity benefits of value in anyone's portfolio.

Most recently, Alicia H. Munnell and Gal Wettstein make this point by suggesting that using tax-deferred 401(k) funds after age 62 as a bridge until age 70 when the flow value of inflation-protected Social Security benefits is maximized effectively uses the OASI system as a relatively safe alternative to stocks and a less expensive alternative to private annuities, which consider adverse selection issues in their pricing.[25]

More General Work-First Disability Program Reforms

The number of workers receiving some form of publicly financed disability cash transfer benefits has increased substantially in most industrialized nations since 1970. Population growth accounts for part of this increase, but so does the disability recipience rate. Figure 1 shows the total number of persons receiving long-term categorical disability cash transfer benefits as a share of the working-age population in six OECD countries. This rate has now peaked and fallen in all six, most recently in the United States.

Duncan McVicar, Roger Wilkins, and Nicholas R. Ziebarth, focusing on the five non–United States countries, trace differences in each and find that individual country policies play a major role in the levels and trends in their rates. They then report the key policy changes that have substantially reduced each country's recipience rate from its historic peak.[26]

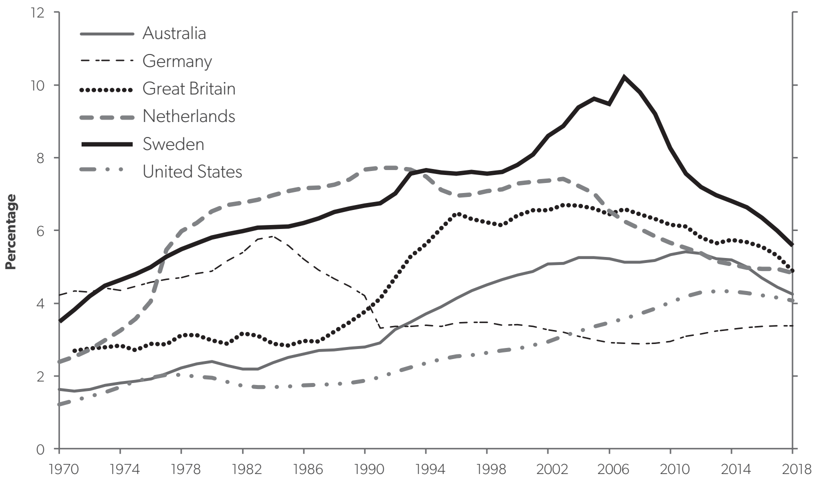
In a forthcoming book chapter I coauthored with Mary C. Daly, we draw lessons from these OECD country reforms for the United States' case.[27] Each OECD country implemented reforms slightly differently, but all shared the goal of curbing unsustainable program growth by changing the cultural and social expectations of and for people with disabilities and better aligning the incentives embedded in program design with these expectations.

Although each country recognizes its reforms have not been completely successful, from the United States' perspective, these reforms demonstrate that policies matter and provide a relevant starting point for discussions about reforming the United States' disability system.

We propose four policy lessons, which should be considered by anyone interested in lowering disability recipience rates in any future bipartisan agreement to bring the OASDI system long-term fiscal stability.

Lesson One: Disability Does Not Mean Incapacity. A substantial share of people who were moving onto long-term cash transfer disability programs could, with reasonable levels of government-provided support, find or maintain employment. Of course, a subset of workers with disabilities had impairments so severe that work was not possible, but this was a smaller portion than previously accepted onto these programs. Those now coming onto the rolls should be, by demonstration rather than assumption, unable

Figure 1. Disability Recipience Rates Across Countries



Source: Data for Australia: Department of Social Services and Australian Bureau of Statistics; Germany: Deutsche Rentenversicherung and Statistisches Bundesamt; Great Britain: Department for Work and Pensions and Office for National Statistics; Netherlands: Statistics Netherlands and Institute of Employee Benefit Schemes; Sweden: Statistics Sweden and Swedish Social Insurance Agency yearbooks; and United States: US Social Security Administration and Census Bureau.

to integrate effectively into the labor market even with appropriate incentives and support.

The lesson for United States disability policy is that the population with disabilities is heterogeneous and many of its members can work. This view is at odds with the current United States system, in which DI applicants must demonstrate an inability to perform substantial gainful activity before receiving access to benefits or any other type of support, including work support. Embracing the ideas of many European countries about the work capacity of individuals with disabilities calls for restructuring the United States' system to bring forward the focus on employment and make long-term cash benefits a last resort once rehabilitation and accommodation have failed.

Lesson Two: Incentives Affect Behavior. Once it is recognized that the social and cultural environment faced by individuals with disabilities partly determines the extent to which their impairment limits them, it is easy to see that the incentives embedded in policy design can affect outcomes. All actors in the process to attain the outcomes desired must be incentivized to do so.

In the Netherlands, this meant making employers bear more of the direct costs of the program and making employees comply with rehabilitation and retraining to maintain benefits. In Sweden, this meant standardizing the disability-screening process and holding disability gatekeepers accountable for engaging applicants in work-rehabilitation plans. Finally, reforms focused on making workers comply with the work-first approach by reducing or eliminating benefits to those workers who did not comply with the rehabilitation and accommodation plans.

The lesson for United States policymakers is that program incentives affect how people with disabilities and their employers react to, and fare after, the onset of a health impairment. In the United States, DI is funded from a payroll tax, and the federal government is responsible for a great share of the costs associated with providing long-term disability benefits to working-age people with disabilities.

Because they bear no direct responsibility for funding benefits paid to former employees, employers have no direct financial incentive to accommodate and rehabilitate employees who become impaired. Incentivizing employers to make greater investments in accommodation and rehabilitation by creating a scheme that makes employers internalize some of the costs of moving employees onto long-term disability could curb DI growth by more effectively aligning incentives. David H. Autor and Mark G. Duggan propose one model for doing this in the United States, and my book with Daly proposes another.[28]

Lesson Three: Early Intervention Reduces Flows. A recurring theme in the experiences of Germany, Great Britain, the Netherlands, and Sweden is that reforms focused on early intervention can successfully reduce the flow of new beneficiaries onto the program and boost the flow of new beneficiaries off the program. In the Netherlands, for example, early intervention that coordinated employer action following the employees' particular health shocks was crucial to keeping impaired workers in the labor force. Such intervention significantly increased impaired workers' return to work and reduced time on the sickness or disability program.

In contrast, none of these countries, including Australia, successfully moved existing longer-term beneficiaries back into the labor market. Across all countries, once enrolled on disability benefits for more than a few months, only a small fraction of recipients returned to work, suggesting that early intervention and prevention were the most effective strategies.

These experiences have implications for United States policy discussions. First, that most current DI recipients do not work is not evidence that they would have been unable to work if given alternative policy treatments (e.g., timely accommodation and rehabilitation). Indeed, the marked difference in outcomes between those given early versus later employment-oriented services in the Netherlands and Sweden shows that in a system oriented toward long-term cash benefits rather than work (arguably, how the US system functions), many of those with residual work capacity will never return to work.

The experiences in these countries also call into question the viability of ongoing attempts to gain control of the growth in DI rolls in the United States by funding additional continuing disability reviews or enhancing postentry rehabilitation or job-training programs like Ticket to Work. While such programs have merits, the experiences in Sweden tell us these efforts will fall short of bringing growth in the rolls down to sustainable levels because the intervention happens too late.

Finally, the reforms and outcomes in these countries show the difficulties of focusing policy reforms on current beneficiaries—a practice the SSA is forced to follow by rules requiring SSA-collected funds to be focused on current program recipients. Congress should eliminate this rule. It should allow SSA to focus its energies on workers with health-based work limitations who are trying to decide whether to stay on the job or apply for benefits. This work-first shift in focus is more likely to curb DI growth than efforts focused on those already on the rolls.

Lesson Four: Hurdles to Reform in the US Are Surmountable. Despite this growing body of evidence that structural reforms to long-term cash disability programs can curb program growth and potentially improve outcomes for those with health-based impairments, the political coalition necessary to achieve fundamental disability policy reform has been slow to evolve in the United States.[29]

One issue raised in response to proposals for fundamental DI reform is that these benefits, while not especially generous, are essential to keeping millions of disabled-worker beneficiaries out of poverty. The evidence from Europe shows that this is a static view that assumes that, in the absence of benefits, individuals with disabilities would remain out of the labor market and dependent on other forms of public or private assistance for support. European disability reforms over the past two decades provide plausible evidence that increased employment will occur when pro-work policies replace policies that have had the opposite effect. Their reform experience shows that a significant number of people with disabilities, who would otherwise have moved onto long-term cash benefits, were able, with reasonable levels of support, to return to work.[30]

When programs are designed to award cash transfers in lieu of work, employment falls. In contrast, when programs are designed to encourage work and award transfers only when work clearly is not possible, employment rises. Since work generally leads to increased income, especially when public policies make work pay, efforts to promote work among those with disabilities can produce positive outcomes.

Another concern is that programs like DI are especially important in economic downturns, when individuals with limited work capacity are not only more likely to be laid off but less likely to find a new job. Experience in European countries, especially the Netherlands, which intentionally or unintentionally used this logic to turn its long-term disability programs into more general unemployment programs, suggests that it can be an expensive and ultimately ineffective policy decision. Indeed, many European nations struggled to regain control over their disability systems, which for many decades were used as long-term unemployment insurance programs.

A key message from the European experience is that explicitly divorcing long-term “unemployability” insurance from DI is crucial to targeting resources toward both populations. Efforts to shift to more work-first policies over the past two decades in Europe suggest that fundamental disability reforms, if done well, can lower projected long-term costs for taxpayers, make the job of disability administrators less difficult, and, importantly, improve the short- and long-run opportunities of people with disabilities.

Conclusion

A bipartisan majority in Congress will by necessity pass and the president will sign a Social Security Act before 2035 that will contain some combination of additional taxes and reduced benefits ensuring the OASDI system can continue paying its beneficiaries through some date in the future, but that bipartisan agreement is most likely to occur just before 2035, as was the case with the just-in-time 1983 reforms.

However, that does not mean serious consideration of such a solution by conservatives should be postponed until that date. Based on lessons learned both from the "success" of the 1983 amendments and the "failure" of President Bush's Commission to Strengthen Social Security in 2001, while it is too early for any proposed changes to OASI or DI to be enacted, it is not too early to consider the ground rules for such a solution when that time comes.

Policy changes that reduce the DI recipience rate via work-first reforms will reduce the burden on both the DI and OASI trust funds by increasing employment.

Acknowledgments

I wish to thank John L. Palmer, John A. Turner, and Andrew J. Houtenville for their comments on earlier versions of this chapter.

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10. Richard Burkhauser and Mary C. Daly, "Lessons for US Disability Policy from Other OECD Countries" in *Work and the Social Safety Net: Labor Activation in Europe and the United States*, ed. Douglas J. Besharov and Douglas Call (New York: Oxford University Press, 2022), 183–203; and Tim Miller, David Pattison, and Sofia G. Ayala, "Trends in Social Security Disability Insurance," US Social Security Administration, Office of Disability and Retirement Policy, August 2019, https://www.ssa.gov/policy/docs/briefing-papers/bp2019-01.html.

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12. For a fuller history of the events leading up to this outcome and the economic and political forces driving them, see Schieber and Shoven, *The Real Deal*; Richard Burkhauser, "Touching the Third Rail: Alternative Solutions for Bringing the Social Security Retirement System into Long Term Balance," in *The Old-Age Crisis—Actuarial Opportunities: The 1996 Bowles Symposium*, ed. James C. Hickman (Schaumburg, IL: Society of Actuaries, 1999), 23–29; and Richard Burkhauser, "*Budgeting for Social Security*: A 75-Year Retrospective on W. R. Williamson's Article in the First Issue of the *Journal of Gerontology*," *Journals of Gerontology: Series B* 75, no. 7 (September 2020): 1489–93, https://academic.oup.com/psychsocgerontology/article/75/7/1489/5891846.

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of Return Under the OASDI Program for Hypothetical Workers," US Social Security Administration, Office of the Chief Actuary, March 2020, https://www.ssa.gov/OACT/NOTES/ran5/an2019-5.pdf.

15. US Social Security Administration, *The 2022 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Fund*.

16. Further delay will make a fiscal solution more expensive. For example, maintaining 75-year solvency with changes that begin in 2035 would require an increase in revenue by an amount equivalent to a permanent 4.07 percentage point payroll tax rate increase. US Social Security Administration, *The 2022 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Fund*, 5.

17. If the Old-Age and Social Insurance (OASI) Trust Fund reserves were to become depleted in 2034 as is currently projected, the operations of the hypothetical combined OASI and Disability Insurance (DI) Trust Funds would not reflect the aggregated operation of the OASI Trust Fund and the DI Trust Fund because part of the OASI benefits could not be paid without a change in the law. The values shown for the hypothetical combined trust funds assume the law will have been changed to permit the transfer of resources between funds as needed. US Social Security Administration, *The 2022 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Fund*, 3.

18. Schieber and Shoven, *The Real Deal*; and Burkhauser, "Touching the Third Rail."

19. Schieber and Shoven, *The Real Deal*; and Burkhauser, "Touching the Third Rail."

20. John F. Cogan and Olivia S. Mitchell, "Perspectives from the President's Commission on Social Security Reform," *Journal of Economic Perspectives* 17, no. 2 (Spring 2003): 149–72, https://www.aeaweb.org/articles?id=10.1257/089533003765888485.

21. One sign that things have gotten worse is that the two public seats on the Social Security board of trustees, which have been appointed via a bipartisan process since 1985, have been vacant since the last year of the Obama administration. In February 2020, the last two publicly appointed trustees published an opinion piece in the *Hill* urging the Senate to confirm President Donald Trump's recent nominations to these two public seats. See Charles P. Blahous III and Robert Reischauer, "It's Time to Seat Public Trustees for Social Security and Medicare," *Hill*, February 11, 2020, https://thehill.com/opinion/finance/482417-its-time-to-seat-public-trustees-for-social-security-medicare. Those nominations were never confirmed, and President Joe Biden has yet to nominate his candidates.

22. Individual OASI and DI benefits are both based on a worker's earnings history and a formula (the primary insurance amount) that adjusts their average indexed monthly earnings to a monthly benefit payment. Increasing the normal retirement age from 65 to 67 reduced the monthly benefit payment to 70 percent of what they would receive at age 67 for those who chose to take their OASI benefits at age 62 but did not reduce the benefit of those who received DI benefits at this or any other age.

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Congressional Budget Office provides cost-saving options for reducing the federal deficit between 2021 and 2030, including the elimination of eligibility for starting DI benefits at age 62 or later. Currently, someone can receive actuarially reduced monthly OASI benefits at age 62 and apply for DI benefits at the same time or later. If accepted onto the DI rolls, that person would be permitted to receive their full non-actuarially reduced monthly DI benefit instead. The Congressional Budget Office estimated that eliminating this option beginning in January 2022 would have reduced Social Security Administration expenditures by $20.8 billion by December 2030. See Congressional Budget Office, *Options for Reducing the Deficit: 2021 to 2030*, December 2020, http://www.cbo.gov/publication/56783.

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SAFETY-NET AND EDUCATION REFORM

8

A Safety Net for the Future: Overcoming the Root Causes of Poverty

ANGELA RACHIDI, MATT WEIDINGER, AND SCOTT WINSHIP

Few conservative domestic policy achievements over the past 40 years have been as important as the welfare reforms of the 1990s. These reforms initially comprised innovative state experiments authorized by policy waivers during the George H. W. Bush and Clinton administrations. They culminated in the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996, which replaced the former cash welfare program Aid to Families with Dependent Children (AFDC) with a work-focused block grant combining state flexibility with federal accountability—the Temporary Assistance for Needy Families (TANF) program.

Along with welfare reform, numerous policy changes during the 1990s provided more generous benefits to low-income workers. These reforms included expanding the earned income tax credit (EITC), creating the child tax credit (CTC), and providing additional childcare subsidies. Efforts to enforce child support payments from noncustodial parents were also strengthened.

Together, these reforms dramatically reduced the number of families receiving cash welfare. In 1992, 14 percent of children were in AFDC-receiving families in a given month. By 2000, just 6 percent were in families enrolled in TANF, and by 2019, 3 percent were.[1] Meanwhile, child poverty declined by over half, and possibly by much more, in the decades following PRWORA's enactment.[2] Employment among single mothers increased from 59 percent in 1992 to 73 percent in 2019.[3] The five-decade increase in nonmarital birth rates preceding welfare reform moderated before declining to rates not seen since the late 1980s.[4]

Yet this policy victory was narrow and incomplete. TANF now comprises a small portion—about 5 percent—of federal safety-net dollars (excluding health care programs). Many safety-net programs retain the work and marriage disincentives that bedeviled AFDC, and when TANF receded, several of those programs expanded. The resulting safety net undermines the very choices that lead families to upward mobility and long-term prosperity.

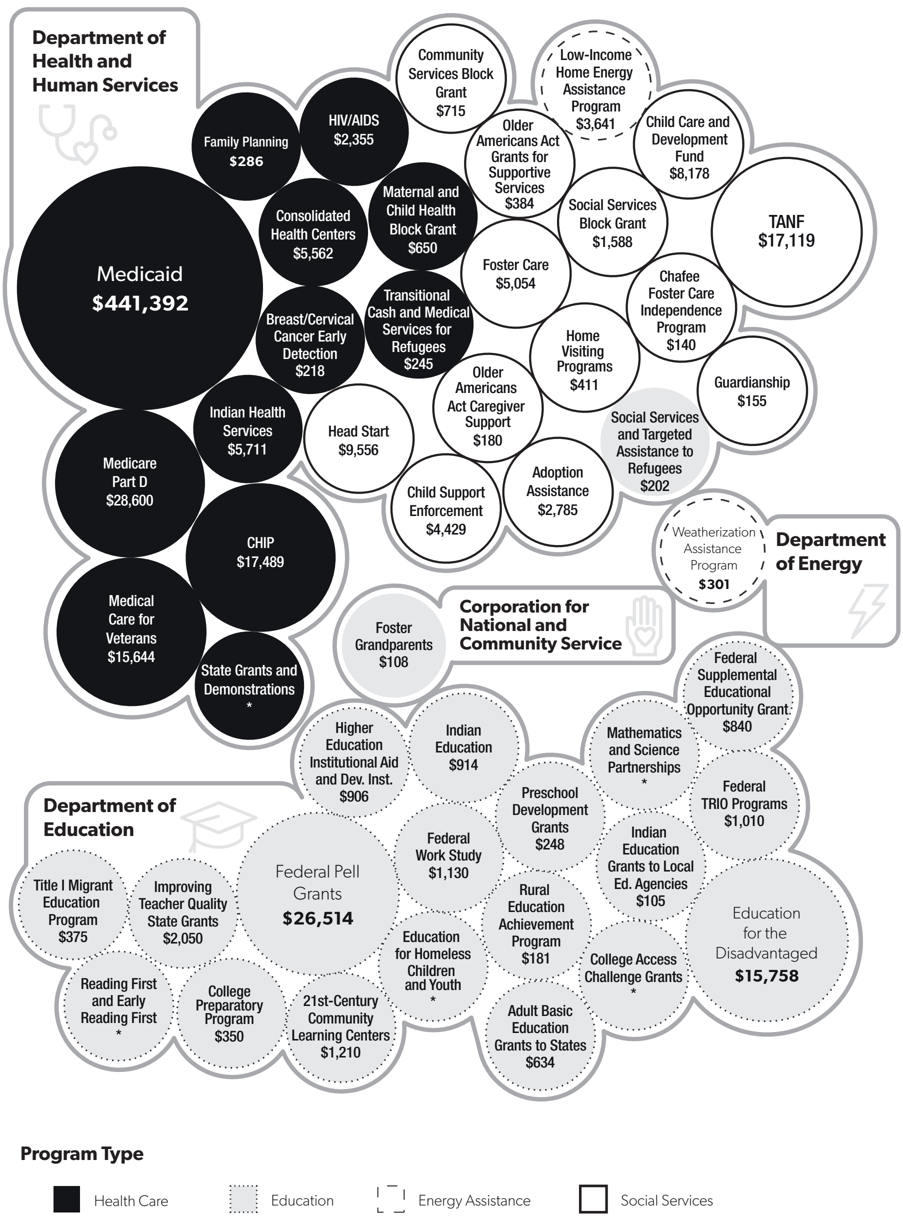
As the 1996 reforms retreat from memory, many activists, advocates, and policymakers have propounded a revisionist history, denying welfare reform's success and concluding that it actually *increased* deep poverty.[5] While these claims contradict the facts, progressives have used them to justify calls for creating a child allowance, which would reverse some of welfare reform's successes. Meanwhile, the rate of single parenthood remains historically elevated, the safety net remains an expensive thicket of programs administered via poorly coordinated bureaucracies, and upward mobility remains disappointing. States have limited means—and few financial incentives—to innovate in order to help families achieve better outcomes.

Low-income families in the US would benefit tremendously from a revival of conservative policymaking to reshape the American safety net. This chapter envisions a safety net for the 21st century that better promotes work and strong families, strengthens the social contract, aligns federal and state incentives, and slows the growth in safety-net spending. In the following sections, we provide an overview of the current safety net, outline principles for reform, and describe specific proposals to realize this vision.

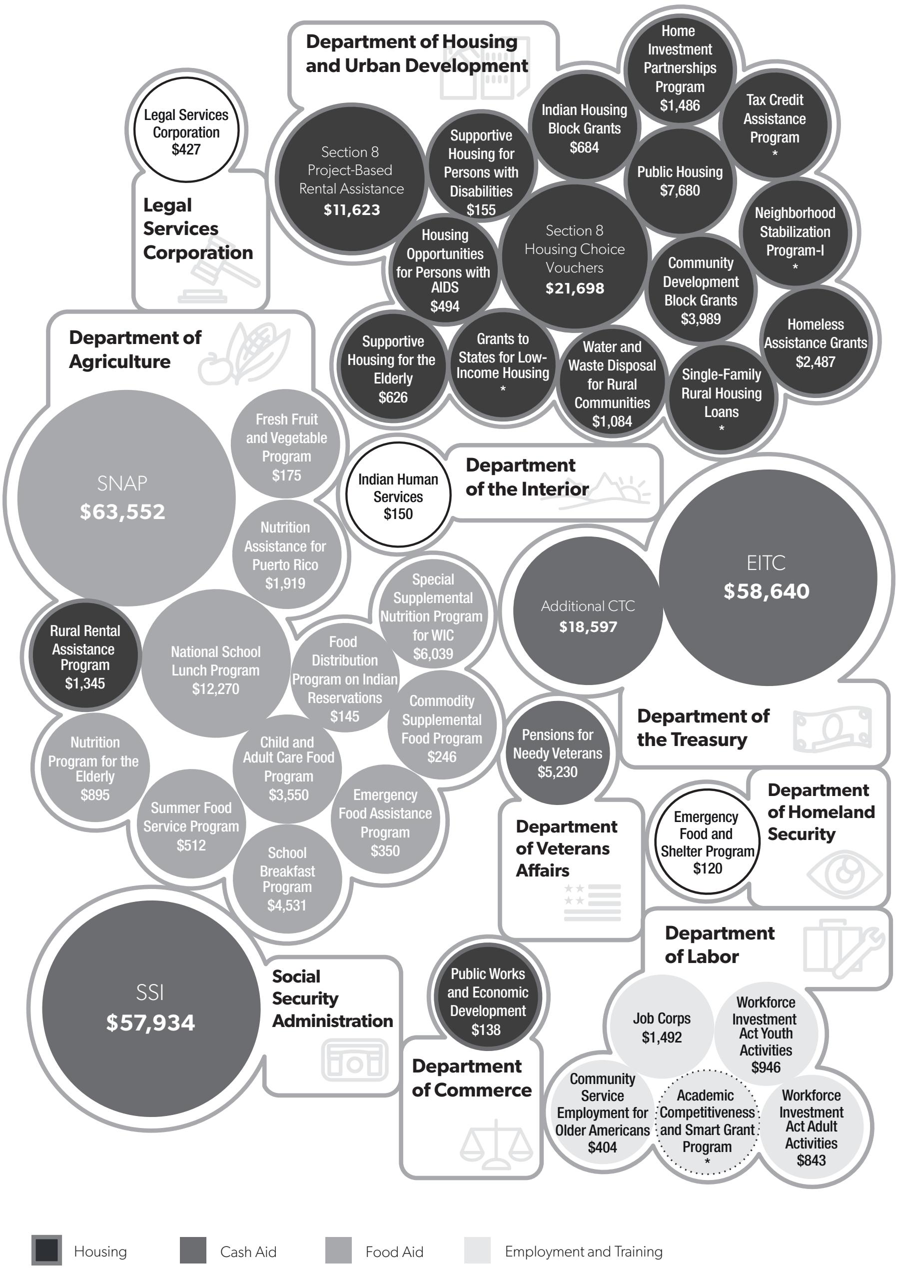
We propose dramatically rebalancing responsibilities between the federal government and states to promote economic independence in service of family well-being and child opportunity. In exchange for greater flexibility in program administration, states would be responsible for financing an increasing share of the largest cash and in-kind safety-net programs. Policies would incentivize states to move individuals from welfare to employment in innovative ways by working within the limits set by federal policies or operating their own programs via waivers.

States would have an incentive to help families find employment, because doing so would allow them to count federal tax credits received by these families toward their share of safety-net spending. In addition to paying half or more of major safety-net program costs, the federal government would support working families through a reformed tax credit consolidating existing credits and better encouraging marriage. The federal

Figure 1. Federal Benefits and Services for Low-Income Individuals



Note: The numbers indicate annual program budgets, in millions of US dollars. * Programs have annual obligations of less than $100 million, according to the Congressional Research Service.



Source: Authors' calculations using data from the Congressional Budget Office, Congressional Research Service, and agency budgets.

government would increase its support for childcare as its responsibility for financing safety-net benefits declined.

Overview of the Current Safety Net for Low-Income Families

The social safety net for low-income families and individuals in the US has evolved over several decades into a tangle of over 80 programs overseen by numerous federal agencies and largely administered by the states. (See Figure 1.) Current programs help low-income people afford food, housing, heating, and childcare while funding employment supports such as health care, education, and job training.

Assistance falls into two main categories: direct cash that recipients can use without restrictions and in-kind assistance. In-kind assistance can take the form of a voucher, which has a monetary value with restricted use (such as for groceries), or direct provision of goods and services (such as public housing and school lunches). Excluding tax programs, which the IRS generally administers through annual federal income tax filings, most safety-net programs operate through the states and involve an application and eligibility determination process.

The social safety net's disjointedness and complexity require needy families to interact multiple times with government agencies to access benefits. Some complexity is necessary to ensure only eligible families receive assistance. However, the myriad possible program and service combinations create a bureaucratic web that government officials and benefit recipients must navigate.[6]

The largest share of safety-net spending goes to means-tested health insurance programs, including Medicaid and the Children's Health Insurance Program. According to data from the Centers for Medicare & Medicaid Services, total Medicaid spending in fiscal year (FY) 2020 topped $649 billion, of which the federal government supported 67 percent, and the program covered approximately 76 million individuals.[7] Medicaid overshadows other safety-net spending and deserves its own reforms (covered in Chapter 5 of this volume).

The remaining major means-tested safety-net programs (including refundable credits paid under the EITC and CTC) cost taxpayers over

Table 1. Description and Recent Federal Cost of Major Means-Tested Safety-Net Programs

Program	Description	Federal Cost in 2019
	Income Support	
Earned Income Tax Credit (EITC)	• The EITC provides at tax time a lump-sum benefit of up to about $6,700, depending on household income and family size, including to those without federal income tax liability.[9] • The EITC phases in at different rates depending on family size, starting with the first dollar earned and increasing as earnings rise. • The EITC phases out completely at $53,000 in annual income (in 2022) for families with three or more children and at lower amounts for families with fewer children. • It is administered by the IRS, which requires little interaction between recipients and the government. • The EITC targets low-income households, with the bottom two-fifths of tax units receiving $59 billion in benefits in calendar year (CY) 2019.[10]	The refundable portion was $62.0 billion, which does not include over $8 billion in annual tax relief that the program provided to families with federal income tax liability.[11]
Child Tax Credit (CTC)	• In CY2022, the CTC provides up to $2,000 per child for families with income tax liability, including up to $1,400 per child for families without income tax liability, phasing in at 15 percent of earnings above $2,500.[12] • The CTC was temporarily expanded for 2021, including by (1) increasing the benefit amount, (2) making the benefit entirely refundable (that is, no longer contingent on work and earnings by recipient adults), and (3) making benefit payments in monthly installments between July and December 2021. • The CTC's refundable portion targets low-income households, with the bottom two-fifths of tax units receiving $32 billion in benefits in FY2019.[13]	The refundable portion was $46.0 billion. The program also provided over $72 billion to families with federal income tax liability.[14]
Supplemental Security Income (SSI)	• SSI provides monthly cash payments to low-income disabled adults, children, and seniors, with benefits ranging up to $841 per month for individuals and up to $1,261 per month for eligible couples in 2022.[15] • SSI requires an application to the Social Security Administration; working-age recipients must demonstrate a severe disability preventing gainful employment, while children are assessed based on the severity of their physical and mental impairments. • Eligibility is generally limited to individuals below the federal poverty guideline, which was $13,590 for a one-person household in 2022.	Direct assistance was $54 billion.[16]

(*continued on the next page*)

Table 1. Description and Recent Federal Cost of Major Means-Tested Safety-Net Programs (*continued*)

Program	Description	Federal Cost in 2019
Temporary Assistance for Needy Families (TANF)	• TANF is a federal block grant administered by the states. • States can use funds to provide various benefits and services, including cash assistance, to low-income families with children. • Direct cash assistance comes with federal time limits and work requirements. • Income eligibility varies by state, and initial eligibility for cash assistance is generally limited to families below the federal poverty level. Benefit amounts also vary by state.[17]	The federal share was $16.5 billion. In FY2019, approximately 21.1 percent of TANF funds supported direct cash assistance; 10.5 percent supported work, education, and training activities; and 24.7 percent supported child-care, including transfers to the Child Care and Development Fund.[18]
Food and Nutrition Assistance		
Supplemental Nutrition Assistance Program (SNAP)	• SNAP, also known as "food stamps," provides a monthly benefit to low-income households for food and beverages. • Benefits for nonworking able-bodied adults without dependents are subject to time limits, which the federal government has allowed states to waive in recent years. • SNAP benefits range from $250 per month for a one-person household to $992 per month for a family of five in FY2022.[19] • Gross income must be below 130 percent of the federal poverty threshold for most household types to qualify.	Direct assistance was $60.4 billion.[20]
Other Nutrition Programs	• These include the National School Lunch Program; the Supplemental Nutrition Program for Women, Infants, and Children; the Emergency Food Program; and the Child and Adult Care Food Program.	Program expenditures were $32.0 billion.[21]

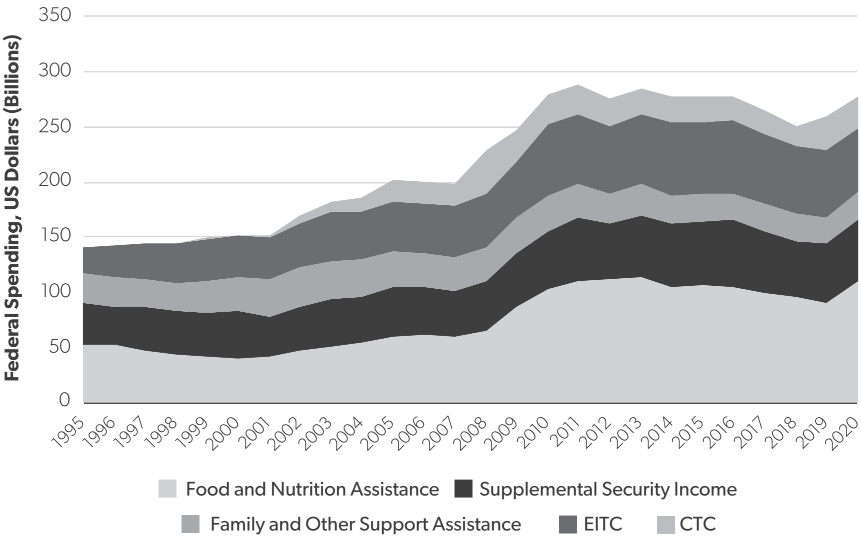
(*continued on the next page*)

Table 1. Description and Recent Federal Cost of Major Means-Tested Safety-Net Programs (*continued*)

Program	Description	Federal Cost in 2019
	Housing and Energy	
Housing (Housing Choice Vouchers and Public Housing)	• Programs provide two types of assistance: tenant-based assistance such as vouchers to eligible families used for housing costs and project-based assistance such as apartments in public housing. • Programs are administered by state housing authorities. • Voucher amounts vary by state and follow fair market rent guidelines. Public housing assigns apartments to eligible recipients. Both programs generally require families to contribute 30 percent of income toward housing costs. • Funding is limited, and not all eligible families receive assistance.	Program expenditures were $29.9 billion.[22]
Low Income Home Energy Assistance Program (LIHEAP)	• LIHEAP assists low-income families with heating and electricity costs. • It is administered by the states. • Income eligibility varies by state, but household income must be below 150 percent of the federal poverty threshold, with categorical eligibility provided through TANF, SNAP, and SSI. • Benefit amounts vary widely by state.[23]	Program expenditures were $3.6 billion.[24]
	Childcare	
Child Care and Development Fund, which includes funding through the Child Care and Development Block Grant, also known as the Child Care Subsidy Program	• The fund provides vouchers to eligible low- and moderate-income families to cover childcare costs, with some assistance through direct childcare "slots." • States generally pay childcare providers directly. Base rates vary by state, with a median of approximately $780 per month for toddlers in 2019 (the most recent available data).[25] • Income eligibility varies by state, but household income must be below 85 percent of the state median income. • Funding is limited, and not all eligible families receive assistance. • Families with income above the federal poverty level generally have a co-payment.	The federal share was $8.2 billion.[26]

Source: Authors' compilation using sources listed in the endnotes.

Figure 2. Real Federal Outlays on Major Means-Tested Safety-Net Programs, 1995–2020



Note: Dollar amounts are adjusted to 2020 dollars and exclude funds spent on health care. Outlays include only the refundable portions of the EITC and CTC, not the portions that offset taxes paid.
Source: Authors' calculations using data from White House, Office of Management and Budget, "Table 8.6—Outlays for Mandatory and Related Programs in Constant (FY 2012) Dollars: 1962–2027," https://www.whitehouse.gov/omb/historical-tables.

$300 billion annually in just federal outlays, as Table 1 illustrates. Excluding health care, the largest programs in terms of recipients and dollars cover four areas: income support, food and nutrition assistance, childcare, and housing and energy assistance. Table 1 briefly describes major programs and their 2019 costs before significant increases related to the coronavirus pandemic.[8]

Participation in tax programs and the Supplemental Nutrition Assistance Program (SNAP) is relatively high because these are open-ended entitlements. Other programs, such as TANF, housing assistance, and childcare subsidies, operate through block grants or other appropriations with fixed federal funds, meaning not all eligible recipients may receive assistance.

Contrary to the impression often given by the political left, federal spending on safety-net programs has actually risen substantially since the 1990s, even ignoring Medicaid. The White House Office of Management and Budget provides historical data on mandatory federal outlays, which show that spending on food assistance, SSI, family support (mainly TANF), and refundable tax credits has almost doubled in constant dollars since the year before the 1996 welfare reforms. (See Figure 2.)

The resulting federal safety net spends a rapidly rising amount on benefits and services for low-income families through a blizzard of federal programs. While that spending has contributed to significant reductions in material hardship over time, it has been less successful at decreasing dependency and increasing upward mobility, which suggests a new "welfare reform" is needed.

Key Conservative Principles for Reforming the Safety Net

Conservatives have long contested the growth of the welfare state, arguing that the rapidly growing spending described above undermines work, marriage, and responsible personal behavior. The same underlying principles that were the hallmarks of 1990s welfare reform legislation remain the backbone of conservative welfare policy today.[27]

These principles start with the belief that sound public policy should *promote work* as the best way to reduce poverty and that this is one of the most effective ways to help a family transition from poverty to the middle class. Closely related is the need to *limit dependence* on government benefits, such as through time limits that focus recipients and the bureaucrats serving them on addressing hurdles that might otherwise leave families dependent for extended periods. We believe policies that encourage dependence counteract what families truly want—the dignity of work and self-sufficiency.

Another key principle is that *strong families*, ideally led by married parents, best advance long-term progress against poverty and dependence. Finally, *shared responsibility between state and federal governments* is fundamental to reducing poverty and increasing upward mobility. The government's funding structure should reinforce that partnership and promote the achievement of positive results, instead of continuously shifting the burden of program financing to the federal government, even when states' efforts fail to help families escape poverty. Unfortunately, a review of recent developments on each front offers cause for concern—and underlines the need for reform.

In recent years, federal policy has shifted from conditioning benefits on participation in work or training, a key feature of the 1996 reforms. SNAP provides benefits to tens of millions of recipients each month, including millions of able-bodied adults without dependents who are not expected to engage in training programs, much less work. This recalls the years following welfare reform, when hundreds of thousands of former AFDC recipients simply transitioned to Supplemental Security Income (SSI) rather than engage in TANF's work activities.[28]

Worse, Democrats in 2021 temporarily eliminated the long-standing requirement that CTC recipients have at least modest earnings to qualify for that benefit. They simultaneously increased the benefit amount, paying it in monthly installments for the first time in the second half of 2021. Combined, those changes temporarily re-created the former work-free welfare check system replaced by the 1996 reforms. Plans by Democrats to make these changes permanent failed, but their intention to roll back work-based welfare reforms was clear.

Recent years have also seen significant backtracking on limiting dependence on government benefits. Much of this has been associated with the COVID-19 pandemic—including an unprecedented $700 billion in federal unemployment benefits paid to, at one point, over 30 million recipients.[29] But other policies—such as significant and permanent expansions in SNAP benefits for over 40 million recipients and the CTC's temporary conversion into a work-free monthly benefit—have nothing to do with the pandemic. Instead, they reflect a progressive vision of a large and universal welfare state.[30]

While marriage has been a significant bulwark for families against financial disruptions during the pandemic, many families have experienced stress as never before. Marriage continues to decline, and the public increasingly perceives it as an elite good.[31] At a minimum, policymakers should avoid creating new marriage penalties and reduce existing ones in benefit programs.

Finally, the trend toward fully federal-funded benefit programs that require no financial "skin in the game" from states has become unmistakable in recent years. This has resulted in even more perverse financial disincentives than those preceding the 1996 welfare reforms. For example, today, federal SNAP benefits automatically flow into a state as more residents qualify. States are not required to contribute a penny of matching funds, even if they fail to assist families in going to work and escaping poverty. The same dynamic applies under SSI. Current policy has incentivized states to shift people from TANF (which has a work requirement but costs states money) to SSI (which discourages work and which the federal government fully funds). That means states generally have no financial stake in helping adults prepare for and find work that accommodates their disabilities.

Safety-Net Reforms to Better Assist Families in Need

With these principles and problems in mind, we propose three reforms to promote work, limit dependence on benefits, strengthen families, and improve the federal-state partnership so safety-net programs deliver better results. Our reforms would reorient the safety net on the federal and state levels so this reformed system's financial architecture encourages more work and intact families, rather than greater welfare receipt and ongoing dependence. We envision a safety net in which the federal government better promotes work through refundable tax credits and childcare subsidies while offering states new opportunities and incentives to innovate—and expecting more state funding, especially from those states that maintain the status quo.

Reform Federal Tax Benefits to Better Promote Work and Marriage. The first priority is to reform existing refundable tax credits so they support work and marriage better. We also believe the existing package of tax credits and provisions needs reform to reduce administrative complexity and eliminate overlapping functions.

To enhance work incentives, federal policymakers could reform the CTC and EITC in various ways, such as increasing phase-in rates, raising the maximum credit amount, extending this maximum amount to workers with higher incomes, and reducing phaseout rates.

Notably, research has found that the EITC induces nonworkers to work more effectively than it increases work effort.[32] Therefore, one of the most important policy goals regarding tax credits is to maintain the work incentive by phasing it in as earnings increase. In fact, research indicates that providing the same credit to workers and nonworkers—as the Democrats proposed in their 2021 Build Back Better plan—would reduce employment (by as much as 1.5 million jobs under the proposal, with most of the decrease coming from single parents).[33]

The current EITC also includes a marriage penalty that policymakers should reduce. The EITC is usually more generous for two low-income working parents if they cohabitate than if they are married, raising the prospect of couples losing thousands of EITC dollars if they choose to marry.[34] The CTC offsets some of the EITC's marriage penalty, but not all of it. And increasing the EITC for childless workers, as temporarily occurred in 2021, exacerbates the marriage penalty.[35]

One way to address the marriage penalty is to increase the income at which the EITC starts to phase out for married couples relative to single parents.[36] Another option is to change the EITC schedule so at any level of earnings, the credit is substantially larger for married parents than for single parents with the same number of children.[37]

In a forthcoming volume, two of us (Angela Rachidi and Matt Weidinger) propose a comprehensive approach that would consolidate the EITC, CTC, and head-of-household filing status into one "working family credit."[38] This would allow policymakers to align EITC and CTC program rules and reduce program redundancy while giving them one tax tool to address poverty and provide tax relief to offset child-rearing costs.

The working family credit would be as generous as current policy is for parents with very low incomes. However, it would be more generous than current tax credits are for working families with earnings between $20,000 and $50,000, and it would phase out more slowly than the current EITC does. Both features would better promote work and marriage.[39]

Our working family credit would have a maximum ranging from $6,000 for a family with one child to $12,000 for a family with three or more children (adjusted each year for inflation), and it would provide a benefit similar to that under current law to families with annual income below $20,000 (for single parents) and $25,000 (for married parents).

To recognize the potential need for more resources at earlier ages, policymakers could also consider allowing families to request an advance on a portion of this credit—effectively drawing down from future credits—when children are young.[40]

We estimate the working family credit would cost an additional $25 billion per year if enacted today. The proposals below, to the extent they succeed in promoting work over dependence, would increase these costs by helping more low-income parents enter and remain in work. Any additional costs, however, would be more than offset by reduced federal spending on other safety-net programs, as we describe below.

Reinvigorate the Federal-State Partnership to Promote More Work and Less Dependence. While the working family credit would strengthen and clarify the federal role in promoting work and stronger families, states (which operate most means-tested benefit programs) must take a larger role in shoring up those key facets of healthy family and community life. Under the safety net's current organization, in which the federal government takes on most of the financial burden, states not only lack strong incentives to support work and marriage but actually have significant financial disincentives to doing so.

A recent Joint Economic Committee (JEC) report noted that "states do not have strong incentives to properly steward the welfare system because the federal government provides the vast majority of funding."[41] As Figure 2 illustrates, this problem has worsened with significant expansions in programs that are entirely federally funded (most notably SNAP, SSI, and the CTC), which absolve states of financial responsibility for assisting low-income families. As the JEC report continued, "Requiring states to contribute more of their own funding to welfare programs could also increase their motivation to discourage long-term dependence and promote self-reliance."[42]

To address this fundamental flaw, we propose a gradual transition toward more equitably shared financial responsibility between the federal and state governments for several of the largest non–health care transfer programs—SNAP, SSI, public housing assistance, and the Low Income Home Energy Assistance Program (LIHEAP). Unless altered as part of state waiver demonstrations (see below), federal policies for these programs would continue as today in terms of eligibility, benefits, and administration. But we envision a steady transition over time so that within one decade, all states share in up to 50 percent of the annual cost of these programs—unless they achieve improved outcomes for those in need, which would allow them to offset some of these new costs.

How could that goal be achieved without creating significant new burdens on states? We propose offering states a financial stake in achieving better outcomes for families. Specifically, when a state successfully moves a family from welfare to work, it would be able to count the additional support that newly working family would receive through the working family credit against its state match requirement. The federal government would partially or fully cover the offset amount. (So in practice, no state would end up bearing half of program costs when benefit recipients work.) States could continue to offset their required match in this way in subsequent years, up to a cap, provided the beneficiary (or former beneficiary) continued to work.[43]

Far from encouraging a "race to the bottom," this approach would incentivize states to invest in families to help them achieve economic independence through employment. Absent their seeking a waiver to operate a demonstration program, states would need to abide by current program rules. SNAP would remain an entitlement, for instance, and SNAP spending would be expected to rise during recessions.

Moreover, our approach would reward states for successfully transitioning families not simply off safety-net benefits but into employment. It would also encourage states to focus their efforts on families with children, since the bulk of federal tax credits go to them. Meanwhile, by receiving offsets to their state match for increasing employment—in the form of additional federal dollars for remaining beneficiaries—states could maintain a robust safety net for those facing temporary unemployment or employment challenges (such as the severely disabled) and the elderly.

Working beneficiaries, such as those receiving SNAP or housing assistance, would generate offsets for states for any tax credits they received as they drew benefits. States would want to invest in these recipients while they generated an offset so the recipients could soon become independent. It would also be in a state's interest to encourage more nonworking families to combine work and benefit receipt. Ultimately, states would want to transition as many families as feasible completely out of safety-net programs and into work.

As successful states decreased dependence on government programs in favor of work, federal costs for those programs would decline, even as costs for the federal tax credits might increase. In the short run, the expected decline in federal spending might not be dollar for dollar due to the proposed offsets to the state match. Initially, federal spending for those programs might not fall at all. However, over time, state incentives should significantly reduce the number of program beneficiaries, lowering costs for the federal government and the states.

Additionally, federal outlays for state match offsets would shrink as former beneficiaries' tax credit amounts gradually exceeded the cap for those offsets. In equilibrium, fewer families would receive safety-net benefits, federal and state spending on those benefits would decrease, and continued incentives would motivate states to operate programs that invest in beneficiaries to move those who can into work. This dynamic would leave federal savings to cover the longer-run cost of pro-work and pro-marriage tax credits. Federal savings would also go toward increased childcare subsidies, administered similarly to current policy, which are needed to ensure that parents can successfully find and remain in work.

The key to this reform is that state governments must pay more toward the safety net, but the financing structure will incentivize them to implement strategies that improve outcomes for welfare beneficiaries—and thereby reduce the state's exposure to increased costs. Because they would be subject to current program policy related to benefits and eligibility, their ability to innovate would be somewhat limited, however. Our next proposal would allow states to experiment with various strategies to overcome these limitations, encouraging them to find creative ways of promoting independence and lowering their costs in the end. We anticipate that most states would seek out such experimentation, given the new incentives to do so.

Expand Demonstration Program Authority. Under the new state-federal financial arrangement we propose, states will face strong incentives to move families out of safety-net programs and into work and independence. To help them achieve this goal, we propose the federal government authorize demonstration programs, including "superwaivers" (waivers of rules that involve multiple federal programs), potentially covering any of the programs displayed in Figure 1. The states' matching requirements for the major programs would remain as described above; however, superwaivers would significantly expand states' control over key program rules and allow them to consolidate funding streams across federal programs.[44]

If states could justify (with respect to family outcomes and program costs) proposed changes to SNAP, SSI, housing assistance, TANF, LIHEAP, or any of the other myriad safety-net programs, they would be allowed to alter benefit, eligibility, and other rules. (See the example in the sidebar.) States would need to demonstrate the capacity to carry out the demonstration project, including an evaluation component, and establish clear and measurable outcomes to define success.

That makes mandating specific federal requirements—as the 1996 welfare reform law did—far less important, leaving room for states to experiment and test what works best given local conditions. It also encourages policies with a proven evidence base, because states would face a financial burden for operating ineffective programs.

In sum, if the financial architecture of the federal-state system points in the right direction—including by holding states financially accountable for failing to achieve positive results—states can and should be allowed to exercise greater control over the policies they deem best suited to local needs. Past federal (and state) policies offer a broad menu from which they might select to implement this vision. But unlike prior such proposals, states would bear direct—and in the early years, growing—financial responsibility for achieving improved results.

For example, states could follow the work-based welfare reforms of the 1990s for the rest of the safety net. Under TANF, states must have a minimum share of adult beneficiaries (that is, those receiving a regular cash benefit) participating in work activities, including subsidized employment, school, and training.

While work expectations and requirements contributed to the remarkable drop in TANF caseloads, few other safety-net programs have successfully implemented them. SNAP has work requirements for non-elderly able-bodied adults without dependents, but this group is a small share of

State Safety-Net Demonstration Project Example

A state could choose to combine Supplemental Security Income, Supplemental Nutrition Assistance Program benefits, Temporary Assistance for Needy Families funding, Section 8 housing benefits, child support, childcare assistance, and education and training dollars to develop a program that provides cash assistance and support services to poor families with children. Rather than requiring families to apply for program benefits separately, the program would establish income criteria, assess eligibility, and develop a family assistance budget and service plan. The budget would help a family meet its food, housing, and other expenses while developing a plan that sets clear goals for employment and self-sufficiency.

The state could impose work requirements as a condition of receiving the assistance and set a time limit for cash support. The state could set state benefit levels to decline as earnings increase, with federal refundable tax credits in mind. In this way, a state could avoid prohibitively high effective marginal tax rates as adults work and earn more. The state could also implement transitional benefits to address marriage penalties, possibly disregarding the second adult's income during the first three years after marriage in determining the household's benefit eligibility.

SNAP households (13 percent in 2019), and states have used exemptions and waivers to avoid meeting even these meager requirements.[45]

Some states have experimented with work requirements for housing assistance; some tried to implement Medicaid work requirement waivers approved by the Trump administration, but courts and the Biden administration blocked those efforts. Consistent with their expanded funding responsibilities, states would have new discretion—but not a mandate—to apply work requirements and other policies proven to reduce dependency, such as time limits and related policies.

Unfolding technology will backstop this improved design by allowing program administrators to tailor benefit packages across multiple programs. Blockchain and other financial technology (fintech) offer opportunities to rethink how the government provides benefits. Emerging fintech tools hold promise to make safety-net policies more efficient and effective. For example, digital currency, using blockchain technology, could "lock" and "unlock" government benefits conditional on parents taking steps to become more independent, such as completing a job-training program or remaining in a job for a specified period.

Fintech could make it more practical to customize and smooth benefit reductions as earnings increase, considering multiple programs to avoid high effective marginal tax rates. Payments could be more easily reserved for particular expenditures, such as services to address child learning disabilities and paid leave after the birth of a new child.

Benefits may increasingly resemble limited-use digital vouchers, designed to support and promote work and healthy marriage. Although this technology is still emerging, experts believe transformation in the financial system is inevitable. Government programs should anticipate these changes and leverage them to improve how benefit programs operate.

Impact on the Federal Budget

The reforms suggested in this chapter would involve significant and, in the coming decade, growing changes in federal and state entitlement spending patterns involving multiple programs. However, it is not the scope of the changes that would make scoring this proposal challenging but rather their intended aim of altering state behavior in the direction of promoting more work and less benefit receipt.

For example, the proposal calls for gradually shifting over 10 years from current full federal funding for major programs such as SNAP, SSI, and public housing to at least 50 percent federal and up to 50 percent state funding. Based on Congressional Budget Office (CBO) baseline projections, if all other factors remain constant, that shift could save federal taxpayers close to $500 billion over the first decade, including nearly $100 billion in the 10th year.[46] Similarly, we estimate that the working family credit proposal would cost an additional $25 billion in 2022, with added costs increasing after 2025 due to the expiration of the child tax credit expansions included in the 2017 Tax Cuts and Jobs Act. Over the entire decade, the expanded benefits reflected in the working family credit would cost federal taxpayers about $50 billion per year, offsetting some of the decade's savings from transitioning certain federal program responsibilities to states. In the 10th year, additional working family credit costs compared to the current-law baseline are expected to be around $60 billion—suggesting the proposal could save federal taxpayers some $40 billion per year by the 10th year when considering the savings from shifting half the costs to the states.

But savings are far from the end, or even the point, of these reforms. Their broad purpose includes driving states toward assisting more people in going to work—or working more—instead of depending on taxpayer benefits for support. To the degree states succeed, federal working family credit payments would rise more than suggested above, but federal and state spending on other benefit programs would decline. If SNAP and SSI caseloads, for example, drop significantly as the reformed system promotes more work and marriage, actual program spending might be even lower than what is projected, resulting in additional savings to the federal government and states. The proposal anticipates devoting such savings to offsetting the cost of greater working family credit payments attributable to more work and supporting additional federal support for childcare.

Those and other complicated interactions will be a challenge for the CBO to score, and lawmakers will ultimately decide how best to allocate any savings. Our purpose is to get the financial architecture right so states have improved incentives to promote work and marriage instead of benefit receipt, thereby better alleviating poverty and improving the prospects of American children and families while slowing the growth of federal spending over the long term.

Conclusion

The reforms outlined above would be transformational, resulting in a more accountable safety net with equitable federal and state roles that support work and marriage as the most effective long-term solution for low-income families. Critics will argue this approach is paternalistic, ungenerous, and even inefficient compared with providing nearly universal federal benefits such as child allowances. But these critiques ignore that supporting and promoting work and marriage helps families empower themselves and achieve improved outcomes in the long run.[47] Our approach shifts from simply accommodating poverty in the US to supporting the principles that will lead to family prosperity—more work, less government dependence, more marriage, and a larger stake in results at the state level.

The alternative approach, popular among some on the left and right, is to offer all but the wealthiest families with children new monthly federal benefit checks while maintaining a vast welfare bureaucracy. Simply put, the thicket of safety-net programs in the US is enormously inefficient, yet the progressive solution is to layer still more benefits on top. We propose comprehensive reform that encourages states to consolidate programs while transitioning as many families as possible from welfare into work and eventual self-sufficiency.

In practical terms, our proposal offers generous federal support to low-income working families through refundable tax credits and childcare subsidies—with tax credits ranging from a maximum of $6,000 to $12,000 per year (adjusting for inflation over time) depending on the number of children. Only those families with no employment for the entire year would be ineligible for federal tax credits. We believe nonworking families are the most vulnerable and need more focused services and supports than federal tax credits and child allowances can provide. With this in mind, our proposal increases states' financial stake in helping nonworking families find and sustain employment and access federal tax credits for working families.

This revised system would spend more on promoting work and strengthening families. But unlike with proposals that simply increase costs for taxpayers without holding programs accountable, the costs of additional support for work would be paid for by reducing the incentives for nonwork and single parenthood—and therefore government benefit receipt. Through demonstration projects, individual states would determine the best route to that goal through rigorous testing and evaluation, leveraging results from other states about what works best. States that fail to achieve improved outcomes would pay a larger share of total costs, as is appropriate and as should have occurred long ago.

In the end, the reforms detailed above would expect and reward personal effort and work, reduce long-term dependence on benefits, promote stronger families and more individual agency, and shift more social-welfare responsibility and accountability to states and localities, where they belong. This contrasts with current policies that absolve parents of responsibility and expect almost nothing in exchange for large monthly federal benefits. If enacted well, these policies would increase upward mobility, promote stronger families, and better position parents to care for themselves and their loved ones, without prolonged support from other taxpayers. American families—especially those needing assistance—deserve no less.

Acknowledgments

Thank you to Peyton Roth, Thomas O'Rourke, and Tim Sprunt for their excellent research assistance and support.

Notes

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44. Congress would need to authorize the federal government to waive compliance with certain program rules so states could align program rules and blend funding streams. Legislation could be modeled on Section 1115 of the Social Security Act.

Section 1115 was used to develop the Aid to Families with Dependent Children demonstration projects, and it is used for Medicaid waivers.

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9

Putting the Kids First: A Child Welfare System That Works

NAOMI SCHAEFER RILEY

There are more than three million reports of child abuse and neglect each year in the United States.[1] Deaths from child maltreatment are on the rise, reaching almost 2,000 in 2020, and nearly 440,000 children are in the foster care system.[2] These numbers are driven largely by our drug crisis, which shows no signs of abating.[3]

Almost every state in the country reports a shortage of licensed foster homes. In Texas and Washington, hundreds of kids have been sleeping in offices.[4] Illinois's head of child welfare has been held in contempt of court for keeping foster kids in utility closets.[5]

The coronavirus pandemic and the lockdowns that started in March 2020 made the child welfare situation in the US much worse. With children missing school and regular pediatrician appointments, early signs of abuse and neglect went unnoticed. Many child welfare workers actually stopped visiting at-risk children (thanks partly to agitation by public-sector unions), and some states even furloughed part of their workforce due to budget constraints. Unsurprisingly, the incidence of severe abuse and neglect cases showing up in emergency rooms tripled nationally during the pandemic.[6]

Although the states run child welfare agencies, the federal government contributes slightly less than half the roughly $30 billion per year spent in this area.[7] The federal government funds everything from foster care training and adoption to frontline child protection and prevention services for families at risk of having their children removed. The evidence suggests state agencies and family courts are not only performing poorly but also violating federal laws that govern how to handle foster care cases.

The Children's Bureau at the Administration for Children and Families (ACF) of the US Department of Health and Human Services (HHS) regularly investigates the states' performance on numerous measures. In the latest round of Child and Family Service Reviews, covering 2015–18, the Children's Bureau found that only four states achieved substantial conformity with the bureau's most important measure: "Children are, first and foremost, protected from abuse and neglect."[8] Indeed, a significant portion (more than one-third in 2019) of fatalities and near fatalities due to maltreatment occur among children whose families have already been investigated by child welfare agencies.[9]

A recent report from Kentucky found that of the 208 suspicious child deaths in fiscal year 2021 (which represented a 22 percent increase in cases of suspected abuse-related deaths from the previous year), 73 were in families the child welfare agency had already investigated.[10] In New York City alone, between 2008 and 2018, the number of child deaths in families that had been previously reported to and investigated by the city's Administration for Children's Services increased from 49 to 59.[11]

In Pennsylvania, a report on 2014–16 found that "of the 220 substantiated fatality and near fatality incidents, nearly two-thirds (64%) of the children and/or families were involved with the county children and youth agency prior to or at the time of the incident." Moreover, of "the 140 children and/or families known to the agency, 58 [cases] were open at the time of the incident."[12] Child welfare officials know these kids are in unsafe situations, but, regrettably, policies are leaving them there.

Increasingly, the evidence shows that child welfare agencies and family courts are much more concerned with adults' needs and sensibilities than children's safety. Reform must come from many different corners of this field, but Congress can play an important role in this effort.

Federal funds given to the states must include safeguards and accountability measures to ensure that children are safe, that they do not languish in the foster care system longer than necessary, and that quality foster homes and, if necessary, institutions are available to care for children when they cannot live with a family. Reform will require using the latest data and technology available to us, training social workers to understand which children are at risk and why, and cleaning up our family court system to ensure it operates on the timelines of children, not bureaucrats.

Diagnosing the Problem

A variety of factors cause poor outcomes in the field of child welfare—many stemming from well-intentioned policies that nevertheless harm children.

Misplaced Efforts to Reduce Foster Care Placements. One reason for our situation is that states are desperately trying to reduce the number of children in foster care. On its face, this seems like a great idea. But foster care placement is an insufficient measure of children's safety; officials can drive that number up and down depending on their decisions about children's safety at home. The real test of whether the child welfare system is working is the numbers on child maltreatment and child fatalities. And those should worry us.

If officials are concerned only with driving down the number of kids in foster care, they risk leaving kids in unsafe family situations, and serious maltreatment becomes a bigger problem. In Maine, for instance, the number of children experiencing maltreatment jumped 30 percent from 2015 to 2019, while the number of children in foster care grew by only 12 percent.[13] This suggests pressure was placed on child welfare workers to leave kids in their homes. Unfortunately, the percentage of children in Maine with a recurrence of maltreatment within six months of exiting foster care almost doubled between 2015 and 2019.

The pressure to reduce the number of kids in foster care comes mostly from the political left, whose priorities for child welfare are misplaced. Like so many of our political debates these days, this one has been reduced to a conversation about racial disparities.

True, the parents of black children are more likely to be investigated for allegations of child abuse and neglect. Their cases are also more likely to be substantiated.[14] And black children are more likely to wind up in foster care. But there is little evidence that these numbers stem from racial bias. If they do, then why isn't the rate of Hispanic children placed into foster care higher than their percentage in the population? And why, in large cities like New York, are most of the agency's caseworkers actually black or Hispanic?[15]

More likely, more black children are in foster care because they are twice as likely to suffer from maltreatment and three times as likely to die from maltreatment as their white peers are. (Child maltreatment–related fatalities among black children rose 17 percent just from 2019 to 2020.)[16] Child abuse highly correlates with family structure. Children living with a mother and nonrelative male are 11 times as likely to suffer abuse as are those living with two married biological parents.[17] Family structure is not distributed evenly across racial groups in this country. According to data from Child Trends, in 2014, 69 percent of all births to black women occurred outside marriage, compared with only 28 percent of all births to white women.[18]

If these arguments about racial disparities sound familiar, that is because the movement to abolish foster care has modeled itself on the movement to defund the police. Just as activists discuss racial disparities in arrests and incarcerations without considering racial disparities in crimes, they discuss racial disparities in foster care without considering the reasons for removal. Just as good policing should benefit the most vulnerable communities, good decisions in the child welfare system should help the most at-risk kids. But activists, caseworkers, and family court judges would rather hide racial disparities and make the spreadsheets come out even than rescue children of any race from dangerous situations.

Failure to Appreciate the Root Causes of Child Maltreatment. In many child welfare agencies, including at the highest levels, workers assume that kids who are removed from their families weren't really in danger and that most of the families involved with child welfare simply can't afford to properly care for their children.[19] By this logic, advocates believe that if government expanded housing vouchers, food stamps, free childcare, and other safety-net programs, child welfare problems would solve themselves.

Unfortunately, the statistics belie this theory. At least 40 percent of kids in foster care are removed from their homes because of parental substance abuse, but most experts say the number is closer to 80 percent.[20] Drug use, alcohol use, and co-occurring mental illnesses prevent many parents from properly caring for young children, no matter how robust the safety-net supports available to them are.

Emphasis on Prevention. In recent years, Democratic and Republican administrations have focused on prevention. According to David Kelly, a key official at the federal Children's Bureau, child welfare agencies are too focused on rescuing children; they should instead be strengthening communities. "We need to let go of the system that was designed to rescue children, and construct a system that's designed to promote health and well-being for all families."[21] However, this goal is expansive enough to intrude on the lives of families that do not need the government's help and narrow enough to fail children who are most at risk.

For instance, Congress passed the Family First Prevention Services Act in 2018 partly to focus the child welfare system more on prevention.[22] The act was supposed to divert money toward prevention services and away from congregate care. But as a careful review of the ACF's clearinghouse shows, few services effectively prevent maltreatment in families that have already harmed children.[23] Even prevention services that show promise do not even distantly work for all families. In fact, the act implicitly acknowledges that prevention services will not keep children safe in their homes, because it also funds informal placements with relatives.

Conservatives must maintain that child welfare agencies cannot fix racial disparities and end poverty; rather, agencies should ensure individual children's safety.

This mission begins at first contact with a child. Child welfare agencies do a terrible job of determining which kids are at high risk. New developments in data analytics could go a long way toward fixing this problem. A pilot program implemented in Allegheny County, Pennsylvania, and Douglas County, Colorado, allows child abuse hotline operators who receive reports of child abuse and neglect to see a risk score for the families involved to determine how urgently someone needs to investigate.[24]

Child welfare agencies have information about many of the families reported to them; they simply fail to use it properly. Officials know whether a child has recently missed school repeatedly, a recently released prisoner has listed that child's home as an address, the child's family has failed to access food stamps and other material supports, and the family has previously been reported for abuse and neglect. Risk scores, which prove much more accurate than the gut instincts of hotline operators and even abuse investigators, do not determine whether abuse and neglect actually took place, but they allow investigators to triage cases in an overwhelmed system. Incentivizing states to develop programs with predictive risk modeling would help bring our child welfare system into the 21st century.

We have other important pieces of information about vulnerable children that we don't use or discover until too late. Five states have adopted birth match programs, which alert child protective services when a baby is born to a mother who has already killed another child or lost her parental rights because of severe child abuse. Policymakers should encourage other states to use this system—which is similar to a sexual abuse registry—so investigators can intervene as soon as possible to ensure a child's safety. Legislators may also consider creating a national registry of child maltreatment cases, as serial abusers often cross state lines.

Workforce Problems. The child welfare workforce also has significant deficits. Far too often, it attracts people who lack other professional options, fail to understand the job, and lack the skills to carry out their responsibilities successfully. Agencies compound the problem by offering investigators little training, little reason—financial or otherwise—to remain in the profession, and no career ladder for those who show promise.

The problems plaguing the profession are evident in the turnover rates for investigators, which are extraordinary: A Casey Family Programs report estimates that the average annual turnover rate at US child welfare agencies is approximately 30 percent, with individual agency rates reaching up to 65 percent.[25] As Sarah Font of Pennsylvania State University notes, staff turnover costs agencies "both financially, through recruitment and training costs, and qualitatively, through having an inexperienced workforce, staff shortages and discontinuity in the relationship between caseworkers and families."[26]

Frontline child protective workers might be better recruited from among law enforcement trainees than among social work trainees. The federal government's training dollars for states in Title IV-E go almost exclusively toward university social work programs, but they should be flexible enough to cover training in criminal justice programs as well.

Even with better workforce training, problems would remain in the child welfare system. Some of child welfare caseworkers' poor decisions have little to do with insufficient training and resources. Rather, ideology is guiding these decisions. State and local leaders have told child welfare professionals to reduce racial disparities in the system. Thus, agency heads and even some family court judges are making it much more difficult to remove black children from their homes, even when there are clear safety concerns.

For instance, a recent investigation by the *Los Angeles Times* and the University of California, Berkeley, into the 2019 death of 4-year-old Noah Cuatro didn't identify caseworker workload as a major contributing factor. The Los Angeles County Department of Children and Family Services didn't have too many kids to handle. Rather, the agency's "less adversarial approach" to parents was to blame.[27] When one caseworker wanted to remove Noah from his family shortly before his death, she was accused of racial insensitivity, and the boy stayed put.

Reforms to Improve the Child Welfare System

If we are serious about improving outcomes for the country's most vulnerable children, we should consider a number of changes.

Reduce the Time Kids Spend in Foster Care. Family preservation remains an important goal for the child welfare system. States should remember that removing a child from home is a temporary measure. According to the Adoption and Safe Families Act (ASFA) of 1997, states should move to terminate parental rights if children have been in foster care for 15 of the past 22 months.[28] In the nation as a whole, 69 percent of kids in the foster care system exit, or parental rights are terminated, after 18 months, and 24 percent exit between 18 and 36 months. Only 7 percent of kids in the system stay beyond 36 months.[29]

In some states the numbers are drastically worse. In Illinois, for example, almost 30 percent of kids in the system stay longer than 36 months. Foster care should be temporary; kids should not be left to languish indefinitely. The challenge of reducing time in foster care even extends to young children. Almost a quarter of kids who entered the Illinois system before they turned age 5 remained in care longer than 48 months.[30]

This excessive time in foster care not only increases the trauma kids experience—including from the multiple placements they may experience during that time—but also makes them less likely to be adopted as they age. The federal government should reward states that achieve the timelines the ASFA laid out. Congress has begun moving to repeal these timelines altogether, but we should understand that the legislation has helped tens of thousands of children find permanent, safe, and loving homes since it was passed in 1997. We don't want to turn back the clock.

The child welfare system should offer parents the opportunity to rehabilitate, such as through addiction programs, parenting classes, and anger management classes. Although these programs often prove ineffective, parents should have access to them as soon as their cases begin. Delays in accessing these services often lengthen children's stays in foster care. Again, policymakers should ensure states make this process timely for the sake of parents, but especially of kids.

Our child welfare system's longest delays often result from inefficient family court operations. It is not uncommon for children under age 3 to wait six months between hearings. This inefficiency has real effects—not just slowing the process down but, more importantly, harming children.

"Children have a very different sense of time than adults," the National Council of Juvenile and Family Court Judges declared in guidelines published in 2016. "Short periods of time for adults seem interminable for children, and extended periods of uncertainty exacerbate childhood anxiety."[31] Even some small pot of funds incentivizing states to adopt a "right to a speedy trial" statute in their family court provisions could greatly improve vulnerable children's lives.

Policymakers should emphasize reducing the time younger kids spend in the child welfare system. The ASFA timelines are maximums, not minimums. In other words, when parents clearly cannot rehabilitate, officials need not drag matters out for children.

Some states, such as Arizona, have adopted shorter timelines for cases when children have been born substance-exposed. If parents have not shown progress toward kicking addiction within the first year after such a birth, the state can move to sever parental rights.[32]

ASFA also specifies that in "aggravated circumstances" the courts can move more quickly.

- The definition of aggravated circumstances may include, but is not limited to, abandonment, torture, chronic abuse, and sexual abuse.

- The parent committed murder of another child of the parent.

- The parent aided or abetted, attempted, conspired, or solicited to commit such a murder or voluntary manslaughter.[33]

Lawmakers might be amazed to see how many of these circumstances states do not consider grounds for immediately terminating parental rights.

Take sexual abuse, for instance. Although no mechanism exists to track whether children are reunified with a non-offending parent or returned to a home with their abuser, several states clearly pursue reunification between children and their sexually abusive parents. For example, some states bypass reunification efforts only after removing the child twice due to sexual abuse.[34]

In Pennsylvania, where state law allows courts to waive family preservation and reunification requirements in cases of child sexual abuse, reunification efforts sometimes proceed anyway.[35] In fact, Pennsylvania has a training protocol for how social workers should place kids back with the family members who have sexually abused them.[36]

"Family Reunification and Case Closure in Child Sexual Abuse Cases," published by the Pennsylvania Child Welfare Resource Center, includes provisions for overnight visits and seems to require other family members to supervise the abuser. Advice includes putting locks on bathroom and bedroom doors and ensuring the abuser remains clothed unless in the bathroom or their own bedroom. It then notes: "If he needs to leave the bedroom during the night he should awaken his wife (girlfriend) and inform her of what he is doing."[37]

Americans who are rightly outraged about the ways various large and trusted institutions in this country (from the Catholic Church to USA Gymnastics) have covered up chronic sexual abuse might be shocked to know that many states keep children with their abusers, as long as those abusers are parents or other relatives. ASFA was not intended to keep children in danger.

Increase the Number of Foster Families. What about the kids who are already in the foster care system? It is clear from the number of children without placements across the country that we simply don't have enough homes for the children who need foster care. Given how foster parents in this country are often treated—as little more than glorified babysitters—it's not surprising.

Prospective foster parents who call their state agencies to volunteer often never hear back. Training is held at inconvenient times and locations. Foster parents are not told about important problems—such as a child's history of sexual abuse—when kids are dropped off. It's no wonder half of foster parents quit within the first year.[38]

The Family First Prevention Services Act provided modest funding to incentivize states to recruit more and better foster parents, but many states don't even report how many foster parents they have. Their counts are often outdated and inaccurate. How can policymakers in Washington know whether any progress has occurred?

Faith-based foster agencies do much of the heavy lifting in this space, working with states to recruit, train, and support foster parents. Numerous agencies are trying to use anonymized data on which foster parent demographics succeed most so they can target those groups in marketing efforts. The federal government should encourage states to partner with these agencies to share data on how many foster homes are open, what areas need more homes, and which groups are doing the best job.

Most importantly, Congress should protect faith-based foster agencies from activists who are trying to shut them down. Some foster agencies work only with parents who share their faith, for example. Since Catholic Social Services does not work with same-sex couples, the city of Philadelphia, Pennsylvania, ended its foster care contract with the organization. But in June 2021, the Supreme Court ruled in *Fulton v. City of Philadelphia* that Philadelphia's decision was unconstitutional because the city's nondiscrimination ordinance "burdened [the agency's] religious exercise by forcing it either to curtail its mission or to certify same-sex couples as foster parents in violation of its religious beliefs."[39]

Apparently, this message was not clear to some. At least 10 cases regarding faith-based foster and adoption agencies' ability to operate are now pending in lower courts, some filed since the Supreme Court decision came down. *Facing Foster Care in Alaska v. US Department of Health and Human Services*—which Lambda Legal filed in January 2021—demands that the federal government refuse to work with foster agencies that don't serve every foster parent in the state.

Nothing seems to deter advocacy groups from trying to drum faith-based agencies out of business. Recently, Alaska reported such a severe shortage of foster homes that children are sleeping in state offices.[40] Three thousand children are in the system, but only 650 homes are licensed to take a child. Under such circumstances, shouldn't the foster care system take an all-hands-on-deck approach?

This type of crisis highlights the importance of ending the back-and-forth at HHS over whether the federal government should restrict faith-based organizations' use of federal funds. Congress should demand to know why, after the Supreme Court has already ruled on this issue, HHS still refuses to settle these lawsuits and allow agencies with clear religious missions to operate at their fullest potential. As a letter to the HHS secretary from Sens. Mitt Romney (R-UT) and Mike Lee (R-UT) recently put it, "HHS should be *welcoming* child welfare providers, not *excluding* them. Children are too important to be pawns in political games."[41]

Recognize the Role for Congregate Care. We must realize that even if policies mitigated the shortage of families willing to foster children in their homes and led to an influx of foster families, some vulnerable children would still have behavioral and mental health problems that need residential care. While policy circles, academia, and even private philanthropy have become unwilling to support congregate care, the alternative for these children, especially older youth, is much worse.

Thousands of foster kids across the country sleep in offices and hotels each night because no family is willing to care for them. These young people may be violent and mentally ill, and they may have substance abuse problems and even criminal records. Some are even sex trafficking victims. Pushing them into one home after another, only to be rejected by families with noble intentions but insufficient resources and experience to care for them safely, punishes these children further.

In the second half of the 20th century, congregate care settings for foster kids developed a reputation for being uncaring, if not abusive, as reports surfaced of neglectful group homes and administrators who seemed to care only about the money they could gain from serving vulnerable kids. Today, of the 425,000 children in the foster care system, only about 55,000 reside in institutional settings.[42] A third of those in institutions spend fewer than 60 days there, and their average age is 14.[43]

The Family First Prevention Services Act, which was passed in 2018, attempted to reduce congregate care by restricting federal reimbursements to states for certain kinds of group-home care (for example, care centers without a 24-7 medical staff).[44] Another regulation, known as the Institutions for Mental Diseases (IMD) exclusion, prohibits using Medicaid for care provided to most patients in mental health residential treatment facilities larger than 16 beds. The exclusion was part of the large-scale deinstitutionalization efforts in the 1970s. But now it may apply to foster children who have serious mental health challenges.

The labor shortage hasn't helped, and two heads of congregate care centers in California recently told me they are losing staff to federal centers housing migrant children, which pay employees significantly more. This is to say nothing of the rising costs of running a residential care program. Insurance rates have skyrocketed, and the possibility of lawsuits makes these programs prohibitively expensive.[45] Far from the stereotype that congregate care is just a way for agencies to make money, many agencies must use their other services to supplement their congregate care budgets.

To preserve the option of residential care for children whose needs are too great for foster families to meet, Congress should pass an exception to the IMD exclusion for children in the foster care system. Children are better off in a home setting in most cases, of course, but kids who have experienced enormous trauma should have as many options as possible.

Conclusion

A crucial piece of the US safety net is the child welfare system and its ability to care for the country's most vulnerable children. From the earliest reports of child abuse and neglect to the decisions about where to place foster children who need safe, loving, permanent homes, the child welfare system in the US is failing.

The federal government should incentivize states to improve family court systems and stick to the timelines for children in foster care that federal law has already laid out. We should hold all families, no matter their race, to the same standards for how they treat children. We should not leave black children in unsafe situations simply to reduce the visibility of disparities.

The federal government, through HHS, should reward states for partnering with nonprofit groups—particularly faith-based organizations, which are on the cutting edge of efforts to recruit, train, and support quality foster parents. And the federal government should require states to provide better data on child maltreatment and foster care.

Although prevention strategies are an important part of child welfare, foster homes will always be needed. Policymakers should reward states for ensuring that each child who enters the system has multiple options for placement, no matter their level of need. America's most vulnerable kids deserve nothing less.

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10

Helping Children Flourish: Early Childhood Policies That Empower Families

MAX EDEN

What should conservatives be *for* when it comes to early childhood education? In 2012, the American Enterprise Institute's Frederick M. Hess wrote that on education policy, "conservatives are nothing if not confused."[1] A central cause for that confusion: The bipartisan education reform project of the past several decades has been a shotgun marriage between the social justice left and the big business right.

The social justice left views education as the key to transforming society; the big business right views education as the key to workforce development. The social left marketed its vision to the business right with the window dressing of "return on investment." Clear-eyed evaluation of the product—much less a truly principled approach to the issue—has been all but entirely absent.

Somewhat ironically, conservatives are confused about early childhood education because they have lost sight of what they say they care most about: the importance of the family—or, to put a more precise policy gloss on it, the importance of the family environment to early childhood development. This chapter is an analytic attempt to reorient conservative policymakers toward the primary importance of a healthy home for young children.

The Social Scientific Sleight of Hand

When President Barack Obama tried to sell Republicans on his early childhood and pre-K proposal in 2015, which would have massively expanded public pre-K, he declared that for "every dollar we put into high-quality early childhood education we get $7 back in reduced teen pregnancy, improved graduation rates, improved performance in school, [and] reduced incarceration rates. The society as a whole does better."[2] But the *Washington Post* gave President Obama "two Pinocchios" for this claim, noting that although he sourced his claim to rigorous studies, none of those studies "fit directly with [Obama's] proposal, on a national scale."[3]

Unfortunately, the reality behind this social science sleight of hand is far worse than the *Washington Post* let on. A full forensic account of the literature suggests that center-based early childcare expansion would likely actually yield a substantially negative return on investment.

On the one hand, the results of public pre-K appear dramatically positive when early childhood advocates market findings from two key case studies: Perry Preschool[4] and Abecedarian.[5] Even more striking, the positive results from Perry have a multigenerational effect—holding for not only children who participate but even *their* children.[6] These studies were randomized controlled trials, the gold standard for internal validity (i.e., we can trust that the results are real and not statistical artifact).

But neither study has any *external validity* (i.e., reliability of result extrapolation), because they do not remotely resemble the policy proposals up for debate. The logical fallacy committed by early education advocates can be justly paraphrased: Because we have strong evidence that small, intensively resourced programs serving deeply disadvantaged students yielded strong benefits, we know that large-scale, less-resourced programs serving all students will also yield strong benefits.

The study with the strongest combination of internal and external validity for the purposes of America's childcare expansion debate comes to us from Canada's Quebec Family Program. In the late 1990s, Quebec launched a program offering $5-a-day childcare, which increased center-based childcare participation by 14 percentage points relative to the rest of the country. This study's authors described their results as "striking in their consistent indication of negative impact of universal child care on children in two-parent families."[7]

Their findings suggest that childcare caused an increase in hyperactivity, anxiety, and aggression and a deterioration in motor and social skills for these children. Negative outcomes on child health resulted, too, including an estimated increase of 156–394 percent in the likelihood of nose-and-throat infection. The negative effects extended to the parents, too, including a deterioration in quality of marriage, "striking evidence of an increase in depression" among mothers, and a significant rise in "hostile/ineffective" and "aversive" parenting. The researchers concluded that "the consistency of the results suggests that more access to childcare is bad for these children (and, at least along some dimensions, for these parents)."[8]

When it comes to America-based, means-tested pre-K, the strongest evidence comes from a randomized controlled trial evaluation of Tennessee's Voluntary Pre-K program (TN-VPK). TN-VPK served 18,000 low-income children in nearly 1,000 classrooms managed through traditional public schools, providing strong external validity to assessing the implications of President Joe Biden's Build Back Better (BBB) pre-K expansion.

Students in this program saw initial gains in "kindergarten readiness," but by third grade, the results turned negative. TN-VPK students performed substantially worse on reading and math, behaved worse, and were more likely to be diagnosed with disabilities, including speech and language impairment and intellectual disabilities.[9] Shortly after the BBB plan failed, updated results from the TN-VPK study were published. When students were measured until sixth grade, the negative results persisted and, across some metrics, actually increased. This was widely reported as a "surprising" negative result, even though it was consistent with the earlier study and the literature as a whole.

It's also necessary to properly consider the results of Head Start. The landmark randomized controlled trial study of Head Start also shows gains in kindergarten readiness, but those results faded to insignificance by third grade.[10] Some conservatives have taken this as evidence that Head Start "doesn't work."[11]

But just as kindergarten readiness is an inadequate metric, so too are third-grade results. Studies have demonstrated that short- and long-run outcomes don't always align. There was a fade effect in the Perry Preschool study, yet it still yielded striking long-term benefits.[12]

Harvard economist David Deming conducted a long-term study on the effects of Head Start by comparing siblings who attended Head Start between 1984 and 1990. He found that although test-score gains faded, especially for African American children, there were still substantial long-run gains. Head Start participants evinced a reduced likelihood of grade repetition, decreased likelihood of a learning disability diagnosis, decreased reports of idleness, and improved physical health. Deming concluded that the gains were "one third of the size of the outcome gap between the bottom quartile and the median . . . and [were] about 80 percent as large as the gains from the Perry Preschool and . . . Abecedarian model preschool programs."[13] Strikingly positive.

But in 2019, a student of Deming's tracked the cohort he studied over a longer time horizon and used his method to evaluate another cohort of students born between 1986 and 1996. That study found that despite the early gains, Deming's cohort actually experienced no boost in college graduation or earnings. It further found strikingly negative effects for the next cohort of students. Compared to the previous cohort, they were more likely to be diagnosed with a learning disability, exhibit problematic behavior, commit crimes, have children as teenagers, and be idle, and they were less likely to attend college.[14]

These conflicting results could be attributable to a secular change in *which* of their children poor parents decided to send to Head Start. But a stronger hypothesis that accounts for not only all the results described above but also a study from Italy that found strong negative IQ effects for children from higher-income families[15] is that the true key to outcomes is the quality of a child's early environment. Advances in neuroscience suggest that early childhood environments leave a lasting, even physical, imprint on the developing brain. If those environments are healthier, child development can be strengthened. If they are less healthy, child development can be harmed.[16]

This pattern is also consistent with biological studies of the diurnal pattern and amounts of the stress hormone cortisol excreted in toddlers as they experience the environment of center-based childcare.[17] For children from deeply disadvantaged and dysfunctional home environments, childcare can provide a healthier alternative setting. But for children from less dysfunctional and middle-class households, childcare can prove a less healthy alternative.

The only reason these results are not intuitively obvious is that we have somehow forgotten the paramount importance of the family. Early childcare advocates routinely invoke Nobel Prize–winning economist James Heckman, who studied the Perry Preschool Program, to justify their proposed expansions. But Heckman himself evinced skepticism of universal childcare and preschool, explaining, "I have never supported universal pre-school. . . . The 'intervention' that a loving, resourceful family gives to its children has huge benefits that, unfortunately, have never been measured well."[18]

Conservatives have so fundamentally misread the academic literature on childcare and pre-K in part because they have been presented with misleading findings and given insufficient context. But this is also partly because of a natural blind spot inherent in the evidence-based policymaking enterprise. We *can't* truly measure the importance of the family. We can only find certain signals of it through the noise of studies on policy interventions tangential to it.

Furthermore, so long as early childhood expansion was sold as modest expansions on existing programs, conservatives were not exactly invited to consider the bigger picture. But this last fact changed during the debate around President Biden's BBB program.

"Building Back" Without Families

President Biden's BBB plan was hardly a modest proposal.[19] He wanted to offer two additional years of free public preschool to all families and deeply subsidize universal childcare. This was marketed to the public as a means to better facilitate female workforce participation. But it also clearly presented the social vision of a state that assumes responsibility for rearing children from the day they are born.

It became clear that there was no room for church-based community in the Biden administration's vision for early childhood. If the Biden administration had chosen, it could have expanded the $10 billion Child Care and Development Block Grant (CCDBG).

CCDBG was a bipartisan compromise both sides used to be happy with. It offered low-income parents vouchers (named "certificates") that provided them with the purchasing power and flexibility to send their children to childcare centers of their choice. And many parents' first choice was religious-based childcare. But Biden's BBB proposal aimed to undercut that compromise by subjecting all federal funding to the full burden of federal regulation, a burden that most church-based childcare centers are ill-equipped to manage. To boot, it included and excluded causes in a way that evinced a probably unconstitutional antagonism against religious childcare.[20]

The Biden administration ultimately recanted this particular anti-religious effort—but not before the issue became a major sticking point for the handful of moderate Democratic senators.[21] This controversy became one of the reasons Biden's initial BBB plan failed in the Senate.

Aside from this apparent antagonism, it must also be mentioned that the simple shape of the plan was vastly out of sync with many Americans' desires. According to polling from American Compass, a majority of married mothers would prefer to have one partner working full-time and one partner staying home to care for children under age 5. A strong plurality of single mothers would prefer the same. Strong pluralities of lower-, working-, and middle-class families would also prefer one parent working full-time and the other parent staying home to care for children.[22] This is all entirely natural and consistent with the historical nature of the human experience.

The only group that prefers to have both parents working full-time with children being largely raised by childcare centers is the upper class. Although American Compass did not display the precise cross tabulation, it's essentially certain that vastly more upper-class liberals prefer this, compared to upper-class conservatives.

The BBB plan, then, could be understood as an effort to impose the preferences of upper-class liberals on the rest of America, which holds different preferences. The state stepping in to assume authority to raise children, against the broadly expressed wishes of the polity, may remind some readers of Plato's *Republic*. It may remind others of Alexis de Tocqueville's prediction of soft despotism:

> It would seem that if despotism were to be established among the democratic nations of our days, it might assume a different character; it would be more extensive and more mild; it would degrade men without tormenting them. I do not question that, in an age of instruction and equality like our own, sovereigns might more easily succeed in collecting all political power into their own hands and might interfere more habitually and decidedly with the circle of private interests than any sovereign of antiquity could ever do. . . .

> I do not fear that in their chiefs [Americans] will find tyrants, but rather schoolmasters. . . .
>
> I want to imagine with what new features despotism could be produced in the world: I see an innumerable crowd of like and equal men who revolve on themselves without repose, procuring the small and vulgar pleasures with which they fill their souls.[23]

Although universal pre-K would not introduce a formal state compulsion to turn young children over to state-run facilities, social expectation and economic necessity would increasingly militate toward it. The social scientific literature suggests that putting young children under the tutelage of government-run centers would be substantially detrimental for their cognitive and, perhaps, moral development. A generation less fitted for self-government would likely then, in turn, argue for more character-degrading government interventions, which would lead to a less individuated mass of citizens—or subjects.

Putting Family First Again

After taking an honest look at the data and remembering our true first principles, the conservative approach to early childhood policy should become far less confused—and far more politically popular. The North Star of conservative early education policymaking should be bolstering—not undermining—the original social contract Americans made on public education. This contract holds that the family is the primary, pre-political unit and legitimate and well-directed policy should help families raise their children, rather than insinuate itself or its vision between the parent and the child. Put more plainly, the salable political vision is: We want to help *you* raise *your* children.

With the CCDBG, conservatives agreed to not call vouchers "vouchers," but rather "certificates." This was satisfactory, because label compromise notwithstanding, these certificates functioned as vouchers that could be redeemed in a system of relatively limited regulation.

Unfortunately, as time has gone on, further regulations promulgated with an eye toward improving childcare quality appear to have reduced the number and diversity of participating childcare providers.[24] If and when Republicans gain full control of Congress and have the presidency, they should have at the top of their to-do list to transition all federal early childhood subsidies into vouchers—or into something even more free and open than vouchers.

The core of the conservative school choice movement has moved beyond vouchers to education savings accounts (ESAs). Vouchers can only be redeemed within a system of state regulation and accreditation. Some voucher programs are launched with quality-control strings that can limit school participation.[25] Policymakers can add more strings over time.[26] And private school accreditors can add de facto ideological regulation above and beyond the formal regulations. The voucher structure is, therefore, inherently vulnerable to regulatory creep and ideological capture that could reduce the diversity of participating schools.

ESAs, by contrast, fund families *directly*. The term ESA is, indeed, a slight misnomer, as the mechanism is less a savings account than a debit card system. Money is deposited into a debit card, and parents may use that money on any permissible education expense, with a truly expansive understanding of what is educational. It doesn't have to be a school. It could be tutoring, horseback riding lessons, music lessons, or art lessons.

Such flexibility for parents is profoundly more important in a child's early years, when multidisciplinary forms of parent-driven enrichment are far more likely to support robust and holistic child development than the routinized "drill and kill" instruction all too often on offer from public pre-K programs. (Any policymaker who wishes to lead on this would do well to read Erika Christakis's book *The Importance of Being Little: What Young Children Really Need from Grownups* for an enlightening discussion of the profound opportunity cost of a bureaucratically managed childcare and pre-K sector.)[27]

Conservative policymakers need to focus on early childhood ESAs. Rather than aim to extract children from their mothers and fathers from the moment of birth, conservatives can use ESAs to start directly supporting families from perhaps even the moment of conception. Every unborn child could qualify the family for an ESA, into which public and private money can start flowing to support mothers and families—even and perhaps especially while the child is in utero.

Early environments leave a profound impact, and studies suggest that the earliest environment may leave the most profound impact of all.[28] Mothers need resources—financial and, to a limited degree, educational—for providing the greatest possible bodily care for their unborn children. Relatively small but proper "investments" in nutrition during pregnancy promise to yield an exponentially higher return on investment than Biden's BBB plan—and at fractions of pennies on the dollar.

Beyond this literally pronatalist early investment, a better use of public dollars than the status quo would be to send them directly into parents' pockets, from the child's point of birth through kindergarten (and ideally, ultimately, well beyond that). One randomized controlled trial study, for example, has shown that cash gifts given directly to mothers when their children are born can create conditions that substantively affect their child's brain activity by the time they turn 1 year old.[29] Providing dedicated money—even if in a relatively small amount—to support early childhood maternal care would provide the "nudge" (to steal that misused term) necessary to prompt mothers to consider the paramount importance of providing a nurturing environment for their infants and toddlers.

Studies have shown that something as simple as intentionally narrating the world in conversation with a child has been shown to far exceed the benefits of center-based childcare.[30] Yet, though it is perhaps politically incorrect to say this, many parents are insufficiently aware of the science-based case for the benefits of "serve and return" interactions with infants and toddlers.

If parents prefer, they certainly could direct this subsidy to childcare centers. Although, as we've seen from the American Compass poll, this is really only affluent liberals' preference. Most families prefer to have one full-time breadwinner and one full-time caretaker. Early childhood ESAs could, then, be at the center of a broader reorientation of conservative family policy that respects and serves the natural and stated preferences of families.

The exact structure and dollar distribution of early childhood ESAs is an excellent subject open for intra-conservative debate. There is certain to be a push from one faction of the conservative movement for keeping this program means-tested rather than universal. In my judgment, that would be a mistake. Early childhood ESAs could be sold to the public as part of the renewal of America's original social contract: The government exists to serve families, not subvert them.

There is certainly a strong case for income redistribution, but income redistribution should be conducted not by qualification or disqualification from a means-tested program, but rather by the distribution of funds in a universal system. Poor and working-class American families need—and perhaps deserve—more support than middle- and upper-class families do. But all families should be eligible, with aid weighted based on economic circumstance.

The $10 billion from CCDBG is a starting point for this finance-model reorientation, but it frankly would not provide sufficient funds to execute it. Federal policymakers should redirect Head Start, federal kindergarten, and other funding streams to flow directly into ESAs. It should not be too ambitious to consider reauthorizing the Elementary and Secondary Education Act to set high school graduation at 11th rather than 12th grade, so that instead of servicing the largely superfluous senior year of high school, up to $15,000 of combined federal, state, and local taxpayer dollars can instead flow into parents' pockets during the far more important first five years of a child's life.

In addition to funding ESAs with public dollars, the federal government should allow individuals and organizations to continue funding ESAs in a tax-advantaged way. However, Congress should consider expanding the annual contribution limits (up from $2,000 currently) and income limits ($220,000 for a married tax filer).[31] The qualified uses of ESAs should also be expanded.

Any such plan is certain to engender manufactured political outrage. Conservatives should pay absolutely no heed to this. In the context of school choice, Jason Bedrick has shown that no matter how mild the reform, Democratic politicians will ring a five-alarm fire about "destroying public education" and the like.[32] Whether the program is extremely small or ambitiously large, the political propaganda response will not actually be responsive to the scope. And progressives should heed his lesson: If they'll "call wolf" at sheep, then conservatives should go big rather than small.

Ultimately, an early childhood ESA could prove a bigger boon to the school choice movement than two decades of bipartisan advocacy have managed to accomplish. When parents become accustomed to leveraging public money to direct their child's education, many will want to continue that practice after their children turn 5 years old. But more importantly than that, it will help mothers and fathers raise children who flourish.

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11

Beyond School Choice: A Conservative K–12 Agenda

FREDERICK M. HESS

When it comes to K–12 schooling, conservatives have been far better at explaining what we oppose than what we favor. Everyone knows we are broadly against federal overreach, reckless spending, and teachers unions. But what are we for?

It often seems the list begins and ends with "school choice" and "keeping Washington out of education." This dearth of ideas means that conservative talk about equal opportunity can ring hollow—especially in those locales where expanding school choice is a less realistic option.

And yet, conservatives are positioned to lead much more effectively on education than the left is. The left's intimate ties with unions, public bureaucracies, and higher education have turned it into the apologist and paymaster for the education establishment. This helps explain why Democratic K–12 proposals today mostly amount to subsidizing the status quo, boosting teachers' salaries, and promoting woke dogmas.

Unburdened by such entanglements, the right is free to reimagine institutions and arrangements in ways the left is not. Moreover, as the contemporary left increasingly takes its cues from its activist fringe, the right has the chance to carry a mantle of broadly shared values that appeals to conservatives and moderates alike.

In doing so, the right should focus on two nested challenges. The first is the need to improve academic outcomes and defend educational excellence. A decade of stagnation in the National Assessment of Educational Progress and middling performance on major international assessments, all evident even before the devastating effects of the pandemic, makes the challenge clear. Moreover, a progressive assault on excellence—in which everything from exam schools to advanced math offerings, gifted programs, and the SAT have been attacked as "racist" and "inequitable"—demands a forceful defense of academic rigor and opportunity.

The second is that bureaucratic inertia and woke groupthink have suffused too many school systems, leaving parents frustrated that schools neither respond to their concerns nor reflect their values. It's equally vital to empower parents by reforming the local schools and enabling parents to find a school that suits.

A Changed Education Landscape

Schools play three main roles in American life: (1) They provide academic and vocational instruction for children, (2) they teach and model values for children, and (3) they keep kids safe and socially engaged.

Most of the time, it's the third of these, the custodial role, that frames how parents think about schools. If the bus shows up on time each morning, if the school feels safe, and if kids make friends and seem to like their teachers, most parents will defer to educators as the experts on academics. That's especially true given that most parents don't have much visibility into what happens in classrooms.

But this longtime dynamic was upended during the pandemic, which shuttered many schools for six months or even a year. Long after much of the nation returned to semi-normalcy, schools were engaging in byzantine quarantine protocols and shutting down intermittently due to COVID-19 scares or to give staff "mental health days." For some students, by spring 2022 it had been two full years since they had eaten in a cafeteria or attended school unmasked.

This behavior largely broke the trust that parents had long placed in schools' custodial function. What's more, the shift to remote learning has been coupled with a rising tide of woke dogma in schools, fueling a furious backlash against practices that travel under the banner of critical race theory. And all this has unfolded against a background of severe learning loss produced by the lack of in-person learning, with McKinsey & Company estimating that students learned only a little more than half as much reading and math in 2020–21 as they would in a typical year.[1]

In short, the landscape of schooling has changed. After a couple years of school closures, bureaucratic indifference, and dismal remote learning, parents express a hunger for options and a growing distrust in the status quo.

The challenge for conservative policymakers is to seize this opportunity.

In answering this call, the conservative education agenda should be at least as much about the bully pulpit and articulating shared values as a policy platform. But the policy agenda is where conservative leaders must walk the walk. That agenda should be oriented around a few simple principles: empowering parents, promoting excellence, and busting self-serving cartels.

Empowering Parents Through Educational Choice

The conservative commitment to parental choice is foundational and has never been more timely. It's rooted in the conviction that parents deserve the freedom to leave schools that aren't serving their children well and find ones that will. It's buttressed by the conviction that traditional bureaucratic systems are too often unresponsive and that they benefit from the pressure applied by empowered parents. But such a notion of choice is only a start.

Indeed, there are other powerful rationales for choice that aren't acknowledged or articulated frequently enough. Choice empowers not only families but also educators frustrated by local districts and eager to find a better fit for their values and talents. Choice allows parents to hold a school accountable for how it is serving their particular child, rather than relying solely on accountability systems that judge schools based on aggregated numerical metrics.

This means that school choice is a foundational piece of the conservative K–12 agenda. Conservatives should support policies that promote choice within school systems, enable families to enroll across district lines, authorize more charter schools, provide substantial vouchers to attend private schools, and make homeschooling convenient.

But such policies are only a beginning. That's because most American families want more flexibility and choice but don't necessarily want to flee their local school—and few exhibit much appetite for "blowing up" school districts. Indeed, even as more than two-thirds of parents support school choice, roughly the same number routinely give an A or B to their own children's schools.[2]

How can we reconcile those two numbers? It's not hard, really. Parents want more options, flexibility, and choice, and they want the ability to access rigorous instruction and protect their kids from wacky math instruction and toxic ideological agendas. At the same time, many suburban families bought their home because they like the local school. Across much of rural and suburban America, schools serve as community anchors, places where children make neighborhood friends and parents forge bonds. These families hear calls to "end ZIP-code education" not as a promise but as a threat.

Yet these parents don't really want to return to the status quo ante of public education. Indeed, more than half of all parents say—after the pandemic experience—that they'd like to retain some element of homeschooling going forward.[3] They don't want to do it full-time, however. Some parents say they want the opportunity to employ a hybrid model, in which they might homeschool one or two days a week and send their child to school the other days. Other parents have jointly hired a tutor or teacher and formed a "learning pod" with several local families, and they now want a voucher that provides the resources to keep this going—not one that allows kids to enroll in a new school. In each case, parents want flexibility, not necessarily the opportunity to leave one school for another.

Then there are parents who are concerned about the curricula or instructional programs their local schools use, especially when states like California or Oregon have attacked advanced math offerings and high expectations in the name of equity.[4] Such parents may be content with their school option but are looking for course choice—the chance, for example, to opt out of their school's math program and use the funds to procure a math course or tutoring from a highly regarded alternative source.[5]

In many of these cases, the answer is not *school* choice but *educational* choice. The optimal tool for this is the *education savings account* (ESA). Modeled on a health savings account, the ESA is like a school voucher that gives families enhanced freedom to spend the funds as they see fit. Optimally, an ESA should be available to the broadest-feasible swath of families and funded as generously as possible. The sums involved in ESAs can vary widely, but policymakers would be well-advised to provide families with as much of the per-pupil state and local allocation as is legislatively feasible. Parents can use these funds for private school tuition (just as with a voucher) but also for any approved instruction, tutoring services, courses, or learning tools. Coupled with policies that make it easier to organize learning pods and encourage school systems to accommodate hybrid homeschooling, ESAs can empower parents profoundly.

Empowering Parents via Transparency and Accountability

Parental empowerment requires choice but also information. Parents need more visibility into how schools are doing. During the pandemic, for instance, state assessments have proved invaluable in showing the devastating consequences of school closures.[6] So maintaining and improving state assessments for reading and math are essential places to start. But transparency regarding academic outcomes is only the beginning.

Those achievement data should be joined with school spending data to provide transparency regarding *return on investment*. The public vastly underestimates how much schools spend per pupil.[7] When informed of the actual cost in their state, the share of respondents who think schools need more money declines by double digits. (Nationally, schools spend more than $14,000 per pupil on average.)[8] Especially after Washington devoted more than $200 billion in emergency funding to schools in 2020–22, parents, taxpayers, and voters deserve to know where those dollars are going and what kind of bang for the buck schools are delivering. State accountability systems should incorporate school spending data, provide insight into where funds are going, and present various outcomes in terms of relative spending levels.

Another crucial kind of transparency is *curricular* transparency, which enables parents to see what schools are teaching and what materials are being used. In too many public schools, it's remarkably difficult—even risky—for a parent to look into what a child is being taught. Parents' requests for information have been met by vague or misleading "frameworks," bureaucratic resistance, and onerous record request fees, and some inquiring parents have even been sued by school districts and the National Education Association.[9]

Obviously, addressing such concerns once children are halfway through an academic unit is hugely problematic for parental engagement and response. It means parents don't have the chance to ask questions or raise concerns on the front end and that potential issues aren't addressed until after the fact.

The right course is for states to ensure that parents can access curricula at the beginning of the school year, *before* they enroll their children. If parents could view curricular materials in the same way that they can access graduation and dropout rates online, they would be empowered to respond appropriately. Such an approach would minimize clashes during the school year, as parents and educators could resolve tensions earlier.

An appealing model is the Academic Transparency Act model legislation developed by the Goldwater Institute, which would require public schools to share a list of the actual instructional materials they used during the previous school year on a publicly accessible portion of their website by each July.[10] Because school curricula tend not to vary greatly from year to year, this would offer parents a good sense of the materials their children are likely to encounter in the coming year. Such an approach avoids imposing extra burdens on teachers, as it requires school staff to post online only the same materials they're already expected to share with their school administrators.

Legislation based on the Goldwater model has been introduced in several states. It should be adopted and put to work. The federal government doesn't have a direct role to play here, but it's worth asking if it might—taking a page from the Clinton-era Improving America's Schools Act or the Every Student Succeeds Act—require states to adopt some kind of transparency model as a condition of receiving K–12 aid.

Embracing an Excellence Agenda

In an era of ubiquitous remote learning, every qualified high school student should have access to a full suite of Advanced Placement offerings. While far too many students are not even proficient in basic subjects, and much more needs to be done for them, it's fair to say that the kids left behind have been the focus of education policy for two decades. While we must strive to do better by those students, we also must address the inattention to excellence—a crisis that has worsened in the face of progressive attacks. School choice programs and investors should launch and grow schools that offer gifted or advanced instruction, like the Arizona-based BASIS Charter Schools.

Four years ago, in "A Culturally Responsive Equity-Based Bill of Rights for Gifted Students of Color," a group of equity scholars argued that "gifted students of color" need skilled gifted educators, gifted programs committed to recruiting and retaining them, and access to "Advanced Placement, accelerated, magnet, early college, and other programs for advanced students/learners."[11] They're right. In fact, when equity is understood this way, there's endless opportunity for simultaneously pursuing equity and excellence.

We need many more teachers prepared to teach gifted students, especially given a pipeline that attracts too few teachers skilled in the sciences or advanced instruction. For starters, those who teach science, math, or computing generally have more lucrative nonteaching opportunities than do those who teach social studies or physical education. Simple respect for labor force realities would suggest altering salary schedules accordingly. While such adjustments are all too rare today, even in private schools and charter schools, it's past time to start allowing compensation to reflect that it's far tougher to recruit and keep chemistry teachers than social studies teachers (no matter how tough a pill that may be for a former social studies teacher, like me, to swallow).

State and school system leaders should prioritize expanding the International Baccalaureate program, Advanced Placement courses, K–8 gifted offerings, and high-caliber opportunities in areas such as robotics and music. One tack is to incorporate information on local offerings, the share of students participating, and the relevant outcomes into state reporting systems. Another is to create state challenge grants to match funds for districts that step up in providing such opportunities.

Of course, there's no reason all this instruction must happen in conventional K–12 classrooms. Apprenticeship and career and technical education programs can engage students and expose them to exciting professional opportunities. Dual-enrollment options allow high school students to enroll in postsecondary courses—either at a local campus or remotely—to accrue college credits, reduce the cost of a degree, and explore intellectual challenges beyond those available on a high school campus. In all this, state and federal officials can play an invaluable role by urging schools to embrace new opportunities, providing more flexibility around the use of funds, and removing bureaucratic and logistical impediments that may get in the way of willing students, staff, or school leaders.

All students need and deserve these things, especially those who've been denied such opportunities. An excellence agenda can help deliver them.

Paying and Professionalizing Excellent Teachers

Teachers today are mostly paid using "step-and-lane" pay scales, with salaries based on years of teaching and advanced credentials rather than performance. Meanwhile, even as after-inflation, per-pupil spending has more than tripled over the past half century, real teacher pay hasn't budged.[12] The primary culprit? Steady growth in employment rolls, with schools adding teachers and nonteaching staff faster than they're adding students. Indeed, between 1992 and 2015, the number of nonteaching staff grew at twice the rate of enrollment.[13]

The problem is that we've tackled the teacher-pay challenge backward: by trying to find enough money to boost pay for a constantly increasing number of teachers (now up to 3.6 million) to do the same things they always have.

There's a better path: rethinking what teachers do and how they do it. The nation's teachers are not all equally adept. Schools struggle enough to replace the 270,000 teachers who depart each year, much less ensure that all teachers are effective. Meanwhile, teachers note that many of the duties consuming their time don't deliver much value to students. This adds up to an opportunity to rethink the shape of the profession so that valuable educators are better paid and skilled instructors aren't spending hours patrolling hallways and filling out virtual forms.

Other professions are arranged differently from education. In a well-run medical practice, for instance, someone other than a skilled surgeon spends time filling out patient charts and negotiating with insurance companies. Such basic division of labor has been largely absent in schooling, meaning many teachers are paid a middling amount, with all of them—veteran and novice, expert and beginner—devoting much time and energy to nonessential tasks.

Policymakers should push state agencies and school systems to explore more promising approaches. One possibility is the New York–based New Classrooms model, in which middle school math teachers share 100 or more students.[14] This allows teachers to customize students' experience, provide intensive support for students who need it, and use technology strategically. The shared-duties model enables veteran teachers to operate more as team leaders than as instructors and allows compensation to more easily reflect individual teachers' duties and roles. Another model comes from the Opportunity Culture initiative in Charlotte, North Carolina, in which accomplished teachers provide online instruction, coach junior colleagues, and otherwise extend their reach—with compensation to suit their responsibilities.[15]

Teacher-led charter schools should play a larger role in pioneering such arrangements. Just as law and medical practices are run by partnerships, education would benefit from a thriving sector of teacher co-ops in which teachers assume school leadership—and use the hefty administrative savings to hire the requisite help while boosting teacher pay. The possibilities are eye-opening: One New York City charter school, the Equity Project, slashed administration and reassigned duties, which allowed it to raise pay to $125,000—for starting teachers![16]

Governors should push their state departments of education to set forth new job descriptions that school districts can adopt without having to run the administrative gauntlet. State leaders should set aside funds for districts and charter schools that develop plans to redesign roles and compensation—with the clearly stated goal that some designated share of teachers (say, at least 5 percent) will earn at least twice the state's median teacher pay, yielding pay of roughly $150,000 to $200,000 per teacher.

Here arises a chicken-and-egg conundrum: Educators are not trained for these kinds of roles. This means new training programs are needed, ideally under the roof of education schools. It's important to keep such efforts out of federal bureaucrats' hands, but Washington can certainly help by making it easier for states and school systems to use Title II dollars (intended to boost educator quality and effectiveness) or redirecting grant programs to support places that are stepping up to lead this kind of redesign.

Moving beyond a one-size-fits-all profession will create new professional opportunities, allow teachers more control over their professional paths, and beget the possibility for life-altering educators to be compensated like life-saving physicians. All this will, of course, challenge the teachers unions to evolve as members' roles do. Such a development would be enormously healthy for the profession and education.

Ending the Teacher Licensure Cartel

Of all the professions, one might expect teaching to be among the most open to embracing a diverse applicant pool. After all, education experts routinely remind us that teaching depends on relationships, empathy, and understanding. Perversely, however, those same experts defend convoluted licensure systems that do not consider those qualities while ensuring that public schools are staffed solely by the graduates of teacher-education programs.

Licensure systems require would-be educators to earn credentials through programs that typically consist of courses at education schools and student teaching under the supervision of education-school faculty. These prerequisites narrow the pool of potential teachers, saddle educators with onerous costs, and deter career switchers and nontraditional candidates from pursuing teaching careers.[17]

The costs of this approach take the form of both money and time. Analyst Chad Aldeman, a former Obama administration official, has estimated that because of licensure requirements, training the average teacher costs about $25,000 and requires 1,500 hours—more hours than the typical teacher works each year.[18] The requirements bar a host of seemingly qualified, promising candidates from applying for teaching positions and are especially burdensome for professionals seeking new careers.

Teacher-licensure proponents make analogies to professions like law and medicine, arguing that being an effective professional requires certain knowledge and skills. They have it partly right; those fields do require licenses, but there is no presumption that licensing ensures someone is a "good" lawyer or physician, much less an empathetic one. It ensures only that the licensee has acquired a basic grasp of certain knowledge and skills. Advocates of educator licensure themselves routinely suggest that the process should be about not knowledge but whether teachers have the right sort of disposition. That may be a reasonable *hiring* criterion, but licensure is ill-suited to identify and cultivate a disposition in hundreds of thousands of candidates each year.

Indeed, teaching is more akin to journalism and business management, in which excellence is an alchemy of interpersonal gifts, natural talents, and acquired skills. In those fields, formal training can be useful and frequently offers a leg up in landing a job. But one need not possess a license to obtain employment as a journalist; employers are free to evaluate a given credential as they see fit.

It is time for a vision of teaching that is more inviting to career switchers and others with prized expertise—one that judges new hires on skills and aptitude rather than suspect credentials. Policymakers should reform state licensure systems via statutes and directives issued in state departments of education. Aspiring educators should be able to apply to work in schools if they possess a degree from a recognized college or an appropriate alternative credential, pass a rigorous criminal background check, and demonstrate competency in relevant essential knowledge and skills.

By no longer requiring school leaders to focus narrowly on candidates who can meet century-old licensure restrictions, licensing reform will enable leaders to ask how they might recruit and best employ career switchers, military veterans, and even local seniors. It will allow students to benefit from the rich experiences and skills of those in their communities.

Such a shift would dramatically change America's 1,400 teacher-preparation programs. But it would not "blow up" teacher education; rather, it would subject these programs to the same healthy market pressures that confront business and journalism schools daily. Absent a licensure requirement, the question will be whether programs are equipping graduates with essential skills and knowledge.

Trust-Busting Through Bankruptcy

Many state laws and school district contracts contain “evergreen” provisions stipulating that contract terms for public employees remain in effect in perpetuity unless both parties agree to alter them. Theoretically, this evens the scale between employees and employers, since public employees are limited in their ability to strike. In practice, of course, teachers unions are among the nation’s most powerful unions, making the justification laughable. The result is that an entirely new school board can be elected with a mandate for reform and still lack the ability to revamp even an *expired* contractual agreement without union acquiescence. Needless to say, such acquiescence is rare.

In the private sector, when past decisions leave ventures struggling with inflated costs, bad contracts, or rigid business models, firms can reinvent themselves through bankruptcy. Chapter 11 bankruptcy, in particular, has given countless corporations legal sanction to downsize costly operations, revisit contracts, and modify long-established but anachronistic practices.[19]

That same option is not widely available to school systems, primarily due to mid-1990s revisions to the bankruptcy code that made it possible for states to block municipalities from filing for Chapter 9 bankruptcy—the kind of bankruptcy that school districts can use.[20] Fewer than half the states allow school districts or other municipalities to file for bankruptcy. Between that restriction and general risk aversion, the nation’s 14,000 school districts simply don’t use Chapter 9 bankruptcy, no matter how grim their circumstances. In many school districts, especially the big, struggling urban districts, bad contracts, regrettable vendor agreements, and ill-conceived school-board policies can border on the immortal.[21]

Experts in bankruptcy law note substantial opportunity exists to restructure school systems through Chapter 9, should school leaders be willing to act. The first step, of course, would be for more states to authorize school districts to file for bankruptcy. There is also a place for more expansive federal action. After all, the US Constitution vests Congress with the authority to set a uniform bankruptcy code precisely because providing individuals, businesses, and communities with the opportunity for a fresh start is integral to maintaining the national fabric.

Federal officials should explore creating a new bankruptcy-like mechanism specifically designed to allow school districts receiving federal Title I funds—virtually every district in the nation—to petition for relief from contractual, benefit, and vendor obligations that constrain their ability to improve schools or otherwise spend funds in alignment with their students' interests. A school district that filed such a petition would propose a plan to reorganize debt, restructure agreements, and alter operations, with a Title I bankruptcy judge considering the filing through an appropriate adjudicatory process. Such changes would obviously address financial constraints, but they could also be used to alter archaic contract provisions, staffing restrictions, and vendor agreements that are as problematic for their academic impacts as for their financial ones.

Critics of charter schools frequently argue that they have an unfair advantage over traditional schools because charters have the leeway to sidestep bureaucratic constraints. This kind of clean-slate proposal levels the playing field and gives traditional districts a shot at a fresh start, empowering reform-minded mayors and school boards to show that they're able and willing to lead.

Even a handful of districts seizing the opportunity could have a salutary effect on the behavior of employee groups, vendors, and others. Indeed, the absence of a bankruptcy threat makes it far easier for local employee unions to eschew even sensible compromises on issues such as health care or pension costs. A viable bankruptcy mechanism just might encourage some to think strategically about revisiting benefit commitments, concluding that doing so is prudent if it forestalls the possibility of bankruptcy.

Final Thoughts

Since the dawn of the Obama administration, I have regularly hosted dinners and off-the-record webinars with leading conservatives who work in education policy. These passionate, knowledgeable reformers have arrived time after time, on topic after topic, at a familiar quandary: Other than "more choice" and "less Washington," what exactly are we for? What are we proposing that will improve the lives of Americans and their communities, promote our shared values, and extend opportunity?

Too often, the conversation has been bogged down at that juncture. The pandemic brought to light, however, that parents are tired and the bureaucracy is stilted—delivering conservatives a powerful chance to lead. Concerns that schools can't be relied on to provide their age-old custodial function, coupled with the transparency of remote learning, have prompted parents to take a hard look at what schools are doing when it comes to values and instruction. And they haven't liked the answers.

When the education debate hinges on who will funnel more dollars into subsidizing 20th-century bureaucracies, conservatives tend to lose. But the advantages that progressives enjoy when education becomes a bidding war quickly turn into weaknesses when the question becomes: Who is able and willing to redesign institutions that no longer work for families, students, or taxpayers?

For decades, Democrats have enjoyed a sizable advantage on education policy, fueled by support for ever more school spending and the perception that they like teachers more than Republicans do. Now the left is stuck defending teachers who won't teach, schools that demand more while delivering less, and ideological extremism in elementary school classrooms.

Conservatives are positioned to challenge the status quo, speak up for common sense, and bust the self-serving trusts that have come to dominate the education landscape. And it just so happens that's the kind of K–12 reform Americans want and need.

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12

From Agencies to Agency: Building a Workforce from Within

BRENT ORRELL

In his 1980 presidential campaign, Ronald Reagan popularized the importance of work as the primary means of self-sufficiency by telling audiences, "The best social program is a job."[1] In 2015, President Barack Obama echoed the same idea, saying, "The best antipoverty program is a job."[2] As a matter of national character, Americans of all backgrounds and beliefs agree: The key to self-sufficiency and intergenerational wealth accumulation is to ensure that every person has the education, skills, and opportunities they need for gainful, satisfying employment.

A shared belief by itself, however, cannot guarantee the outcomes we seek for ourselves and our communities. Technological change, the globalization of the economy, and stagnating educational performance and work readiness have conspired to put "good jobs at good wages" out of reach for a growing number of Americans, especially those who live on the social and economic periphery.

Declining access to good employment is a multidimensional problem that will require solutions tailored to the specific needs of local and regional economies, businesses, and—of greatest importance—workers themselves. Our existing workforce development system is not up to this challenge. As my AEI colleague and workforce systems expert Mason Bishop says, "We have a New Deal workforce system for an iPhone economy."[3]

The modern economy is "dematerializing" as our processes become more efficient and we advance further into job markets dominated by services and information-related skills.[4] The result of this shift is a market premium for noncognitive or "soft" skills—such as communication, teamwork, critical thinking, and grit—that are challenging the dominance of the types of narrow, repetitive technical skills that were more common in the industrial age.[5] Correspondingly, the systems and approaches we've used to assist workers relying on cumbersome, in-person service provision, often outdated technology, and a two-steps-behind understanding of market changes are inadequate to the needs of workers scrambling to meet the demands of the economic moment.

In this context of rapid change and relatively static systems, it is also clear that American workers have not been keeping up. In their seminal book on this topic, *The Race Between Education and Technology*, Harvard professors Claudia Goldin and Lawrence Katz argue that the virtuous cycle of rising educational attainment, jobs, and income that characterized the American economy from the dawn of the Industrial Revolution until the 1970s has broken down.[6] The pace of skill acquisition among American workers has simply not kept up with technological change, and, as a result, family-sustaining jobs have gradually moved further out of reach for growing numbers of workers. With the advent of powerful new tools such as artificial intelligence and robotic process automation, the task of synchronizing education, training, and technology is becoming more difficult, not less—especially for those with lower levels of education, training, and skills.

As I wrote in a 2018 report, the roots of our work-readiness and job-training challenges are deep and have their ultimate source in family formation and the problems that underprepared and under-supported children have in maximizing school performance.[7] Our long-term workforce problems are, in this view, part of a broader human development problem. Other contributors to this volume are addressing these underlying challenges, and I will not rehearse their scholarship here.

Rather, in this chapter, I focus on the question of how we can better deploy and align our fiscal resources, workforce systems, and programs to help new and incumbent workers start or restart their careers. To help workers, especially those in low-income and disadvantaged communities who are the special concern of this volume, my recommendations focus on four areas:

1. Improving noncognitive (social-emotional) skill development through increased investment in evidence-based programs such as home-visiting programs that strengthen educational readiness, long-term educational attainment, and employment outcomes;[8]

2. Shifting workforce development resources from bureaucratic systems to individuals through increased use of Individual Training Accounts (ITAs) that build work skills and reinforce the development of personal agency;

3. Reforming, updating, and enhancing labor market information technology and systems to improve worker awareness of in-demand jobs and skills; and

4. Promoting state-level flexibility through federal waivers that promote innovation in workforce system redesign.

Improving Noncognitive and Soft-Skills Deficits

Over the past 70 years, Americans have invested heavily and disproportionately in so-called hard, cognitive, or technical skills in the hope and belief that these skills are the surest path toward the economic security that high-paying careers in STEM fields afford. Yet the skills gap between what employers say they want and what American workers have to offer continues to grow.

Workforce success is built on a pyramid of skills. Figure 1 is a rendering of that pyramid. At the top of the pyramid are technical skills that focus on either particular tools or processes that are most directly applicable to the job market, especially the digital skills that are increasingly crucial across the economy. In the middle are basic skills such as reading, writing, and mathematics—core work competencies for literate and trainable employees.

The base of the workforce pyramid is noncognitive or soft skills such as communication, critical thinking, teamwork, grit or persistence, and collaboration. Workers who manage to land jobs on the strength of basic and technical skills but without strong noncognitive skills often find themselves disadvantaged in retention and advancement. As workforce development professionals say, "Technical skills get you hired, but noncognitive skills get you fired."[9] And even if they don't get a worker fired, the lack of noncognitive skills tends to hamper progression toward higher-paying management jobs.

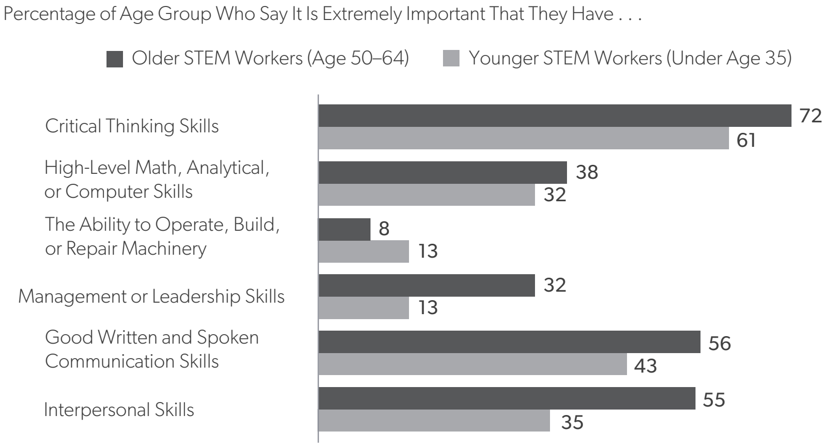
Figure 1. The Workforce Skills Pyramid

Source: Adapted from CareerOneStop, Competency Model Clearinghouse, "Building Blocks Model," 2018, http://www.careeronestop.org/CompetencyModel/competency-models/building-blocks-model.aspx. See also Brent Orrell, ed., *Minding Our Workforce: The Role of Noncognitive Skills in Career Success,* American Enterprise Institute, May 18, 2021, https://www.aei.org/research-products/report/minding-our-workforce-the-role-of-noncognitive-skills-in-career-success.

Employers confirm the need for a workforce with higher levels of noncognitive skills. Survey data from employers on LinkedIn show that industry experts, organizational partners, executives, talent developers, and managers all say soft-skill training was their top training priority in 2020.[10] Talent developers in all sectors allocate the majority of their budgets toward soft-skill development programs rather than technical training. LinkedIn's 2018 survey among these business and organization leaders best sums up the rationale behind soft-skill development and why it is a top priority today: "In the age of automation, adaptability rules. While maintaining technical fluency will be important, demand for soft skills will continue to accelerate."[11]

Data from a recent AEI survey of STEM workers help explain why such skills are important over a career lifetime. AEI found that "69 percent [of] STEM workers say good written or communications skills are extremely

Figure 2. Skills STEM Workers Say Are Important to Do Their Job, by Age Group



Source: AEI STEM Education and Workforce Survey, 2019. See also Brent Orrell and Daniel A. Cox, *STEM Perspectives: Attitudes, Opportunities, and Barriers in America's STEM Workforce*, American Enterprise Institute, July 15, 2020, https://www.aei.org/research-products/report/stem-perspectives-attitudes-opportunities-and-barriers-in-americas-stem-workforce.

important." Forty-six percent said interpersonal skills are important, compared with only 36 percent who say "high-level math, analytical or computer skills" are important to do their jobs. The perceived need for such skills rises with age. As Figure 2 suggests, older STEM workers (the ones most likely to have advanced into management occupations) rate skills such as critical thinking, written and spoken communication, and interpersonal skills as significantly more important than their younger colleagues do.[12] These data suggest noncognitive skills are crucial to turning a job into a career.

If noncognitive skills are so important, what can we do to get more of them? I covered this question in-depth as part of my 2018 report "STEM Without Fruit"[13] and in a follow-up volume released in 2021, *Minding Our Workforce: The Role of Noncognitive Skills in Career Success*.[14] In brief, the report and the volume argue we should be focusing on a life-cycle approach to workforce development to ensure that more kids arrive at school age better prepared to successfully complete K–12 education and advance into postsecondary training. This means greater investment in family stability and relationship-education programs and ensuring that our schools and community organizations, especially those that disproportionately serve low-income and disadvantaged students and communities, are better informed about the long-term impact of building these skills.

For older students preparing for careers, programs such as the Federation for Advanced Manufacturing Education, which uses an advanced manufacturing training approach, have shown great success at combining technical and noncognitive skills training and building pathways to long-term employment.[15] For welfare-dependent families, programs such as Economic Mobility Pathways help participants improve goal-setting, decision-making, and problem-solving skills that help them reach and sustain economic self-sufficiency.[16] For those already in the workforce, several highly successful model programs such as Year Up and Per Scholas focus on integrating technical and noncognitive skills training, resulting in rapid and dramatic increases in wages and workforce success.[17]

Increased Investment in ITAs

The previous section dealt with the need to strengthen America's human capital base by placing more emphasis on developing noncognitive skills that undergird workforce success. Noncognitive skills training is meant to increase flexibility and longevity in the workforce by helping people gain the ability to relate well to others on the job and in the rest of their lives. For both practical and philosophical reasons, the workforce system itself needs to mirror and support this bias toward cultivating personal agency in training and career decisions.

Shifting more decision responsibility to workers is especially important in light of how quickly technology and skill demands are changing. No government agency can, by itself, fully and accurately predict what skills might be needed, especially on a short time horizon. Workers who are actively pursuing jobs may be in the best position to know what kind of training is most relevant to the market and their own interests. Putting resources in the hands of workers, therefore, can add to the agility and flexibility of our training system.

ITAs are one mechanism for achieving this objective. Replacing the 1998 Workforce Investment Act (WIA), the 2014 Workforce Innovation and Opportunity Act (WIOA) introduced these accounts as an effort to better serve the integration of workforce development and economic development. Rather than rely on local workforce system authorities to decide which training programs would receive public contracts, WIA authorized ITAs to empower workers in the same way a voucher is sometimes used in public school education. ITAs are used by workers to pay for training from a list of approved training organizations and entities including community colleges, technical schools, and private, for-profit training organizations.

Because this approach has been around for a considerable period, there has been time to test and evaluate its effectiveness. A government-funded, randomized control trial evaluation of ITAs conducted by Mathematica Policy Research (MPR) tested three different ITA models: structured choice (intensive case manager involvement), guided choice (moderate case manager involvement), and maximum choice (voluntary case manager involvement).

Per Table 1, MPR's evaluation showed that Model 1 (structured choice) participants earned about $500 more per quarter than Model 2 (guided choice) participants did. Model 1 and Model 3 (maximum choice) were roughly comparable in outcomes. Over 20 years, MPR estimated that workers using the structured choice model would show "large, positive impacts on long-term earnings . . . while generat[ing] $46,600 per ITA job seeker in net social benefits." The other models also showed significant income gains for workers using ITAs.[18]

The expanded use of ITAs is of particular relevance in the post-COVID-19 economic environment. Some Americans, especially those at the lower end of the wage scale, have been relatively slow to return to work for various reasons, including fear of illness, day care and school closures, and the availability of expanded federal unemployment benefits.[19] The workforce has also been marked by historically high levels of quits, especially among low-wage workers seeking better pay and benefits.[20] This labor market churn strongly suggests that many workers are anxious for advancement and motivated to seek the necessary skills to move up. For such workers, ITAs could be a vital resource for accessing the skills training they need to achieve higher earnings and better working conditions.

The stresses of the COVID-19 return to work provide a second reason for expanding individual choice and resourcing through ITAs. A survey by

Table 1. The Three Service Delivery Models Tested in the ITA Experiment

	Model 1: Structured Choice	Model 2: Guided Choice	Model 3: Maximum Choice
ITA Award Structure	Customized	Fixed	Fixed
Required Counseling	Mandatory, Most Intensive	Mandatory, Moderate Intensity	Voluntary
Counselor Discretion to Reject Customer's Program Choice	Yes	No	No

Source: Irma Perez-Johnson, Quinn Moore, and Robert Santillano, *Improving the Effectiveness of Individual Training Accounts: Long-Term Findings from an Experimental Evaluation of Three Service Delivery Models*, Mathematica Policy Research, October 2011, https://wdr.doleta.gov/research/FullText_Documents/ETAOP_2012_06.pdf. See also Brent Orrell, Mason Bishop, and John Hawkins, *A Road Map to Reemployment in the COVID-19 Economy: Empowering Workers, Employers, and States*, American Enterprise Institute, July 24, 2020, https://www.aei.org/research-products/report/a-road-map-to-reemployment-in-the-covid-19-economy-empowering-workers-employers-and-states.

Strada Education Network found that over 30 percent of Americans would need more education or training to get the job they really want,[21] a number that would swamp the capacity of the workforce system. Expanding access to ITAs would permit many of those workers to quickly access training resources while preserving limited case management capacity for workers who need more support and guidance.

Consistent with the principle of choice and to support the development of personal agency, Congress and the Biden administration should consider a significant expansion of ITA funding and some reforms to the use of these accounts that would make them even more flexible.[22] First, Congress should pass legislation to increase funding for ITAs and direct decisions for the disbursement of those funds to state governors rather than sending the money directly to local workforce investment boards by formula. Under recovery conditions, governors are better positioned to understand overall state needs and ensure that regional and interstate-state economic clusters suffering from significant staffing shortfalls receive the resources they need to address the labor and skill shortages that will be of greatest benefit.

A second important reform would be to loosen restrictions on training programs that are eligible to receive ITA funding. Expanding options for training in ITAs would allow for a greater range of choices workers could use that best fit their needs and career interests. The accounts could be used to pay for traditional classroom-style learning at a community college, vocational training at a private or for-profit institution, on-the-job training as a stand-alone opportunity, or part of a certified or industry-recognized apprenticeship program.

Finally, restrictions should be relaxed on the types of services ITA resources can be used for. The top barriers to employment normally fall into one of three categories: housing, childcare, and transportation. At a minimum, workers should be able to apply some of their ITA to address nonwork barriers that are preventing the return to work. Individuals who face limited employment opportunities could also use these funds to offset relocation costs within and between states to move to an available job.

Improving the Quality and Accessibility of Labor Market Information

So far, we've examined the importance of noncognitive skills and argued that our workforce system should expand the use of ITAs, a policy vehicle that reinforces the exercise of individual choice and self-direction among workers and assists motivated workers to quickly gain skills they need to advance. To facilitate and support effective choices, however, workers and employers still need timely, accurate, and tailored information about the types of jobs available and the sorts of training and skills required to prepare for them. This is especially true for new or less-experienced workers, who often struggle to align their skills and interests to a regional or local economy. Labor market information (LMI) provides both context and direction for identifying, leveraging, and applying skills to the workforce.

In the past, workforce development professionals and labor market economists have collected LMI for aggregate-level analysis of labor market trends. While understanding these trends is extremely important for policymakers and analysts, LMI should also be made more accessible and approachable for job seekers, students, workers, and employers to inform their touch points with the labor market. Improving the collection, display, and accessibility of LMI would help workers, educators, and employers identify the range of possible opportunities and align their training programs to them.

The advent of powerful new information management and analysis tools has dramatically accelerated innovation in LMI. This has been complemented by large public and private investment in creating systems for making such information useful to Americans. The following examples comprise just a few of the efforts in progress around the country targeted at better integrating LMI and improving understanding among policymakers, workforce practitioners, and workers about the full range of relevant LMI and how to better use it.

- **The US Labor Department Workforce Data Quality Initiative.** The initiative has invested nearly $70 million in competitive grants to help states modernize state LMI and educational data systems.[23] At the height of the early COVID-19 pandemic, Congress provided $1 billion to the states to upgrade administration and technology for the nation's unemployment insurance system.[24] The improvements made through this spending need to be considered as part of broader LMI integration initiatives.

- **The Bill & Melinda Gates Foundation.** The foundation is funding several multistate collaboratives to improve quality and interoperability of LMI systems. The National Association of State Workforce Agencies was a recipient of such funding for its National Labor Exchange data-matching and analysis project that will help the public sector get access to higher-quality and timelier LMI.[25]

- **The US Chamber of Commerce's Jobs and Employment Data Exchange.** The initiative addresses the issues of data standardization across jobs, skills, and credentials and aims to create a trusted repository of employment data from its member-employers nationwide.[26] When the initiative is completed in 2024, the breadth and timeliness of the information will improve strategy and practices for employer-based LMI reporting for government evaluation and social science research.

- **The Alabama Terminal for Linking and Analyzing Statistics.** This data-matching initiative aims to create a federated system of education and labor-agency databases through shared data naming and tagging.[27]

- **Atlanta United Negro College Fund.** The fund is working with Emsi to standardize occupational language around skills with a new tool that identifies regional skills demand and helps workers build skill-based resumes.[28]

- **The Markle Foundation's Skillful Initiative.** This initiative is attempting to serve both state governments and businesses in transitioning job descriptions in the labor marketplace into skill-based nomenclature.[29] Since skills are the DNA of the labor market and the smallest units in labor market analysis, clustering skills together and classifying them into a progression helps precisely and accurately define roles based on their essential components across a range of potential job opportunities.[30]

The databases described above create the foundation for more comprehensive and integrated LMI systems. These data still have to be shaped for use in public-facing tools available to workers and employers that are usually not experts in understanding LMI. The following are some examples of efforts trying to realize those next-step applications.

- **Kentucky's Local Area Workforce Dashboard.** The dashboard gives the public a way to see training and employment services availability, workforce program information, and other labor market information.[31]

- **The Kentucky Center for Statistics.** The center has developed an online tool that offers several methods of exploring Kentucky-based jobs. Using an intuitive computer interface, users can complete a simple knowledge, skills, and abilities self-assessment that can help workers align skills, interests, and education with available jobs.[32]

- **The Alabama College and Career Exploration Tool.** This tool is Alabama's effort in addressing the need for LMI-augmented career-exploration resources and learning and employment records.[33] This will function as a secure online portal for Alabamians that houses their education and employment records in a verified digital resume. It will also feature an Alabama-specific job and education marketplace and an education and career exploration tool based on county-level LMI data.

- **The New Jersey Department of Labor and Workforce Development.** The department has developed an LMI resource on its website, featuring a Microsoft Power BI dashboard of relevant and malleable labor market indicators, an occupation-exploration tool, and a database of employers in the state.[34]

The above examples represent a small sample of the kinds of public and private innovations states and regions are pursuing to improve LMI accessibility and application. This means that one of the most helpful things the federal government can do at this point is serve as an investigator and researcher analyzing and evaluating the technology and practices under development. The US Department of Labor should invest in these monitoring activities to identify promising approaches and technologies and promote cross-fertilization between initiatives rather than prescribing a single, national approach to improving LMI systems.

Federal Waivers for Workforce System Innovation and Redesign

The discussion above relating to the problems in our existing approaches and systems to labor market data points to a much broader, long-term need: full-scale reform of how we organize and administer workforce development and the many overlapping programs that form the patchwork of supports that low-income and disadvantaged workers rely on. The bottom line is this: Just as we apply principles of choice and self-direction to workers in making decisions about training, jobs, and careers, we should apply those same concepts to the organization and administration of the workforce system itself to foster a greater sense of local ownership of workforce challenges and programs.

In 2019, Bishop wrote a report looking at the workforce-program landscape that brings into sharp focus just how complex and inefficient these programs frequently are.[35] The point of Bishop's observations is not so much an indictment of the way workforce programs have evolved over nearly 100 years but to point out how the complexity of the system itself erects barriers to self-efficacy and self-sufficiency. He points out three primary problems:

1. Ad hoc program development with competing interest group constituencies and overlapping bureaucracies,

2. Intrusive federal requirements that have inhibited reform and innovation at the state level, and

3. Administrative complexity arising from steadily multiplying education, workforce, and social services initiatives and programs that leads to wasteful and duplicative systems at the state and local level.

As part of Bishop's work, AEI produced a webpage that illustrates the patchwork of patchworks that is today's workforce system, with each state organizing its programs in somewhat different fashions.[36] The rule of thumb in looking at the individual state system structures is the more boxes at the lower level of the schematic, the more fragmented and duplicative the system is. Figure 3 shows a relatively complex organizational structure in one state (Alabama) and a streamlined and consolidated system in another (Utah).

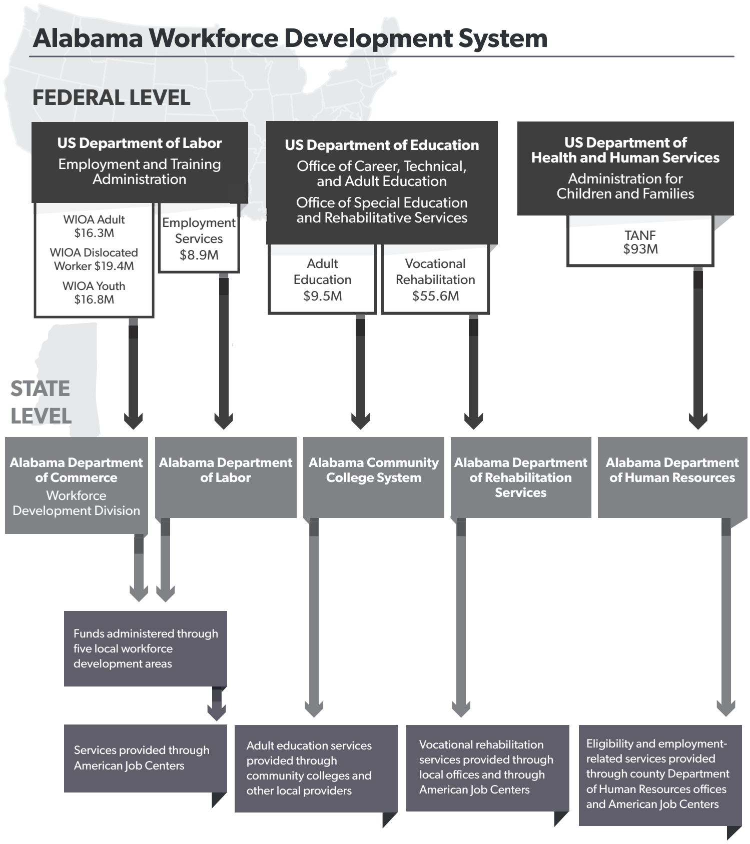
Under a federal system that seeks to devolve power, resources, and administration away from the federal government, we should expect and welcome variation as states adjust programs to their own social and economic realities. But the complexity of many state systems is also the consequence of the way federal laws "silo" funding with a variety of program requirements, desired outcomes, and performance standards and restrictions that inhibit states trying to rationalize and connect programs serving similar and, in some cases, identical customers. These duplicative and competing programs drain resources away from *people in need* and toward *systems* that administer services (e.g., duplicative staffing and offices and competing data management systems). Finally, complex and overlapping structures create a bureaucratic thicket that is confusing and exhausting to navigate for administrators and citizens alike.

The good news is that some states, such as Utah, are on the way to taming the beast of bureaucracy in the workforce and social services and refocusing available resources on disadvantaged citizens' needs. Beginning in 1992 as part of its welfare reform initiative, Utah used demonstration authority under Section 1115 of the Social Security Act to begin reorganizing and consolidating fragmented welfare and human services programs. Over the intervening three decades, the state has gradually corralled 26 federally funded programs into just two agencies: the Department of Workforce Services and the State Board of Education. Under the WIA, the state also received permission from the US Department of Labor to create a single workforce area covering the entire state, helping reduce inefficiency and maintain greater consistency of service provision across the state.[37]

Today, Utah has consolidated workforce development with Medicaid eligibility, housing assistance, refugee resettlement, and vocational rehabilitation programs to create a unique "one-door" system that helps Utahans access the full range of workforce and social and human resources programs they need to move toward self-sufficiency. The consolidated system also conserves resources and shifts more dollars toward services and away from administrative overhead.

The additional virtue of Utah's administrative structure is that it has vastly simplified accounting for federal dollars and the state's reporting relationship with the federal government. Department of Workforce Services case managers and other employees are randomly sampled regularly to keep track of how these workers are spending their time across the various programs. Using this sample, the state then reports its expenditures to the federal government under a cost-allocation formula rather than submitting detailed justifications for individual programs. Further, rather than reporting to multiple federal agencies, Utah's consolidated workforce–human services system works exclusively through the US Department of Health and Human Services, which provides fiscal oversight

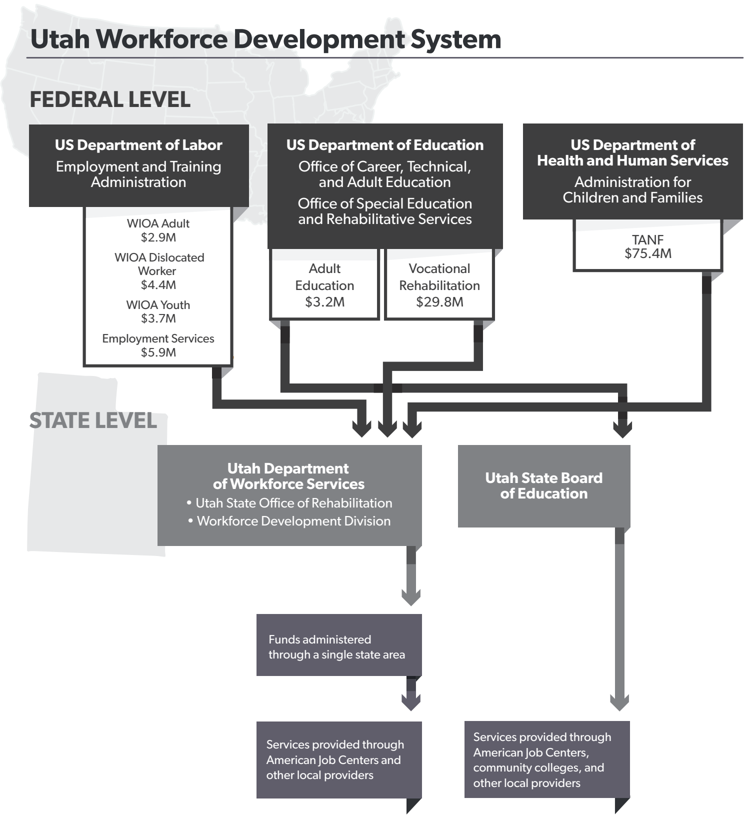
Figure 3. Comparing the Public Workforce Systems of Alabama and Utah



Source: Information for infographics derived from federal and state agency websites from March 2019 to January 2020, alongside Workforce Innovation and Opportunity Act state plans. See also American Enterprise Institute, "Employment and Job-Training Reform: A Framework for Policy and Practice," https://www.aei.org/employment-and-job-training-reform.

and coordination with other federal agencies that contribute to Utah's overall federal funding.

One response to the Utah experience would be to try to impose it on all other states. This would be a mistake. Utah is a relatively small state in terms of population, and what works for Utah might not work elsewhere. Federal social engineering and the overriding of the prerogatives



and interests of state governments are also inconsistent with federalism generally. Rather, the lesson to be drawn from Utah's experience is how it might be leveraged as a model for incentivizing and supporting state innovation itself.

This approach should sound familiar because it is similar to the path followed on welfare reform. Beginning in the 1980s, the federal government encouraged states to exercise Section 1115 waivers to improve welfare programs. States moved to test innovative methods for encouraging and requiring work and work-related activity in exchange for welfare benefits.

After a decade of experimentation, a Republican-led Congress and the Clinton administration recognized the success of these and other efforts and moved to transform the existing Aid to Families with Dependent Children program into the time-limited, work-focused Temporary Assistance to Needy Families (TANF) program. The TANF program continues today as a flexible block grant that allows states to tailor their welfare programs to low-income families' needs and opportunities. Welfare caseloads have dropped dramatically, while incomes have gone up and poverty among children has gone down.[38]

Section 1115 authority, which dates to the Kennedy administration, remains in place and could be directed toward new state-directed efforts to reorganize, consolidate, and integrate workforce development and human services. As part of the next reauthorization of the WIOA, or separately, Congress and the Biden administration might explicitly encourage (not require) states to submit plans to the US Departments of Labor and Health and Human Services for their own service-integration plans to simplify and integrate their workforce, social and human services, and educational programs to better support economic self-sufficiency and harmonize program structures and administration. Since WIOA itself does not fall under Section 1115, additional flexibility from Congress to explicitly incorporate WIOA programs for this demonstration would be extremely helpful. Chapter 8 in this volume by my AEI colleagues Angela Rachidi, Matt Weidinger, and Scott Winship proposes a similar approach but recommends giving states the authority to reorganize and consolidate the balance of the safety net, including Supplemental Nutrition Assistance Program, Supplemental Security Income, TANF, and other safety-net programs.

Conclusion

Intentions and philosophy are not enough when boosting skills and employment among disadvantaged or low-income Americans. Work, and the dignity and self-sufficiency it fosters, is an indispensable good for individuals and society. Our challenge is to overcome mismatches between available workers and available work and ensure that every American has the education, training, and support they need to find, retain, and advance in employment.

For disadvantaged individuals, this means strengthening interventions that address both technical and noncognitive skill deficits, expanding programs that increase personal agency in training and employment, and improving labor market information to help individuals match their interests, skills, and training to employer needs.

Finally, creating a more robust and effective workforce system requires greater innovation in program design, implementation, and administration. While we cannot and should not reinvent the nation's workforce system overnight, multiyear experiments by governors, state legislatures, and WIOA system administrators are needed to develop new strategies to boost program efficacy and outcomes. Our states are laboratories of democracy and economic development, and our policies should leverage and support them as assets to improving opportunity for all Americans.

Acknowledgments

Thank you to Jake Easter for his excellent research support.

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13

Family at the Center: Parental Leave and the Social Contract

ABBY M. McCLOSKEY

In a country mired in debt, with prodigious and unbridled spending from both political parties, the least that citizens should expect in exchange from such spendthrift is a basic level of support for the most vulnerable populations. Yet there's a gaping hole in our safety net.

America has no national policy to ensure that infants can spend the first weeks of life with their family without their parents fearing financial instability or job loss. The lack of paid parental leave has consequences that extend from the health of the baby and the parents (mothers, in particular) to workforce attachment, welfare dependency, and social norms about caretaking.[1] The issue is particularly pressing with the rollback in abortion access because of the Supreme Court decision overturning *Roe v. Wade*,[2] resulting in more babies being born into potentially unstable and financially insecure households that cannot afford to bond. This rollback will be pronounced in pro-life conservative states, underscoring the need for a thoughtful conservative response that supports family flourishing.

Liberals have attempted to use the obvious gap in paid leave benefits upon the birth or adoption of a baby to ram through a freight train of unrelated and expansive paid leave policies at considerable expense to taxpayers and businesses. Conservatives can and should do better, addressing paid parental leave as part of broader fiscal reform and modernizing our social contract to increase financial security for American families, reconcile a generational imbalance in our federal portfolio, and create a more effective and sustainable safety net for the next generation.

A federal policy that makes it easier for parents to invest greater time caring for their newborn children is a pro-life, pro-work, and pro-growth policy that fits squarely within conservative values. At the most basic level, a helpless baby would benefit greatly from having one or both parents around. Yet for reasons discussed below, this is often not possible given financial pressures and lack of job protection—especially for low-income households.

Data show that access to paid parental leave reduces neonatal fatalities and improves health outcomes for mothers and infants. It increases workforce attachment and decreases welfare dependence for mothers by allowing them to stay connected to the labor force. And it sends a strong cultural signal that caretaking is valuable and worth protecting, especially in the crucial time of healing, attachment, and development following birth.

Understandably, there have been conservative concerns that paid leave for new parents would be a slippery slope to other types of government-sponsored leave, crowd out private action, overly burden business, and drive up our already unsustainable levels of federal debt or raise taxes on working Americans. But few workers have access to paid family leave through their employers; birth is a predictable and limited event, unlike other types of medical or caregiving leave; and the slippery-slope logic leaves our most vulnerable population—infants—unprotected, despite the obvious benefits and relative ease of a modest paid parental leave program. Policymakers can structure such a policy in ways to minimize the fiscal and business burden.

The chapter flows as follows: The first section reviews existing paid leave policies and identifies where gaps and unmet needs exist. The second section summarizes the literature on the outcomes of paid leave programs. The third section reviews current congressional proposals for reform. The fourth section articulates a way forward on federal policy for conservatives, anchored by principles of supporting family, opportunity, and growth.

Landscape of Paid Leave Access

Paid leave generally refers to policies that provide pay to workers who need time away from their job after the arrival of a new child (parental leave), to care for an ill or elderly family member (family leave), or for their own personal medical needs that would extend beyond sick leave (medical leave).

While it is often said that the US is the only developed nation without a federal paid leave policy, US policymakers are not starting from scratch in the paid leave space. The private sector has been the leading provider of paid leave in America, and employer provision of paid leave has expanded considerably in the past decade.

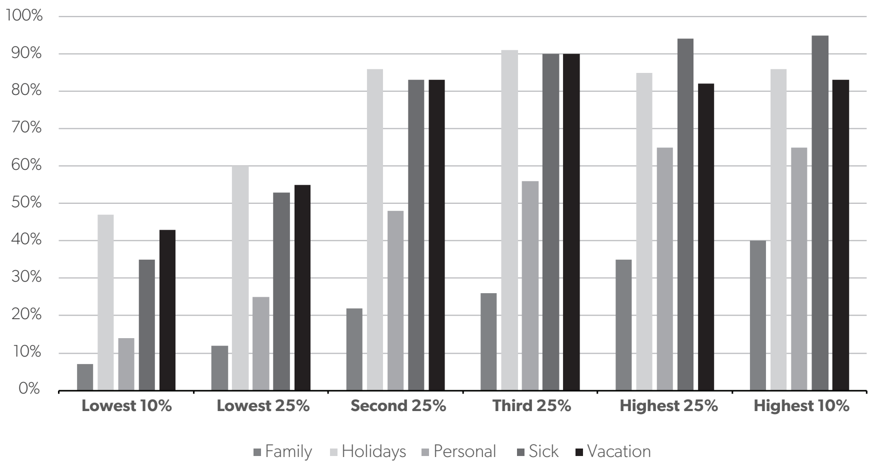
According to the Bureau of Labor Statistics, access to paid family leave (including parental leave) grew from 19 percent to 35 percent between 2011 and 2021 for the highest 25 percent of wage earners. For the lowest 25 percent of wage earners, paid family leave access more than doubled during the same period, from 5 percent to 12 percent, though access still remains notably low.[3] Other types of paid leave are more widely available. In 2021, nearly 90 percent of full-time workers (86 percent) had paid sick leave from their employers,[4] and almost half of full-time employees had access to employer-provided temporary disability insurance or medical leave (Figure 1).[5]

Government provision of paid leave also has expanded in recent years. In 1993, the Family and Medical Leave Act (FMLA) became law, requiring 12 weeks of *unpaid*, job-protected leave for parental, family, and medical reasons. Since then, nine states, the District of Columbia, and many cities have introduced paid family and medical leave programs.[6] Federal workers were given 12 weeks of paid parental leave through provisions in the National Defense Authorization Act for Fiscal Year 2020. Companies extending paid leave benefits to mid- and lower-wage employees began to receive tax credits partially offsetting the cost of these benefits through a provision in the 2017 tax reform legislation. And emergency paid family and medical leave provisions were passed in response to the COVID-19 pandemic in 2020.

Even so, gaps remain in paid leave access. Such gaps are particularly pronounced around paid leave for the birth or adoption of a child and for low-income workers. Paid family leave (including parental leave) remains the least available benefit from employers.[7]

Fewer than one in four civilian workers had access to defined paid family leave in 2021, according to the Bureau of Labor Statistics. While workers often use sick days, vacation days, and other types of personal leave to provide paid time off for family or medical-related events, nearly four in 10 workers report that they received no pay upon taking such leave,

Figure 1. Access to Selected Paid Leave for Civilian Workers, by Wage Category, March 2021



Source: US Bureau of Labor Statistics.

according to Pew Research.[8] This helps explain why, according to one Abt Associates survey, one in four previously working mothers return to work within two weeks of giving birth.[9]

As mentioned above, access to paid leave policies is particularly minimal among low-wage workers, with only 12 percent of workers in the lowest wage quartile having access to paid family leave of any duration from their employers.[10] Without paid leave, many low-income parents go on welfare or take on debt following the birth of a child. A survey by Pew Research reported that, of households with under $30,000 in income that didn't receive full pay during parental leave, 57 percent took on debt and nearly half (48 percent) went on public assistance, suggesting the status quo carries a fiscal burden.[11] Access to *unpaid* leave is also uneven, with 40 percent of workers excluded from FMLA job protection due to exemptions.[12] This means that in addition to not being paid, a low-income new mother may not have job protection following her child's birth.

What We Know About the Economic Impact of Public Paid Leave Programs

A significant body of academic literature highlights the socioeconomic benefits that accrue from increased access to public paid leave benefits. Importantly, the vast majority of this research focuses on the outcomes of paid leave for new mothers and infants, despite supporters of public paid leave programs often conflating such benefits with those of other types of leave, such as medical leave and leave to care for an ill or elderly family member. Internationally, paid maternity leave is the most common and generous paid leave benefit provided, adding to the depth of research on the socioeconomic impact of public paid parental leave programs on new mothers in particular.

Research suggests that access to a public paid parental leave program is associated with a wide range of health benefits, including reduced neonatal deaths, longer durations of breastfeeding, improved maternal healing, and increased attachment and involvement from mothers and fathers extending beyond the period of paid leave.[13] Unsurprisingly, these benefits tend to be most pronounced for low-income women who would have been the least likely to have access to paid leave benefits before. The short-term employment impact of paid parental leave programs is also positive, including higher wages as a derivative of improved labor force attachment, reduced welfare dependency, and improved job continuity for mothers. One study found up to a 20 percent reduction in women leaving their jobs in the year following a child's birth when provided access to paid leave.[14] Another study found that California mothers who took paid parental leave relied less on public assistance, including a 40 percent drop in food stamp usage.[15] This suggests that while such a policy wouldn't pay for itself, cost savings are associated with paid parental leave.

There's some uncertainty about the long-run employment effects of paid parental leave programs. A recent study found that accessing paid leave decreased employment and earnings for new California mothers six to 10 years after childbirth, which could be perceived negatively from an economic perspective, but it also could reflect parents having increased choices for work and spending time with children. Other studies have found that women in Europe have higher labor force participation rates because of access to family-friendly policies, such as paid parental leave.[16] Another study found that over the long term, the availability of paid family leave nearly closed the gap in workforce participation between mothers with young children and women without minor children.[17] This suggests that certain features of paid family leave policies, such as whether job protection is included and the duration of leave, can have different effects on employment for new mothers.[18]

In contrast, the evidence base on the socioeconomic impacts of non-parental family and medical leave is less robust, despite supporters of paid leave often using the benefits of paid leave for new parents to advocate for much broader leave packages. This is largely because the wide range of eligible illnesses and caretaking relationships makes it difficult to track individualized health or labor market outcomes. It's also because the take-up rate for family caregiving in public paid family leave programs has historically been significantly lower than the take-up rate for new parents. Internationally, paid caregiving and medical leave policies are less generous, consistent, and comparable than paid parental leave is. Relatively few Organisation for Economic Co-operation and Development countries provide paid family care leave, especially for adult family members, and it tends to be linked to terminal illness for a spouse or child, isolating its usage for the most extreme medical events and limiting its recurrence and business interruption.[19]

Given policymakers' growing interest in issues such as eldercare and the recent introduction of state-based paid family and medical leave programs, more research will likely emerge that will improve our understanding of the impacts. But this research is still largely in its infancy, especially relative to the evidence base for paid parental leave, suggesting that we know little about how a national paid medical and family leave policy would work in practice and that, therefore, it would be premature to implement a federal policy.[20] As such, policymakers should prioritize paid leave for new parents and pursue it as a stand-alone policy.

Examining the Existing Proposals for Paid Leave Reform

There's considerable public energy across party lines to increase access to paid leave, with one poll finding that 94 percent of Democrats and 74 percent of Republicans support a national paid leave policy.[21]

Recognizing the demand for reform, along with the unmet need for paid leave and benefits that can accrue from paid leave, federal policymakers have put forward multiple proposals. Their approaches generally fit into three categories.

A Universal and Comprehensive Federal Paid Parental, Family, and Medical Leave Program. The most prominent Democrat-led proposal has been the Family and Medical Insurance Leave (FAMILY) Act, which would provide 12 weeks of paid family and medical leave, funded by higher employee payroll taxes. A version of this proposal was included in the Biden administration's Build Back Better plan in 2021. However, Joe Biden's proposal was scaled down to four weeks instead of 12 to reduce costs, and it suggested higher taxes on companies and wealthy individuals to pay for it.

Treating all types of paid leave the same could engender a broad coalition of support. It would allow leave to be accessible for all workers, not just those with children, and it would fit within the existing unpaid leave framework of the FMLA. But such an approach risks significant business interruption, as paid leave can be used for intermittent periods and workers could theoretically access leave every year. Additionally, a universal benefit is likely to crowd out policies that companies already provide, and it goes beyond most of the state-based paid leave offerings and most private policies, which tend to average six weeks in duration.

The FAMILY Act is also expensive, adding a new taxpayer burden upward of $100 billion annually by some estimates. And it is funded by payroll taxes, which are regressive and place a disproportionate burden on low-wage workers relative to other funding streams.[22]

A Paid Parental Leave Policy Paid for by Increased Flexibility of Existing Government Benefits and Tax Credits. Other legislators have tended to focus on parental leave only, funded by parents trading out other government benefits and tax credits. For example, bipartisan legislation introduced in 2019 by Sens. Bill Cassidy (R-LA) and Kyrsten Sinema (D-AZ) and Reps. Elise Stefanik (R-NY) and Colin Allred (D-TX) would have allowed parents to advance $5,000 of future child tax credit (CTC) payments at the birth of a new child. This has a small price tag and increasing flexibility for people to access existing government benefits when they need them the most. This kind of program could also be compulsory, so people would not be required to pay taxes to a new system from which they may never benefit. It also would accrue to working and stay-at-home parents alike.

However, as an inescapable aspect of a broad credit, there is no guarantee the money would be spent on children at all. Further, little to no research suggests that additional family supports outside of a formal paid leave benefit have led to substantially more families taking time away from work after the birth of a new child. The "advance CTC" approach could fail to accrue more benefits to families for the purpose of paid parental leave.

This approach would also do little to address the relative imbalance of federal safety-net dollars against children, with an already outsize share of resources increasingly directed to adults over age 65. This lopsided generational spending, in addition to the debt burden inherited by future generations to pay for it, is unsustainable and economically inefficient. It's well-documented that spending early in the life cycle has the greatest return on investment, as research by James Heckman and Dimitriy Masterov has shown.[23]

Another example of repurposing existing funds for paid parental leave comes from the Child Rearing and Development Leave Empowerment Act, sponsored by Sens. Joni Ernst (R-IA) and Mike Lee (R-UT), which would allow a parent to pull forward Social Security benefits during their child's first year of life. Similar to increasing flexibility around CTC payments, this opt-in system would be largely budget neutral over the long term. However, the Social Security program already faces substantial financial challenges of its own, and opponents argue that there's something unfair about making women choose between taking benefits after the birth of a child and receiving support during old age when the need might exist for both. A litmus test for entitlement reform should be that it strengthens or at least does not make worse the solvency of existing programs and that it does not reduce *need-based* benefits.

Encouraging the Private Sector to Provide Paid Leave Policies Through Tax Incentives. Other legislators have focused on expanding the private sector's offering of paid leave. For example, bipartisan legislation by Sens. Deb Fischer (R-NE) and Angus King (I-ME) included in the 2017 tax legislation provided tax credits for companies offering paid family leave. Employers could receive up to a 25 percent replacement for providing up to 12 weeks of paid family leave. To minimize the risk of rewarding companies that already provide paid leave, the policy was targeted to companies that extended paid leave to employees who did not previously have access to this benefit and were making under $72,000 per year, the least likely to have paid leave benefits. However, it is unclear to what extent this has increased access to leave-taking, as companies would still be footing a substantial portion of the bill.

Alternatively, companies simply could be mandated to provide some level of paid leave. Public polling on paid leave indicates that this is what most Americans support—companies, not the government, footing the bill for paid leave.[24] This would come at zero cost to taxpayers, which, like raising the minimum wage, may make it appealing for policymakers.

But there are other large potential costs, such as significant business costs to cover absent employees, which would be most burdensome for small businesses that lack a broad workforce to smooth out costs, and higher consumer costs if prices rise to cover increased business costs. These mandates could also lead to discrimination against workers expected to use the policy, particularly women in their childbearing years, which could reduce labor force attachment for women. For these reasons, employer mandates receive little support among scholars and policymakers.

A Way Forward

The wide range of paid leave reform proposals put forward in recent years suggests an energy around paid leave reform in the near future. At a minimum, this should be a reason for conservatives to engage to help shape what reform looks like instead of being on the sidelines of the conversation.

But a key element has been missing from the previous attempts to close the gaps in paid parental leave outlined earlier. That's situating paid parental leave upon the birth of a child as integral to our social contract, embodied in a sustainable and comprehensive system of benefits, instead of a stand-alone benefit or perk. Viewed in this way, paid parental leave is not just one more thing to be taken on by Washington, but a key component to modernizing our social contract for the 21st century and making it more effective and sustainable for the next generation.

Conservative policymakers have a fresh opportunity to move sensible paid leave reform forward in the US. The foundation should be a federal baseline of support for new parents—available to all workers—covering at a minimum six to eight weeks of lost wages following childbirth or adoption, before which a woman likely has not recovered from birth nor would an infant be accepted at a childcare center. This is where the largest gap in private-sector benefits exists and where the evidence is strongest on economic and health benefits. But it should be treated as part of a larger overhaul of existing benefits, including old-age and health care entitlements, instead of simply rearranging the deck chairs on what we already spend on children, already a rapidly shrinking part of the federal budget.

In practice, Congress could design a paid parental leave policy in multiple ways. As discussed earlier,[25] providing families the option to front-load CTC payments is good policy and should be done irrespective of whether such flexibility is officially considered paid leave. Ideally, instead of cutting CTC benefits for those families later in the child's life—when there are still innumerable child-related expenses—the funding should come from a broader overhaul in our spending portfolio and not from the limited and declining relative sum earmarked for children.

If paid leave benefits were provided through Social Security, ideally this would be done as a broader overhaul of entitlement benefits instead of simply added onto the existing bankrupt system or making a parent trade out retirement benefits to stay home with their infant. As I proposed in a *National Affairs* essay titled "Beyond Growth,"[26] means-testing Social Security benefits would help restore fiscal balance, and a sliver of the savings could be used to offer parental leave benefits. In Chapter 6 in this volume, Andrew G. Biggs proposes substantial reforms to the Social Security program to address its solvency problems, a portion of which could be used to fund six to eight weeks of parental leave.

Without change, future generations will have less economic opportunity than their parents did because of the debt and bankruptcy of existing programs. Parents are currently asking their children to pay for their benefits—and opposing any small changes to them—with the full knowledge that such programs will not exist for their children. Meanwhile, parents watch their children struggle to balance work and family life in an increasingly competitive economy. As Biggs proposes, an overhaul of Social Security, such as means-testing benefits, would restore their fiscal solvency and modernize benefits for today's labor force.

Another option is to create a stand-alone paid parental leave program at the federal level that is not tied to reducing a parent's benefits elsewhere. Such a plan could also take the form of Sen. Mitt Romney's (R-UT) proposal to allow pregnant workers to receive an additional year of CTC payment, without drawing from future CTC benefits. The Trump administration proposed a six-week paid parental leave program, funded by payroll taxes and reduction of fraud and waste in the unemployment insurance system. The AEI-Brookings Working Group on Paid Family Leave proposed an eight-week federal paid parental leave benefit, funded by a combination of payroll taxes and repurposed government spending.[27] Or a paid leave policy could simply be a new lump-sum benefit—an "infant bonding birthright"—that parents could register to receive at the hospital following the birth of their child while they submit paperwork for their child's Social Security card and birth certificate.

In all these approaches, the cost is minimal relative to other federal programs. My back-of-the-envelope calculation for a lump-sum benefit, equivalent to six weeks of full-time minimum wage work (which would be $1,740 per parent), with 3.6 million babies born in the US, is that it would cost roughly $6 billion if the take-up rate were 100 percent, a standard never met in benefit programs. If both parents were eligible, the cost would be somewhere less than double that (almost certainly not reaching $10 billion), given the one-third of households headed by single parents.

More formal cost estimates for a paid parental leave program conducted by the AEI-Brookings Working Group on Paid Family Leave found that a six- to eight-week paid parental leave program with 70 percent wage replacement would cost between $3.5 billion and $11 billion annually, depending on participation. For perspective, this is less than 0.5 percent of the cost of federal entitlements each year.[28]

Importantly for fiscal hawks, a natural safeguard prevents paid parental leave from becoming a spiraling new entitlement: Birth is by nature a limited occurrence, happening less than twice in a person's life on average. Further, birth is a well-documented event and thus is not subject to widespread fraud or subjective medical diagnoses.

Regardless of the policy pathway taken, remaining questions need to be answered. The most pressing challenge is the 40 percent of Americans who currently lack job protection following the birth or adoption of a child, who are arguably some of the most disadvantaged workers. Resources to provide pay for periods of leave—whether from advance CTC payments, Social Security benefits, or a newly created benefit—are helpful. But the effects of these benefits would be most helpful if accompanied by job protection and a broader reshaping of social norms wherein American parents do not feel discouraged against taking leave following the birth of a child.

Without job protections and a changing norm around leave-taking, even with increased resources, workers may still hesitate to take advantage of leave. It is worth exploring an extension of the FMLA to cover these excluded workers for a shorter duration and more limited use, perhaps six weeks following birth, which is a materially different burden than small businesses providing the full three months of leave for a broad range of uses. A deeper cultural question about the value of family and life must emanate locally, from the bottom up, in accompaniment with any successful federal policy. Companies, churches, and communities must work to establish the norm that parents and children should spend the first weeks of life together to complement federal policy change.[29]

Conclusion

Conservatives have the opportunity to lead on paid parental leave as part of a broader package to shore up the country's finances and maintain a strong social contract for the 21st century. For social conservatives, paid parental leave has well-documented pro-life and pro-family benefits, including reduced neonatal fatalities and the protection of and investment in families, which are the foundation of social capital and society. This is especially crucial in a post-*Roe* landscape. For those concerned about America's growth trajectory, significant pro-work, pro-growth benefits accrue from providing parents with more choices for blending work and family, which is a much-needed priority given our international lagging labor force participation and aging workforce, as workforce attachment is the foundation of upward mobility. And for those concerned about our rapidly deteriorating budgetary outlook, even a generous paid parental leave policy is far from a budget leviathan. It can be paid for, at least largely, out of existing spending, and it could be a needed salve to accompany necessary yet uncomfortable fiscal reforms at a relatively small cost.

It should be the birthright of all American children to spend their first weeks of life with their mother and father without their parents experiencing unnecessary financial or employment-related stress. This is where America's social contract begins.

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14

Mending Our Social Fabric and Strengthening Civil Society

HOWARD HUSOCK

The idea that government can do something to improve American civil society is in many ways a contradiction in terms.

The growth of the US government's reach has crowded out many of the arrangements that cooperating private citizens have made to take care of those in need and work together to build and maintain healthy communities. As Nathan Glazer put it in *The Limits of Social Policy*:

> The simple reality [is] that every piece of social policy substitutes for some traditional arrangement, whether good or bad, a new arrangement in which public authorities take over, at least in part, the role of the family, of the ethnic or neighborhood group, of voluntary associations.[1]

Despite the apparent widening scope of civil society, its actual force seems to have diminished. In other words, Facebook or national advocacy groups such as AARP may link us, but they're not as impactful as are local organizations dedicated to specific purposes, such as school improvement groups and Little League.

As the Joint Economic Committee's Social Capital Project has concluded, "Associational life and institutional health are in decline across a range of indicators." Further, "Our institutions of civil society have weakened and withered, and our relationships have become more circumscribed."[2] Citing Current Population Survey data, the Social Capital Project also reported in 2019 that the number of Americans who do favors for their neighbors fell from 40 percent in 2008 to just over 20 percent in 2017.[3] This is much more than a matter of providing assistance; as the sociologist Robert Nisbet wrote in his classic book *The*

Quest for Community, the degradation of relationships to others and to local institutions leads to isolation and alienation.

> There are countless persons today for whom the massive changes of the past century have meant a dislocation of the contexts of function: the extended family, neighborhood, apprenticeship, social class, and parish. Historically, these relationships had both depth and inclusiveness in individual life because they themselves had functional significance; because, however informally, they had a significant relationship to that distribution of function and authority which is a society's organization. *And because they had this, they had meaning in the lives of individuals.*[4] (Emphasis added.)

As we see Americans struggle with a loss of meaning and purpose in their lives—and succumbing, for instance, to drug addiction—this is no small matter.

Yet faced with the reality of a sprawling federal government that touches every corner of the country and intrudes on the functioning of civil society, nostalgia for the sort of America Alexis de Tocqueville found—one where "Americans of all ages, all conditions, all minds constantly unite"[5]—is not an adequate response. "Programitis" of the sort that plagues Washington, DC, and legislators is not an answer either.

Indeed, the George W. Bush administration's efforts to call civil society into action—its Faith-Based and Community Initiative—arguably drew formerly independent groups into an embrace with government.[6] Responding to the emergence of every novel symptom of social malaise with a new federal program will miss the underlying problems linked to the vacuum of community life and healthy family ties.

We would be remiss not to seek ways to refine existing public policies and regulations in such ways that help, rather than hinder, self-organized groups. These groups help establish healthy social norms and encourage citizen involvement, both because of what they can accomplish and, indeed, because such cooperation can be considered a worthwhile goal per se. Anyone who has been involved in churches, synagogues, or mosques; 4-H; Boy and Girl Scouts;

parent-teacher organizations; or local historical societies and park conservancies can likely attest.

Conservatives should be guided by the principle that civil society is a per se good—and that deferring to it and the associational life it engenders has inherent value beyond the utilitarian. Progressives like to argue that the use of carbon-based power sources leads to a "social cost of carbon" that is not measured by market price alone.[7] Similarly, conservatives can argue that a diminished civil society creates unmeasurable costs—the subtle externality of diminished social capital and its concomitant loss of trust and community life.

Of course, we can look to measures such as improved mental and physical health, levels of crime, and drug use. But focusing on civil society can address these without merely targeting them; their improvement should be a collateral benefit, not the result of programs staffed by professional social workers. It can be seen as the approach of the Zen archer—hitting the target without aiming for it.

Five Strategies to Encourage Civil Society

This chapter proposes five types of efforts at the federal level to encourage—but not prescribe—a healthier local social fabric and civil society as a whole. It aims to encourage the traditions of civil society participation and charitable giving so they are accessible to all Americans, not just those who live in high-income ZIP codes. It also aims to resist the temptations of programitis while expanding on what works and phasing out what has outlived its use. Specifically, I propose the following.

Expand the Charitable Tax Incentive. Because of the 2017 tax code revisions and the increased standard deduction, a decreasing number of Americans qualify for the charitable tax deduction, which requires taxpayers to itemize their returns. To expand the tax incentive to make charitable contributions, the incentive should be available as either a deduction or tax credit, even to those who do not itemize their returns.

Maintain the Charitable Deduction's Universality. Conservatives should also push to retain the tax cap on deductions for state and local taxes (SALT). It may restrain high state and local government spending by ending the tax subsidy, which mitigates its impact on taxpayers. At the same time, it leaves charitable giving as a major potential means to reduce taxes for taxpayers in high-tax states and helps reduce the federal deficit and debt. It could, in other words, indirectly encourage charitable giving.

As the system is currently structured, any donation to a legally designated 501(c)(3) nonprofit organization qualifies a taxpayer for the charitable deduction. But progressives continue to push for limits on which types of donations qualify, proposing to restrict tax-incentivized giving to efforts viewed as reducing economic inequality, for instance. Conservatives should defend the current unrestricted deduction but should not shrink from considering its outright end rather than accept limitations. This is, to be sure, not a first choice—but in the face of a potential assault on an unrestricted charitable deduction, it should not be ruled out.

Adjust Current Federal Programs That Affect Civil Society. Any number of federal programs affect civil society directly or indirectly. Modest adjustments in how they are administered can limit their prescriptiveness and centralization in ways that encourage voluntarism and localism. As the Social Capital Project has argued regarding goals for public policy:

> First, it would seek to leave space for mediating institutions, removing policies and barriers that undermine them. Second, it should attempt, wherever possible and appropriate, to utilize mediating institutions for the delivery of public services and the realization of social goals. It should actively seeks [*sic*] to incorporate civil society into public policy, not circumvent it.[8]

This chapter examines the practices of the Corporation for National and Community Service (CNCS) and the Corporation for Public Broadcasting (CPB).

Use the March of Dimes Precedent. On rare occasions linked to crises, the government should consider turning to civil society for financial support for uncontroversial national causes. Precedents include selling liberty bonds during World War II and creating March of Dimes to raise funds for polio treatment and vaccine research—both spearheaded by Washington.

The popularity of such historic efforts suggests that their precedent might have been applied during the COVID-19 pandemic. This is not to say that Operation Warp Speed, which led to the development of the COVID-19 vaccine, was not a success—only that it might have been accompanied by less public skepticism.

Phase Out Programs That Have Outlived Their Use. New federal social spending programs tend to develop in response to crises. When there is reason to conclude that a crisis has waned, it can be time to consider phasing out such programs—both because progress has been made and because citizen cooperation in dealing with social needs has value that goes beyond the utilitarian. One example includes programs aimed at reducing teen pregnancy, which has fallen in incidence and been the focus of a national drive led by a civil society, nonprofit organization called Power to Decide.[9]

Charity and the Tax Code: Expand the Charitable Tax Incentive

A clear first response might be to enable an increase in charitable support (the lifeblood of many civil society groups that do not rely on federal government contracts).

Because of the 2017 Tax Cuts and Jobs Act (TCJA), the overwhelming majority of American taxpayers can avail themselves of the so-called standard deduction, linked to such factors as their number of dependents. Thus, close to 90 percent of taxpayers do not itemize their tax returns—and consequently have no access to specific taxable income deductions, including the one for charitable giving.[10] Those who do still itemize are overwhelmingly high-income earners, meaning the high-income population has a disproportionate incentive to give. Charitable giving should be accessible and incentivized for all communities and earners in the United States, and it is worth examining how our tax code could be adjusted.

An above-the-line charitable tax deduction or even a dollar-for-dollar tax credit for all taxpayers (including non-itemizers) would be a conservative response to those who argue that such indirect support is little more than a tax expenditure. In other words, this would repurpose what is fundamentally not the government's money—based on the implicit understanding that government does not have an inherent first call on private funds and that Americans retain funds to direct at their own discretion only at the government's sufferance.

Further, the fact that government direction of social spending is not inherently fairer nor more effective underlies this argument. Private charitable giving enables individual self-expression and investments in unpopular but worthwhile ideas—whether related to science, culture, social services, or public policy. It is a hallmark of American life and remains why Americans are some of the most generous givers in the world.[11] A tax code that effectively makes charitable giving a luxury denies the large majority of taxpayers an incentive that is provided to the affluent.

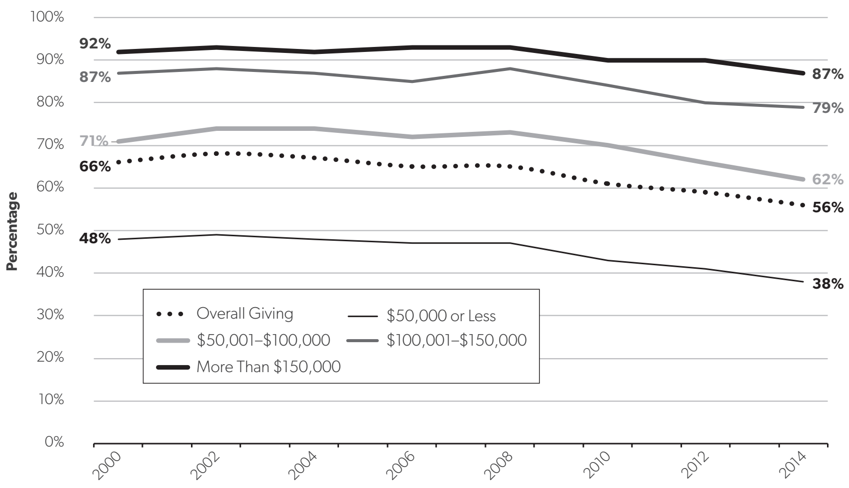
Figures 1 and 2 track the percentage of households giving to charity by income, itemizing status, and cause from 2000 to 2014. The drop has been particularly pronounced among non-itemizers, those giving to religious causes, and lower-income Americans, although the trend is also apparent for itemizers, those giving to secular causes, and higher-income Americans. While total individual giving has increased over time, its *share* of total giving has decreased by 18 percentage points, from 83 percent in 1978 to 68 percent in 2018.

As the Social Capital Project noted in its 2019 report *Reforming the Charitable Deduction*, "While total giving has increased, the *percent* of Americans giving has decreased, from 66 percent in 2000 to 56 percent in 2014. In other words, growing donations are coming from a shrinking share of the population."[12] (Emphasis in original.)

Revising the tax code to include a universally available above-the-line charitable deduction would have only modest revenue effects—but could reverse the decline in individual charitable giving and encourage giving among lower-income earners.

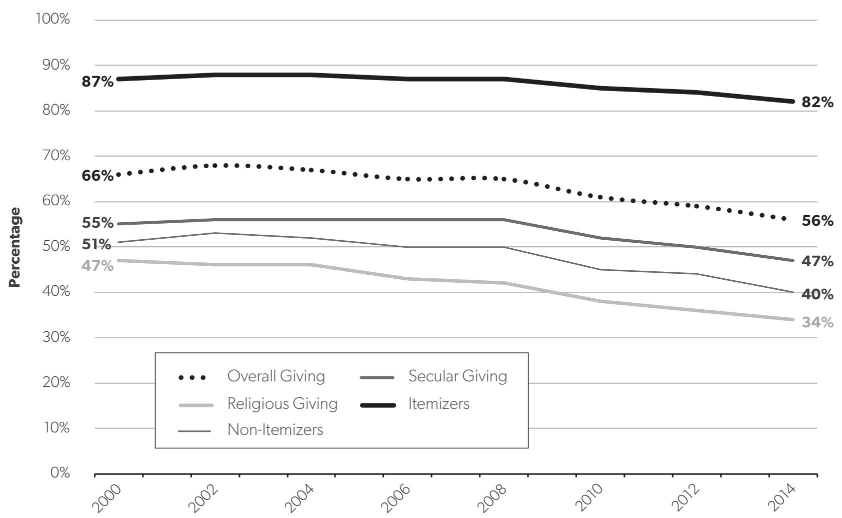
A 2018 American Enterprise Institute study by tax economists Alex Brill and Derrick Choe estimated that replacing the current charitable deduction with an above-the-line deduction would increase giving by $21.5 billion in 2018 and reduce revenue by $25.8 billion.[13] However, the revenue

Figure 1. Percentage of Households Giving to Charity by Income, 2000–14



Source: Nicole Wallace and Ben Myers, "In Search of . . . America's Missing Donors," *Chronicle of Philanthropy,* June 5, 2018, https://www.philanthropy.com/article/in-search-of-americas-missing-donors.

Figure 2. Percentage of Households Giving to Charity by Itemizing Status and Cause, 2000–14



Note: Estimates of itemizers include those who gave but did not claim the deduction or did not know if they claimed the deduction.
Source: Nicole Wallace and Ben Myers, "In Search of . . . America's Missing Donors," *Chronicle of Philanthropy*, June 5, 2018, https://www.philanthropy.com/article/in-search-of-americas-missing-donors.

effects of extending the reach of the charitable deduction to lower-income taxpayers should not be our major consideration. Rather, extending the incentive to give to charity to the less affluent should be seen as an end in itself, a tool to help revitalize civil society and neighborhood life in lower-income communities.

The same study estimated that replacing the charitable deduction with a 25 percent nonrefundable tax credit would have a greater impact, increasing giving by $23.3 billion in 2018 and reducing revenue by $31.1 billion. Moreover, the report found that the credit would mostly increase the number of households choosing to make charitable contributions.[14]

Such an effort should be viewed in much more than financial terms. By incentivizing charitable giving among taxpayers of more modest means, such a tax law change could effectively target civil society organizations in lower-income neighborhoods.

As I found in my American Enterprise Institute report *Is Civil Society Becoming a Luxury Good?*, far more local not-for-profit groups can be found in higher-income Census tracts and ZIP codes than in lower-income ones.[15] Thus, a tax incentive that targets lower-income taxpayers would not only provide support for the churches and YMCAs in lower-income areas but potentially support new organizations through which associational life would expand and improve. As stated in the report: "Civil society's role in creating social trust makes it important to identify ways to reinforce and rebuild civil society in lower-income communities."[16] In other words, supporting civil society must be viewed in more than utilitarian terms. The sheer dimension of associating—"uniting," as per Tocqueville—must be understood as a benefit in itself.

The SALT Cap: Maintain the Charitable Deduction's Universality

That an expanded tax incentive for charitable giving reduces federal tax revenues should reinforce conservative support for the existing $10,000 cap on the tax deduction for SALT. This SALT cap, in place since the 2017 tax law changes, increases federal tax revenue by some $80 billion annually—no small amount.[17] Yet the SALT cap is also worth retaining for its implicit incentive for charitable giving.

The charitable tax deduction is one of the few remaining ways for affluent taxpayers in high-tax, blue states such as California and New York to reduce their taxable incomes. Such donors have historically been major sources of charitable giving, which has continued to be the case in the years following the enactment of the 2017 TCJA.

From the point of view of affluent taxpayers in high-tax states, the charitable deduction is a virtually unlimited means to reduce one's adjusted gross income; up to 50 percent of one's annual income can be deducted. The increasingly popular individual charitable accounts known as donor-advised funds (DAFs) provide a vehicle to reduce tax liability in high-earning years (contributions are fully deductible) and then disburse funds in subsequent lower-earning or retirement years.

Conservatives, indeed, should oppose efforts to require rapid payouts from DAFs, lest they discourage contributions and reduce the ability to give during times of crisis (such as the coronavirus pandemic). Such contributions should not be viewed as a means of tax avoidance. Rather, these funds are directed to organizations other than the government because donors believe such organizations will serve as better stewards—or, at the least, use funds in ways that the government overlooks or cannot execute well.

This is not to say that broader changes in tax law will obviate the importance of the SALT cap for potential charitable giving. Higher marginal tax rates, per se, have been shown by themselves to lead to greater charitable giving by effectively increasing the tax reduction value of the charitable deduction. But relatively modest top marginal income tax rates combined with the SALT deduction cap create an even larger incentive for high-income taxpayers to avail themselves of the charitable deduction.

Nor is it to say that the charitable tax deduction should always be defended. A school of left-liberal critics of American charity asserts that the deduction is both regressive (by giving the affluent greater tax relief) and supports charitable giving, which itself fails to benefit the poor.

Stanford political scientist Rob Reich leads the way on such criticism, as Inside Philanthropy has observed:

> Reich says that it's far from clear what American taxpayers are really getting in return for the tens of billions that the U.S.

> Treasury loses annually from the charitable deduction. What we do know, he says, is that the "distribution of charitable giving *does not* predominantly benefit the poor."[18]

Reich documents this familiar point in detail but takes it one step further by noting that wealthy taxpayers who take the deduction give the least to help those at the bottom: "The higher up the income ladder, the less likely donors are to direct their giving to the poor."[19]

Reich profoundly misunderstands the value of charitably funded organizations in supporting cultural, educational, and medical institutions, which benefit society broadly. But should his views gain acceptance—and lead to strictures on which types of donations qualify for the charitable deduction—conservatives should not shrink from withdrawing support for the charitable tax deduction altogether, rather than accepting the view that the deduction reflects a government-first claim on the funds and a right to decide where they should be directed. To be sure, this would be a radical response in defense of what might be termed philanthropic freedom.

The core concern is this: If the deduction were reserved for select purposes, such regulation might prioritize those purposes and crowd out other forms of charitable giving. Rather than acquiesce in such a dramatic narrowing of the charitable deduction, it might be better to forgo it.

Reforming Existing Programs: Adjust Current Federal Programs That Affect Civil Society

Federal social programs, by their very nature, affect civil society by lessening the importance of civic institutions. Many government social programs will likely continue for the near future. In that context, it is worth considering ways to minimize harm they might cause or reform them in ways that might benefit civil society. Indeed, as programs are renewed, Congress should view them through the prism of civil society.

Here are two examples—offered to be illustrative, not exhaustive—of programs that could be made less prescriptive and therefore benefit civil society.

AmeriCorps. The national service program known as AmeriCorps, administered by the CNCS, aims to support, through an annual stipend and prospective college tuition support, thousands of volunteers, age 18–24, working for nonprofit civil society groups. The CNCS, which describes itself as the only federal agency for community service and volunteerism, has supported 270,000 members, disburses $800 million at the federal and state levels, and partners with 2,000 organizations. (CNCS also oversees the Peace Corps and the Volunteers in Service to America, which targets senior citizens.)[20]

Crucially, however, AmeriCorps does not let those paid volunteers choose which type of group they will help. Rather, groups are chosen based on six priorities: education, economic opportunity, disaster relief, economic stewardship, healthy futures (for the elderly), and veteran services. The way AmeriCorps chooses organizations can be overly bureaucratic, focused on "educational opportunity and economic mobility for communities experiencing persistent unemployment or underemployment, and students experiencing homelessness or those in foster care" or "evidence-based interventions on the AmeriCorps Evidence Exchange that are assessed as having Moderate or Strong evidence."[21]

Many organizations and communities benefit from the work of AmeriCorps members. But it is well worth questioning why these so-called paid volunteers should not be permitted to choose to assist any IRS-approved 501(c)(3) nonprofit organization. As matters stand, the national and state AmeriCorps programs are implicitly choosing what sorts of organizations will qualify for what amounts to free labor. That, after all, is what true volunteers do in American civil society.

In the current system, CNCS is effectively substituting for Congress by choosing to direct funds with such specificity. This amounts to unelected bureaucrats making the sort of spending and values choices that should be reserved for representative government. The nation simply cannot know what it is missing by limiting these volunteers to select causes and purposes.

Far better for the volunteers, through a voucher system, to make their own choices—leading to the prospect that ideas and organizations not approved in Washington or state capitals might improve communities. Such an approach envisions a first-come-first-serve method to apportion the AmeriCorps fellowships. Those selected, rather than being screened based on their expressed interests and the extent to which they align with CNCS priorities, would then be free to bring their labor to any bona fide nonprofit.

This approach would free civil society from the strictures of government while still allowing it to take advantage of federal financial support, which is, in all likelihood, destined to continue to win congressional approval. By screening volunteer applications, AmeriCorps is again, de facto, choosing which portions of civil society to subsidize. Not doing so would release civil society—at least those organizations that do not already contract with government to provide services—from the chains of Washington.

CPB. Federal financial support for public broadcasting has long been a controversial issue for conservatives, who believe public "media," as it's now called, leans left in its story selection and story treatment. But public broadcasting is undoubtedly here to stay. The $445 million appropriation for the CPB—which is, in turn, distributed to public television and radio—survived the Trump administration's effort to reduce it to zero; a Republican Congress refused to go along (choosing to renew the funding).[22] But public television and radio directly touch civil society across the US, through a network of more than 1,500 local stations that are charged with serving their communities—and must, by statute, raise local matching funds to receive their "community service grant" financial lifeblood.[23]

In this context, it is worth considering whether the public broadcasting funding formula can be altered in such a way as to help civil society. Such a question arises in the context of a significant need for a mission with which public broadcasting local stations are charged: local news coverage. As the CPB ombudsman has noted in this regard:

> Some 2,100 newspapers have closed in the past 15 years—many in economically struggling communities. Private-equity firms have snapped up others and stripped away their newsgathering operations. Thousands of journalists have been laid off. And the advertising-supported business model for news has been decimated by the ad-intensive internet behemoths Google and Facebook.[24]

Local communities find themselves in "news deserts," which threaten local democracy and the health of communities. Some commercial online news sources have begun to develop, but many communities are too small to support such alternatives. This raises the possibility that public broadcasting funds might be distributed in a manner that more directly allows local stations to retain federal funds and direct them toward local newsgathering—augmented and market-tested by funds from local donors. Indeed, 57 percent of overall local-station revenues come from individuals and private businesses.[25]

At stake is $315 million, which is distributed in the form of community service grants. Although these funds are directed to local stations, they come with strings. Some $22.8 million directed to local public radio stations, for instance, must, by statute, be used for national programming—such as that of NPR. So, too, are local stations required to pay for PBS television programming.[26] Put another way, federal funds for "community service" are redirected to Washington—at a time when local communities need local journalism.

Notably, much national programming can now be accessed via smartphones—obviating the need for local, over-the-air broadcast channels. This, in turn, suggests that local television and radio license holders, which currently pay for the right to broadcast the likes of *Downton Abbey* and *PBS NewsHour*, might better husband their resources for local content. And even though the range of media types—visual and audio—have merged online, CPB funding, based on 1967 legislation, continues to direct a far larger appropriation ($74 million) to television,[27] even as public radio podcasting and online visuals have become common and popular.

Put broadly, a civil society–oriented approach to public broadcasting would focus on ensuring that more local journalistic content is produced by the system—and continue to require that any federal funds be matched by local donations, a key civil society test. More specifically, it is time to end required local support for NPR and PBS, which should face their own market test. As a nonprofit, NPR itself has an inherent advantage in raising funds, as do many PBS producer stations. (PBS itself functions mainly as a program distributor and funder of productions.)

The animating idea of public broadcasting when it began during the Johnson administration was that of a market failure in broadcast—a so-called vast wasteland that government funding could improve by supporting programming based on "creative risk." The landscape has changed dramatically in the intervening years, as production services such as Amazon, Apple, HBO, and Netflix invest in new and varied productions that are critically well received. If there is a market failure today that is relevant to public broadcasting, it is that of local journalism. Major stations in cities including Boston, Dallas, Los Angeles, and New York have already moved to specialized local journalism—and should, indeed, see their formula grants reduced so that funds can be diverted to smaller communities that find themselves in news deserts.

A healthy civil society relies on information about local government and discussion and debate about local issues. Public media can contribute to civil society health—but not by sending local funds back to Washington.

Civil Society Awareness in Policymaking: Use the March of Dimes Precedent and Phase Out Programs That Have Outlived Their Use

The ideas above are based on programs and policies with which I happen to be familiar. Implicit, however, is a broader vision: that policy thinkers cease to default to Washington-centric approaches as new challenges arise and current ones persist. How might consideration of civil society have played a role in the response to the COVID-19 pandemic? There may be moments of national crisis in which the government actually can partner in a non-harmful way with civil society. Franklin Roosevelt arguably did so through the March of Dimes, encouraging widespread citizen support for the development of a polio vaccine in part through hundreds of local chapters.

What if the country had done something similar with the COVID-19 vaccine? Would there have been a higher level of citizen trust and less vaccine hesitancy? A fundraising campaign, albeit providing modest amounts of resources, might nonetheless reduce the psychological distance between research and rollout—and could have provided a means for Americans to feel invested in a dramatically positive way. Instead, Operation Warp Speed was a black box to most citizens—many of whom became vaccine skeptics.

Similarly, policymakers should acknowledge the capacity—and intrinsic value—of civil society as they consider new appropriations for existing programs. I would suggest that some federal social programs may be phased out and returned to civil society—based on changed circumstances. For instance, teen pregnancy in the US has dropped dramatically over the past three decades. Should the federal government continue to direct grants to organizations dedicated to reducing it? Mentoring programs have proliferated. Is federal support for them necessary? The argument for such phase-out must rely on the idea that there is a loss associated with replacing civil society with government intervention.

Teen pregnancy prevention is especially notable. The decline in teen pregnancy has been sharp and dramatic, falling from more than 60 per 1,000 female teens in 1990 to just over 17 per 1,000 in 2018. Yet funding for public programs has remained consistent or risen during this period.[28] Indeed, since 2010, the budgets for the four types of teen pregnancy programs (including evaluation components) have, according to the Congressional Research Service, increased from $235 million to $285 million, even as teen pregnancy has sharply fallen.[29] To be sure, rolling back any program that addresses a widely acknowledged social problem would not be easy. But that should not mean that all social programs continue without end.

Conclusion

Conservative policymakers should be guided by the principle that civil society is a per se good—and that deferring to it and the associational life it engenders has inherent value beyond the utilitarian. I am somewhat skeptical that the government can do much about civil society except through the charitable tax incentive. However, some government programs can be adjusted to limit damage to civil society and perhaps help it, and we should not shrink from phasing out some programs and turning them back to civil society. Washington policymakers should resist the temptation of programitis that has plagued much of the civil society initiatives of the past 30 years, often crowding out nongovernment actors.

Government must recognize that no amount of policy experimentation can replace citizens dedicated to their own communities. Government's long-running encroachment on civil society cannot be easily reversed—but incremental reversals would still matter in terms of their immediate effect and the signal that they send. As government encroaches on and crowds out civil society, community is harmed, and collateral damage results.

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TAX AND MONETARY POLICY REFORM

15

A Simpler, More Responsible, and Pro-Growth Tax System

KYLE POMERLEAU AND ALEX BRILL

In 2017, lawmakers passed the Tax Cuts and Jobs Act (TCJA), the most significant overhaul of US tax law since 1986. Among its many changes, the TCJA raised the standard deduction, limited several itemized deductions, eliminated the personal exemption, doubled the child tax credit, reduced the corporate income tax rate, temporarily allowed businesses to expense short-lived assets, and reformed the tax treatment of US multinational corporations' foreign profits. While the 2017 law made substantial improvements to the tax code, major opportunities for additional reform remain. This chapter outlines a set of reforms to the individual and business tax systems that would create a broader, more neutral, and simpler tax base and encourage economic growth by reducing marginal tax rates on investment.

The individual income tax reforms we recommend would broaden the tax base by eliminating most itemized deductions and the exclusions for employer-provided benefits and municipal bond interest. We would also reduce marginal tax rates by replacing the current income tax schedule with four income tax brackets for wage income and just two tax rates for all types of capital income. In addition, our plan would repeal certain tax preferences (such as education tax credits) and modify others (such as the earned income tax credit and child tax credit).

Our business tax reform would replace the current tax treatment of businesses with a 15 percent cash flow tax on all businesses, regardless of their legal form of organization. The cash flow tax would be destination based, which would greatly simplify the tax treatment of foreign profits. Our plan would eliminate several non-neutral business tax expenditures. It would also enact a border-adjusted excise tax on carbon emissions.

Relative to current law, under which key TCJA provisions expire at the end of 2025, our proposal would reduce long-run revenue. However, our proposal is approximately revenue neutral relative to a baseline in which Congress extends the expiring TCJA provisions permanently. Crucially, the reform would reduce disincentives for investment and work and increase business competitiveness.

Guiding Principles for Tax Reform

Good tax policy is simple, pro-growth, and fiscally responsible. It provides neutral treatment of different economic activities and is perceived by citizens as fair. Unfortunately, the current tax code violates each of these principles.

Simplicity. A tax code should be easy for taxpayers to understand and comply with. The US tax code, which has fostered an industry of tax advisers and tax planners, is not simple. The Office of Information and Regulatory Affairs estimates that the cost of compliance is more than three billion hours of work annually.[1]

Pro-Growth. A pro-growth tax system requires low effective marginal tax rates. For individuals, low marginal rates not only minimize disincentives to work and save money but also reduce the incentive to misreport or underreport income.

For businesses, high marginal tax rates reduce the incentive to invest by increasing the required return on new projects.[2] As presented in Table 4, we find that under current law, the tax burden on new investment is 8.4 percent, scheduled to rise to 16 percent in 2031. Including the individual income tax on business income (capital gains, dividends, and interest), the effective tax rate is 20.4 percent, scheduled to rise to 27.8 percent in 2031. Reducing the tax burden on investment can lead to a larger stock of productive capital and higher economic output.

Neutrality. A tax code should distort economic decision-making as little as possible. The individual income tax is inherently non-neutral between current and future consumption because it taxes savings, which finance future consumption. The individual income tax distorts many other

Table 1. Projected Federal Revenue and Outlays, Percentage of GDP

	2022	2023–32	2033–42	2043–52
Revenue				
Individual Income Taxes	10.6	9.6	10.0	10.5
Payroll Taxes	5.9	5.9	5.8	5.8
Corporate Income Taxes	1.6	1.5	1.4	1.3
Other	1.4	1.1	1.2	1.3
Total Revenue	**19.6**	**18.1**	**18.4**	**18.9**
Mandatory Outlays				
Social Security	4.9	5.5	6.1	6.3
Health Care Programs	5.8	6.2	7.6	8.6
Discretionary Outlays	**7.0**	**6.5**	**6.0**	**6.0**
Net Interest	**1.6**	**2.6**	**4.0**	**6.2**
Total Outlays	**23.5**	**23.2**	**25.8**	**28.9**
Deficit	**–3.9**	**–5.1**	**–7.4**	**–10.0**

Source: Congressional Budget Office, *The 2022 Long-Term Budget Outlook*, July 27, 2022, https://www.cbo.gov/system/files/2022-07/57971-LTBO.pdf.

decisions, including whether to enter or exit the labor market, how many hours to work, the type and quantity of investments to hold, where to live, whether to rent or own a residence, and what vehicle to drive.

Current business tax provisions violate neutrality along several dimensions. The tax burden on new investment, including both business-level and individual-level taxes, varies significantly by asset type. For example, equipment that benefits from 100 percent bonus depreciation faces much lower effective tax rates than do inventories, which businesses cannot deduct until sold. In addition, the income tax distorts the forms of financing used for investment, favoring debt financing over equity financing.

Fiscal Responsibility. The tax code should generate sufficient revenues to enable the federal government to meet its financial obligations in an economically efficient manner. At present, the federal government is on a fiscally unsustainable path, as shown in Table 1 and discussed further in Chapter 3. The only truly sustainable fiscal strategy requires significant reductions to future entitlement spending, which is growing rapidly due to population aging and rising health care costs.

Even with entitlement spending restraint, however, we believe that the federal government will need revenue equal to the level it would receive under a baseline that assumes a permanent extension of the TCJA provisions slated to expire in 2025. Our proposal keeps revenue at that level.

Fairness. Tax fairness is a subjective concept, but a few simple principles should guide policymakers. First, the individual income tax code should be progressive, meaning that tax burdens as a share of income should rise as income rises. Second, the individual tax code should strive for horizontal equity; that is, taxpayers who are similarly situated should pay similar amounts of tax. Third, tax burdens should be visible to the people who bear them. The current business tax arbitrarily favors certain industries and legal forms of organization over others. Moreover, business taxes impose burdens on workers that those workers cannot easily observe.

Reforming the Individual Income Tax

Conservative tax reform proposals in the 1990s featured various types of consumption taxes. Most other developed countries have adopted a consumption tax known as a value-added tax. Although consumption taxes do offer an advantage in terms of efficiency, the transition from an income to a consumption tax in the US would pose political hurdles. Significant reforms to the individual income tax can maintain income as the primary base of the tax code and still improve efficiency.

Decades of tinkering have left the individual income tax code riddled with credits, deductions, and exclusions that narrow the tax base. Due to the narrower tax base, tax rates must be increased to maintain revenue. While the 2017 tax law achieved significant improvements, major opportunities for additional reform remain.

The proposed individual income tax reform plan features a simple, broad-based, low-rate structure that is transparent and stable, beginning with the repeal of many tax preferences that litter the tax code today and a reduction in statutory tax rates to encourage work and saving and reduce other distortions. The repeal of tax preferences would simplify the tax system and generally improve horizontal equity. The tax code would remain progressive—but likely less so than the tax code in 2022.

The goal is not to modify the tax code by giving everyone a tax cut and driving the federal debt higher. Some households would pay more tax, and others would pay less. While that approach may pose political challenges, it allows us to present a plan that promotes simplicity, growth, neutrality, and fairness while preserving fiscal responsibility.

Reduce Statutory Tax Rates. High marginal tax rates create incentives for taxpayers to alter their decisions, generally in unproductive ways. High marginal tax rates on labor income, for example, reduce the return to work and thereby discourage labor supply and economic output. The deadweight loss (or excess burden) associated with a tax, which measures the loss of economic efficiency, is proportional to the square of the tax rate.[3] A tax rate increase from 10 percent to 12 percent, for example, causes only half the inefficiency of an increase from 20 percent to 22 percent. Our reform would reduce tax rates and simplify the tax treatment of ordinary and capital income.

Ordinary Income Tax Rates. There would be four ordinary income tax brackets for single filers: 10 percent ($0–$55,000 of taxable income), 20 percent ($55,001–$150,000), 30 percent ($150,001–$250,000), and 33 percent ($250,000 and above). The income ranges in which each tax rate applies for married taxpayers would be double the ranges listed for single tax filers.

Capital Gains, Interest, and Dividends. Under current law, the individual income tax system taxes long-term capital gains and qualified dividends at rates up to 20 percent and interest income and short-term capital gains at rates up to 37 percent. In both cases, the income is also subject to the 3.8 percent net investment income tax (NIIT), enacted as part of the Affordable Care Act.[4]

Our reform would repeal the NIIT. It would impose just two tax rates for all types of capital income (i.e., capital gains, interest, and dividends). The rate would be zero for taxpayers in the 10 and 20 percent income tax

Table 2. Average Effective Marginal Income Tax Rates by Form of Income, 2022

	Baseline	Reform	Difference
Wages and Salaries	22.2%	20.6%	**–1.6%**
Long-Term Capital Gains	21.2%	17.3%	**–3.9%**
Short-Term Capital Gains	32.6%	27.4%	**–5.3%**
Qualified Dividends	17.8%	13.1%	**–4.7%**
Interest Income	28.5%	12.6%	**–16.0%**

Source: Authors' calculations using Tax-Calculator, version 3.1.0, March 3, 2021, https://github.com/PSLmodels/Tax-Calculator.

brackets and 20 percent for taxpayers in the 30 and 33 percent brackets. The top tax rate on interest income would be slashed to the lowest statutory rate since 1917. The overwhelming majority (97 percent) of taxpayers would not be subject to any tax on their dividends, capital gains, and interest income. The other 3 percent of taxpayers, who earn the majority of capital income, would be taxed at a low, flat rate.

Table 2 compares the average marginal tax rate on wages, capital gains, interest, and dividend income in 2022 under current law and our reform. Marginal rates under our reform are lower in all cases, and the largest decline is for interest income.

Repeal the Estate Tax. The estate tax, gift tax, and generation-skipping tax are additional taxes imposed on asset accumulation. The tax rate ranges from 18 to 40 percent, but the tax can be reduced by a credit for estates valued at less than $12.06 million ($24.12 million for married couples).[5] Inherited assets also receive a step-up in basis for the capital gains tax. If a stock that was purchased for $100 is sold for $1,000 immediately before death, for example, the $900 capital gain would be taxed. If the same stock was inherited and sold by the heirs for $1,000, they would enjoy a new "stepped-up" basis of $1,000 and would not pay tax on the $900 capital gain.

Economists have found the current estate tax to have adverse economic effects by reducing savings and entrepreneurship.[6] While the magnitude of these effects is not large, partly because the current estate tax applies to only a few taxpayers, this additional tax burden also creates complexity and raises relatively little tax revenue.

Our reform would repeal the estate and gift tax. It would also eliminate the step-up in basis at death, thereby broadening the tax base and reducing the lock-in effect whereby taxpayers are discouraged from selling long-held assets.

Broaden the Income Tax Base. Because the tax code is riddled with exemptions, exclusions, deductions, and credits, many economic activities face zero (or even negative) marginal tax rates, while other activities face relatively high marginal tax rates. This non-neutral treatment encourages taxpayers to pursue less productive activities to avoid taxes, reducing economic growth.

Itemized Deductions. Our plan would repeal the mortgage interest deduction. Combined with other reforms we propose, this would eliminate the tax disparity between renters and owners who are otherwise similarly situated. Likewise, our plan would eliminate the state and local tax deduction, which the TCJA capped at $10,000 through 2025.

Similarly, the tax deductibility of certain medical and dental expenses, investment interest expenses, and theft and casualty losses would be eliminated. Our plan would reform the charitable deduction, as discussed below. Deductibility of gambling losses and certain other currently allowable—but infrequently claimed—itemized deductions would be retained but converted to above-the-line deductions.

Employer-Provided Benefits. The exclusion for employer-provided health insurance is one of the largest tax expenditures and creates a strong incentive for employers to provide nonwage compensation over salaries and wages, a tax-induced distortion that has likely contributed to slower wage growth over time. Our plan would repeal the exemption, and the value of these benefits would be subject to both payroll tax and ordinary individual income tax. Employer arrangements whereby workers can receive certain other benefits, including transit and parking benefits, on a pretax basis would also be eliminated.

Education Tax Credits. In recognition of the importance of education, the tax code includes tax credits for education costs and a partial deduction for student loan interest. However, the empirical evidence indicates that these tax breaks do not increase the likelihood of a student attending college or the cost of the college they attend.[7] Instead, the tax breaks simply transfer money from those who do not attend college to those who do. Our plan would repeal these ineffective tax breaks.

Municipal Bond Income. Our plan would eliminate the exclusion of interest payments from newly issued municipal bonds, restoring neutrality between state and local government financing and private financing. The exclusion would offer only a small tax advantage with interest income facing only a 20 percent top tax rate (down from 40.8 percent), and its repeal would promote simplicity and fairness.

Energy. The current tax system provides scores of tax credits and other tax preferences related to various forms of energy production, mostly clean or renewable energy such as wind, solar, and geothermal—but other forms as well. The Joint Committee on Taxation estimates that under current law, clean energy–related tax expenditures will exceed $60 billion between 2020 and 2024.[8] Even in the confines of clean energy, current policy defies the principles of neutrality by favoring some technologies over others. Moreover, the temporary nature of many clean energy policies creates uncertainty and provides windfall gains to certain taxpayers.[9]

Reform Tax Benefits for Workers and Families. Current tax law includes myriad policies intended to adjust tax liabilities based on income and household size and encourage work for low-income earners. The TCJA of 2017 made significant but temporary changes to a number of these policies, including an increase in the standard deduction coupled with the elimination of the personal exemption and an increase in the child tax credit. The earned income tax credit (EITC) would further encourage work if expanded, while the child tax credit has grown so large that it creates significant and undue fiscal reliance on nonparent taxpayers.

Standard Deduction. Current law allows a standard deduction in 2022 of $12,950 for single filers and $25,900 for married couples filing jointly.[10] With the elimination of most itemized deductions, the standard deduction

Table 3. Current-Law and Reform EITC Parameters

Filing Status	Parameter	Current-Law Parameters (2022 Dollars)			
		Number of Qualifying Children			
		0	1	2	3+
Single or Head of Household	Maximum Credit	$560	$3,733	$6,164	$6,935
	Credit Percentage	7.65%	34.00%	40.00%	45.00%
	Earned Income Amount for Maximum Credit	$7,320	$10,980	$15,410	$15,410
	Threshold Amount for Phaseout	$9,160	$20,130	$20,130	$20,130
	Phaseout Percentage	7.65%	15.98%	21.06%	21.06%
	Earned Income Amount for Completed Phaseout	$16,480	$43,492	$49,399	$53,057
Married Filing Jointly	Maximum Credit	$560	$3,733	$6,164	$6,935
	Credit Percentage	7.65%	34.00%	40.00%	45.00%
	Earned Income Amount for Maximum Credit	$7,320	$10,980	$15,410	$15,410
	Threshold Phaseout Amount	$15,290	$26,260	$26,260	$26,260
	Phaseout Percentage	7.65%	15.98%	21.06%	21.06%
	Earned Income Amount for Completed Phaseout	$22,610	$49,622	$55,529	$59,187

(*continued on the next page*)

can be replaced with a flat, nonrefundable tax credit of $1,500 for single filers and $3,000 for married joint filers. This reform would be revenue neutral, but it would be simpler to understand and more progressive than current law. For example, the credit would be worth more than the standard deduction for a taxpayer in the 10 or 12 percent marginal tax rate bracket, but it would be worth less than the standard deduction for a taxpayer in the 30 or 33 percent tax bracket.

EITC. The EITC is a tax credit designed to reward and encourage work among low-income individuals, particularly those with children.[11] In addition, the current EITC has been shown to efficiently reduce poverty and induce a host of related beneficial effects.[12]

Table 3. Current-Law and Reform EITC Parameters (*continued*)

Filing Status	Parameter	Reform Parameters (2022 Dollars)			
		Number of Qualifying Children			
		0	1	2	3+
Single or Head of Household	Maximum Credit	$1,120	$4,233	$7,164	$8,435
	Credit Percentage	15.30%	38.55%	46.50%	54.75%
	Earned Income Amount for Maximum Credit	$7,320	$10,980	$15,410	$15,410
	Threshold Amount for Phaseout	$9,160	$20,130	$20,130	$20,130
	Phaseout Percentage	7.65%	15.98%	21.06%	21.06%
	Earned Income Amount for Completed Phaseout	$23,800	$46,620	$54,147	$60,182
Married Filing Jointly	Maximum Credit	$1,120	$4,233	$7,164	$8,435
	Credit Percentage	15.30%	38.55%	46.50%	54.75%
	Earned Income Amount for Maximum Credit	$7,320	$10,980	$15,410	$15,410
	Threshold Phaseout Amount	$15,290	$26,260	$26,260	$26,260
	Phaseout Percentage	7.65%	15.98%	21.06%	21.06%
	Earned Income Amount for Completed Phaseout	$29,930	$52,750	$60,277	$66,312

Source: Internal Revenue Service, "Revenue Procedure 2021-45," November 10, 2021, https://www.irs.gov/pub/irs-drop/rp-21-45.pdf; and authors' proposed EITC parameters.

As shown in Table 3, the maximum EITC would increase by $500 for workers with one child, $1,000 for workers with two children, and $1,500 for workers with three or more children. For example, the maximum EITC in 2022 for a worker with two qualifying children would be $7,164, instead of the current $6,164. The EITC would also be doubled for childless workers, from $560 to $1,120.

Child Tax Credit. Since its establishment in 1997, the child tax credit has ballooned from a $500 per child benefit worth roughly $16 billion per year to a policy costing the federal government over $220 billion in 2021.[13] Far from providing a targeted benefit to low-income households with children and encouraging work, the child tax credit expansion in 2021 pushed the tax system toward one that increasingly relies on childless households to finance government. The 2021 child tax credit expansion (temporary for one year) also removed the work incentive for low-income households that had been a core component of the policy since its creation.

The revised credit would be $1,500 per child. The $1,500 value is $500 more generous than the pre-TCJA law's $1,000 credit but $500 less generous than TCJA's $2,000 credit (which is scheduled to expire at the end of 2025). The credit would be refundable in cash for taxpayers who do not owe income tax, up to a limit of 15 percent of the taxpayer's labor income. Under current law, the phase in of the refundable credit begins after $2,500 of earned income. Eliminating the income threshold increases the maximum value of the credit by up to $375 for lower-income households.

Alternative reforms to these policies are made by AEI's Angela Rachidi, Matt Weidinger, and Scott Winship in Chapter 8, where they propose consolidating the current EITC, child tax credit, and head-of-household filing status into a "working family credit" that is generally more generous than the policy reforms outlined above.

Reform the Tax Benefit for Charitable Giving. Under current law, a deduction for charitable donations is available to taxpayers who itemize their deductions but not those who claim the standard deduction. A consequence of the TCJA's large increase in the standard deduction is that fewer taxpayers itemize their deductions and can receive a deduction for charitable giving.

To broaden the availability of the charitable deduction, our plan would allow an above-the-line deduction available to all taxpayers, not just those who itemize under current law, to the extent that the annual total exceeds $500 for single filers ($1,000 for married couples filing jointly). Such a reform would result in a modest net increase in charitable giving relative to pre-TCJA law.[14] Chapter 14 by AEI's Howard Husock delves further into the justification for an above-the-line deduction.

Reforming Business Taxation

Our business tax reform plan focuses on addressing the remaining problems with business taxation after the TCJA. This plan would eliminate the tax burden on new investment and reduce distortions across different types of investment, forms of financing, and legal forms of organization. It would also improve the tax treatment of US multinationals by reducing incentives to shift profits out of the United States while maintaining competitiveness.

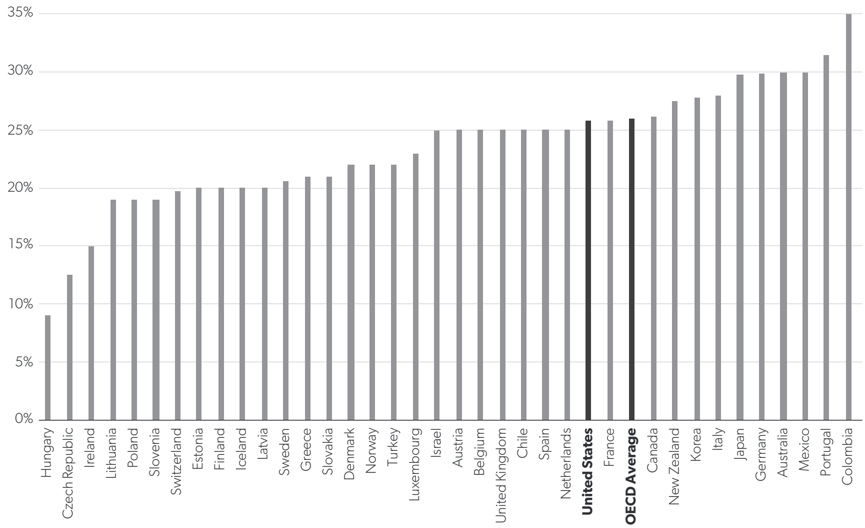
Reduce the Corporate Income Tax Rate to 15 Percent. In today's economy, goods and services may be produced across multiple jurisdictions using labor and many types of capital. This supply-chain complexity presents a challenge for the corporate income tax. Corporate income tax systems are generally based on where production takes place. If a company has a factory in Germany, for example, Germany generally has the right to tax those profits. For large multinational corporations with production spanning multiple jurisdictions, "sourcing" taxable income can be complex. Companies can claim deductions and realize revenue in different countries, enabling them to book net income in countries where tax rates are lower.

The incentive for corporations to shift profits is primarily from the difference in statutory tax rates between countries. Under current law, the US statutory corporate tax rate of 25.8 percent (21 percent federal tax rate plus 4.8 percent average state and local tax rate) is near the average among Organisation for Economic Co-operation and Development (OECD) member nations (weighted by gross domestic product, or GDP) of 26 percent (Figure 1).[15] It is slightly higher than the OECD median corporate tax rate of 25 percent and is the 12th highest rate among the 35 OECD member nations. It is also near the average of all countries.[16]

This reform would reduce the corporate income tax rate to 15 percent. Combined with state and local corporate income tax rates, the weighted average statutory tax rate in the United States would stand at roughly 21 percent. This would be 4 percentage points below the OECD average and lower than the rates in Canada, France, Germany, and Japan.

Convert the Corporate Income Tax into a Cash Flow Tax. Under current law, the tax treatment of business investment varies by type of asset

Figure 1. Statutory Corporate Income Tax Rates, OECD Countries, 2022



Source: Kyle Pomerleau, "The Tax Burden on Corporations: A Comparison of Organisation for Economic Co-operation and Development Countries and Proposals to Reform the US Tax System," American Enterprise Institute, October 13, 2021, https://www.aei.org/research-products/report/the-tax-burden-on-corporations-a-comparison-of-organisation-for-economic-co-operation-and-development-countries-and-proposals-to-reform-the-us-tax-system.

and how the investment is financed. Fixed assets such as equipment, structures, and intellectual property (IP) are deducted over time, according to depreciation schedules. Short-lived investments qualify for "100 percent bonus depreciation" and can be expensed or immediately deducted. That provision, however, is scheduled to phase out between 2023 and 2026. In contrast, inventories are only deducted when sold. In addition, the costs of debt financing (interest expense) are deductible, subject to limitations, while the costs of equity financing (dividends) are not deductible.[17]

Our reform would replace the depreciation system with expensing all capital investments. Businesses, regardless of size and legal form of organization, would fully deduct the cost of new investments in the year in which the asset (regardless of type or value) is placed into service. Inventory accounting methods—first-in, first-out accounting; last-in, first-out accounting; and average cost—would similarly be replaced with expensing.

Land would also be expensed. Special expensing provisions, such as Section 179 expensing for small businesses, would become unnecessary.

In addition, the reform would eliminate the deduction for net interest expense. Businesses would no longer be able to deduct net interest expense, matching the tax treatment of dividends.

Replacing the corporate income tax with a cash flow tax would reduce distortions in business tax in three ways. First, a cash flow tax would not penalize new investment at the entity level. For an investment that earns just enough to break even in present value, the tax value of the upfront deduction (15 percent times the value of the investment) is exactly equal to the expected tax on the returns (15 percent times the discounted present value of future cash flows). As a result, the marginal effective tax rate would be zero for all types of investment, except certain types of IP, which would enjoy a negative marginal effective tax rate due to the research and development credit (Table 4).

Second, the cash flow tax would be neutral across different types of investment. As mentioned previously, the tax burden at the entity level would be zero across all assets except IP.

Finally, the cash flow tax would eliminate the debt-equity bias at the entity level. On average, both debt-financed and equity-financed investment would face an average marginal effective tax rate of –1.6 percent. The total tax burden on debt and equity, including the individual income tax, on holders of these securities would largely be equalized. Debt-financed investment would face a total effective tax rate of 12.9 percent, compared to 14.4 percent for equity-financed investment. A small bias would remain because holders of debt have lower incomes on average than holders of equity. As a result, interest income faces a slightly lower average marginal tax rate than do capital gains and dividends.

Expand Net Operating Loss Deductions. Under current law, businesses that earn profits face immediate taxation. However, businesses that lose money do not receive an immediate refund. Instead, they are required to carry forward losses to future years and deduct them against the income earned in those years.

In addition, losses face a general limitation of 80 percent of taxable income. The delay in the ability to realize losses reduces their value. This

Table 4. Impact of Reform on Marginal Effective Tax Rates on New Investment

	Current Law		
	2022	2031	Reform
Entity Level			
Equipment	–10.7%	9.2%	0.0%
Structures	7.1%	13.2%	0.0%
IP	–17.2%	–9.1%	–29.1%
Land	20.7%	25.0%	0.0%
Inventory	21.5%	23.9%	0.0%
Overall	**8.4%**	**16.0%**	**–1.6%**
Standard Deviation	15.5%	12.7%	8.8%
Debt Financed	–24.7%	–22.0%	–1.6%
Equity Financed	17.9%	25.7%	–1.6%
Entity-Level Tax Plus Individual Income Tax			
Equipment	4.7%	22.8%	14.3%
Structures	19.7%	25.8%	14.8%
IP	–0.2%	7.7%	–11.1%
Land	29.8%	34.4%	16.8%
Inventory	32.1%	35.0%	14.9%
Overall	**20.4%**	**27.8%**	**14.0%**
Standard Deviation	12.5%	9.4%	8.3%
Debt Financed	10.1%	15.4%	12.9%
Equity Financed	23.5%	31.0%	14.4%

Source: Authors' calculations using Cost-of-Capital-Calculator, version 1.2.11, July 24, 2022, https://github.com/PSLmodels/Cost-of-Capital-Calculator; and Tax-Calculator, version 3.1.0, March 3, 2021, https://github.com/PSLmodels/Tax-Calculator.

tax treatment creates a bias against risky investments that may lose money for several years before breaking even.[18] Further, companies that do not currently have taxable income may lose out on investment incentives because they must wait to get the benefits of their expensing deductions for new investments.

Our proposal corrects those problems. Our plan eliminates the limitation on net operating losses of 80 percent of taxable income. Net operating losses would continue to carry forward indefinitely, but unlike under current law, losses that are carried forward would earn interest at the 10-year Treasury bond rate. For example, if a business generates a $100 loss in the current year and carries it over to deduct it the following year, the business would receive a $103 deduction, assuming the interest rate is 3 percent.

Tax All Businesses the Same. In the United States, there are two major business forms: traditional C corporations and pass-through businesses. Pass-through businesses include sole proprietorships, partnerships, limited liability companies, and S corporations. About 95 percent of all businesses are pass-through businesses, and these businesses report about 60 percent of all business income in the United States.[19]

Pass-through businesses do not face an entity-level tax. The owners pay tax at their current ordinary rates, between 10 and 37 percent, but they receive a special 20 percent deduction (called Section 199A) on some types of business income. Owners also often pay 3.8 percent additional tax on their pass-through business profits, either from the Self-Employment Contribution Act tax of 2.9 percent plus the 0.9 percent Medicare surtax or from the 3.8 percent NIIT.[20]

In contrast, traditional C corporations face the entity-level 21 percent corporate income tax. After-tax corporate profits are then taxed as dividends, if distributed to shareholders, or as a capital gain, if the profits are retained and the shareholder sells their stock. Long-term capital gains and dividends are taxed at rates between 0 and 23.8 percent (20 percent top income tax on long-term capital gains and qualified dividends plus the 3.8 percent NIIT).

Under current policy, a business owner who faces the top statutory individual income tax rate could experience a tax increase if they decided to incorporate and become a C corporation. As a sole proprietor, this taxpayer faces a tax rate of 32.7 percent when considering Section 199A, self-employment tax, and the Medicare surtax (Table 5).[21] However, as a C corporation, this business owner would face a tax burden as high as 39.8 percent.[22] The C corporation could lower its tax burden if it retained some of its profits rather than paying them out as dividends and the

Table 5. Overall Top Statutory Tax Rate, Sole Proprietor vs. C Corporation, Current Law (2022)

	Current Law		Reform	
	Sole Proprietor	C Corporation	Sole Proprietor	C Corporation
Entity-Level Tax	0.0%	21.0%	15.0%	15.0%
Individual Income Tax	29.6%	20.0%	20.0%	20.0%
Self-Employment Tax	2.9%	—	0.0%	0.0%
Medicare Surtax	0.9%	—	0.0%	0.0%
Net Investment Income Tax	0.0%	3.8%	0.0%	0.0%
Total	32.7%	39.8%	32.0%	32.0%

Note: Tax rates do not sum to total due to the deductibility of certain taxes.
Source: Authors' reform parameters and calculations using current law values from the Internal Revenue Code.

owner did not sell the stock, thereby avoiding any current individual income tax burden.

Under this reform, all businesses would be subject to the same tax regime, no matter their form of organization. They would face the 15 percent entity-level tax plus individual income tax on distributed profits. For pass-through businesses, profits earned would immediately face an entity-level tax of 15 percent. Profits distributed to owners as a dividend would be taxed as dividend income. Any profits retained and reinvested in the business would not face additional taxation until distributed or unless that owner sells their stake and realizes a capital gain. Our plan would also eliminate Section 199A. Businesses would face an all-in statutory tax rate of 32 percent, regardless of legal form of organization.[23]

On net, this proposal would reduce the overall tax burden on pass-through businesses relative to current law. In 2026, the top individual income tax rate on pass-through business income will rise from 29.6 percent (37 percent top statutory rate reduced by the 199A deduction) to 40.8 percent (39.6 percent plus the impact of a special provision called the Pease limitation).[24] In addition, pass-through businesses could defer the second layer of tax by retaining profits, an option they do not have under current law.

Lawmakers may also want to consider anti-avoidance measures for closely held businesses. Because retained earnings would not immediately face tax and because labor income would face higher tax rates (including payroll taxes) than business income, owners who participate in day-to-day business operations would have an incentive to label their income as profits rather than as labor. To prevent business owners from mislabeling income, lawmakers could create rules that require business owners to split their income into capital and labor portions, based on the amount of capital invested in the business.

Although it is not part of this proposal, lawmakers could consider integrating the entity-level tax and the individual income tax, similar to the proposal by Eric Toder and AEI's Alan D. Viard, as a way to eliminate double taxation of business profits.[25] Under such a proposal, interest, dividends, and capital gains would be taxed as ordinary income. However, business owners, shareholders, and bondholders would receive a credit for entity-level taxes already paid. Under integration, business income would ultimately face the individual income tax rate.

Make Business Taxes Destination Based. The TCJA introduced a new international tax system meant to reduce the incentives to charter corporations abroad and shift profits to low-tax jurisdictions. The law created an exemption for dividends paid to US parent corporations from foreign-controlled foreign corporations, effectively eliminating the residual US tax on foreign profits of US multinationals. At the same time, it introduced a new minimum tax regime targeting highly mobile income. This regime includes two new income categories: global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII). Together, these provisions tax the returns to IP products used to serve foreign markets at a minimum tax rate of between 10.5 and 13.125 percent.[26]

In addition, the TCJA introduced the base erosion and anti-abuse tax (BEAT). This minimum tax requires large multinational corporations to pay a top-up tax if their BEAT liability exceeds their corporate tax liability. BEAT is a 10.5 percent tax on an alternative broader tax base with only a limited number of deductions. This minimum tax is designed to reduce the incentive for both US and foreign-based multinational corporations to shift profits out of the United States.

Although the TCJA provisions attempt to strike a delicate balance between protecting the US tax base and maintaining the competitiveness of US multinationals operating in foreign countries, they are not without flaws. GILTI and FDII somewhat arbitrarily define the returns to IP. Additionally, GILTI's foreign tax credit rules can result in taxpayers with foreign effective tax rates above the GILTI rate paying residual US tax, and BEAT is complex and creates several arbitrary tax cliffs for taxpayers.[27]

A cash flow tax, such as we propose, can be either destination based or origin based. Under a destination-based cash flow tax, businesses are denied deductions for all purchases of foreign goods and services (imports), and revenues from foreign sales (exports) are excluded from taxable income. For example, if a business imports goods from the United Kingdom for sale in the United States, the cost of those goods would not be deductible against taxable income. If a business exports goods from the United States for sale in the United Kingdom, the gross revenue from those sales would not be part of taxable income.

There are several significant advantages of a destination-based cash flow tax. First, cross-country transactions are effectively ignored, which eliminates the ability to shift profits through transfer pricing.[28] Second, it eliminates the incentive to locate high-return investments in low-tax jurisdictions.[29] Third, it eliminates the need for all current-law anti-profit-shifting provisions (e.g., GILTI, FDII, BEAT, and Subpart F).

Under an origin-based cash flow tax, imports and exports would be treated as they are under current law (imports deductible and export income taxable). An origin-based cash flow tax would be a less disruptive change from current law, but the current-law opportunities for multinational corporations to shift profits out of the United States would persist. To be sure, those incentives would be reduced due to a much lower statutory tax rate (15 percent) and the elimination of the interest deduction.

We propose that the tax be destination based. However, if lawmakers opt for an origin-based cash flow tax, they should consider a simplified minimum tax on foreign cash flow to reduce profit-shifting incentives.

The OECD is working toward a global deal on the taxation of multinational corporations. The deal includes a "Pillar Two" proposal to enact a 15 percent minimum tax on the foreign profits of multinational corporations. It is not yet clear whether all countries will enact and enforce the minimum tax. Lawmakers may need to consider how the OECD proposal would interact with any potential US reform.

Tax Carbon Emissions. While repealing poorly designed clean energy tax subsidies would broaden the tax base and remove distortions in the tax code, it would also remove all tax policies geared toward addressing costs that will arise from climate change. This reform would replace the costly and inefficient clean energy policies with an excise tax on CO_2 emissions. Economists across the political spectrum have long agreed that a carbon tax efficiently and effectively reduces carbon emissions.[30]

The tax would be set at $20 per metric ton and increase 5 percent per year, similar to a proposal outlined by the Congressional Budget Office.[31] The tax would be imposed on the upstream businesses that refine petroleum, extract coal, and process natural gas.

The tax would be border adjusted, applying to imports based on their carbon content but exempting exports. Including a border adjustment mechanism is crucial for the continued competitiveness of US businesses, including their ability to compete in foreign markets and avoid any unfair advantage to imports of carbon-intensive goods. A border adjustment for imports and exports of fossil fuels would be straightforward. Border adjusting other energy-intensive products, such as steel and aluminum, would pose challenges, but researchers have offered multiple strategies for addressing these.[32]

A carbon tax would most efficiently encourage utilities, manufacturers, commercial building operators, and households to reduce emissions as they seek to (lawfully) avoid this tax. While reducing emissions and encouraging innovation into new and cost-effective forms of energy and energy efficiency, a carbon tax would also raise revenue to offset some of the costs of other reforms outlined above.

Broaden and Simplify the Business Tax Base. In addition to the major proposals, our reform would simplify the corporate tax base by eliminating business tax expenditures that subsidize specific economic activities. This includes the exemption for credit union income, tax credits for green energy investment and production, the tax credit for marginal wells, and the capital gains exclusion of small corporation stock. All accelerated depreciation provisions would be superseded by the expensing provided for all investments under the cash flow tax.

Revenue Impact

Repealing the exclusion for employer-provided benefits and repealing most itemized deductions would significantly broaden the income tax base. Repealing education tax preferences and green energy tax preferences would also raise revenues. Our plan would use the increased revenue to lower marginal tax rates on ordinary and capital income while reforming the tax treatment of charitable giving and repealing the estate and gift tax. The reform's expansion of the EITC is offset relative to current policy by the reform to the child tax credit.

The baseline for expected revenue increases after 2025 with the scheduled expiration of the TCJA. The individual tax reforms would yield a modest increase in revenues in the 2023–25 period of roughly 0.3 percent of GDP. Relative to the long-run post-2025 revenue baseline, they would reduce revenues by 0.4 percent of GDP annually. Repealing the estate and gift tax and the step-up in basis would reduce revenues by roughly 0.1 percent of GDP annually.

The business tax reforms, including the price on carbon emissions, would increase federal revenues by 0.3 percent of GDP against a current-law baseline each year. Reducing the corporate income tax rate to 15 percent would reduce federal revenue by 0.2 percent. However, converting the corporate tax to a cash flow tax would have a negligible impact on revenue. This is primarily because the loss of revenue from expensing would be offset by eliminating the deduction for net interest expense. Replacing the current tax provisions affecting foreign profits with a border adjustment would raise revenue by 0.3 percent of GDP. Expanding net operating losses and treating all businesses the same would each reduce federal revenue by 0.1 percent of GDP, and the carbon tax would raise an additional 0.3 percent of GDP.

Taken together, the individual and business tax reforms would reduce revenues by approximately 0.2 percentage points as a share of GDP beyond 2025, relative to current law (Table 6). However, they would be

Table 6. Revenue Impact of Proposed Reforms, 2031

Provision	Revenue Impact Relative to Current Law as Percentage of GDP
Individual Income Tax Provisions	–0.4
Repeal Estate and Gift Tax	–0.1
Repeal Step-Up in Basis	0.0
Reduce Corporate Income Tax to 15 Percent	–0.2
Convert Corporate Tax to Cash Flow Tax	0.0
Expand Net Operating Losses	–0.1
Treat All Businesses the Same	–0.1
Replace GILTI, FDII, BEAT, and Subpart F with Border Adjustment	0.3
Carbon Tax	0.3
Total	**–0.2**

Note: Line items may not add to total due to rounding.
Source: Revenue estimates for the individual income tax provisions are calculated using Tax-Calculator, version 3.1.0, March 3, 2021, https://github.com/PSLmodels/Tax-Calculator. Other provisions are estimated off model.

roughly revenue neutral relative to a baseline that extends the expiring TCJA provisions.

Conclusion

The TCJA improved the tax code, but the opportunity for additional reforms remains. Our tax reform proposal further improves the tax code by reducing marginal tax rates for individuals and businesses and broadening the tax base. Our proposal would not only make the tax code simpler and fairer but also reduce economic distortions and encourage economic growth. The proposal would reduce federal revenue relative to current law but raise about the same amount of revenue as making the TCJA permanent. Taken together, these reforms will contribute to higher standards of living for future generations and make the US a more globally competitive place to do business.

Acknowledgments

The authors wish to thank Grant M. Seiter for excellent research assistance and Alan D. Viard for valuable comments and suggestions.

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16

Money Matters: The US Dollar, Cryptocurrency, and the National Interest

KEVIN WARSH

The 21st century is off to a rocky start. Recent shocks of plague and war make the global financial crisis of 2008–09 and the terrorist attacks on 9/11 seem like ancient history. But the United States and the global economy were rocked by these events, too—one and two decades ago, respectively.

The cumulative effects on our nation loom large. The scale, scope, and frequency of economic and geopolitical shocks threaten to change something fundamental in the American ethos. And the rest of the world looks at America through a fuzzier lens.

Until recently, most official measures of economic and employment growth appeared strong, but something is seriously amiss in the nation. US inflation is running at a rate not seen in more than 40 years. National debt is now greater than national output. Approval ratings for major American institutions have fallen dramatically. More than three-quarters of all Americans believe the country is on the wrong track.[1] The chasm is bigger and more consequential than captured by a single statistic or remedied by a particular piece of legislation.

Still, the US dollar has more than held its own. The greenback is trading near its strongest level since 2002, including against the next four most widely held sovereign currencies. Year-to-date (as of September 13, 2022), the dollar is 12 percent stronger against the euro, 20 percent stronger against the Japanese yen, 15 percent stronger against the British pound sterling, and 8 percent stronger against the Chinese yuan. Relative dollar strength, however, may say less about the United States and more about fortunes in the rest of the world.

The value, prevalence, and durability of the US dollar—and the concomitant financial and economic architecture—are crucial to American economic stability and our standing in the world. The dollar has proven an important signal and symbol of American economic power since World War II. It makes the financing of the US government less costly. It bestows a significant comparative advantage on American business. It also lowers the costs of consumer goods.

The dollar, termed the exorbitant privilege, reinforces American strength.[2] Benefits of dollar dominance, however, extend far outside the United States. The dollar is a global public good: The world is better off managing its affairs around a single currency. There is good reason the dollar's use in global trade, international bond issuance, and cross-border borrowing significantly outstrips the US share in these activities.[3]

The dollar's persistent, outsize role in global markets is also a function of network effects: The more people use the dollar, the more valuable it becomes. And the harder it is to dislodge.

The dollar's more recent strength owes significantly to an about-face at the turn of the year by the Federal Reserve. Having failed to act on a timely basis to dampen incipient inflation, the Fed is now belatedly raising rates. Other major central banks, including the European Central Bank and Bank of Japan, have been considerably slower to change course. They appear relatively more devoted to policies championed by the Fed in prior years. Some central banks appear more accepting of higher levels of inflation or more persuaded it is transitory. No matter the rationale, the relative interest rate divergence has caused the dollar to surge.

Policy regime change by the Fed in August 2020 catalyzed and amplified the new era of high inflation. The Fed set forth a newfangled policy framework that kept monetary policy inert even as the economy and inflation surged.[4] In 2021, US economic output reached record levels, economic growth accelerated to its fastest rate in decades, and the unemployment rate fell to near-historic lows.[5] In an ahistorical action, the Fed maintained the loosest monetary policy amid the boom. What's more, the Fed supported highly expansive spending by Congress, which the Fed accommodated in 2021 by buying a majority of net Treasury issuance.

At the time of writing this chapter, the price level is growing more than four times the Fed's price stability target of 2 percent.[6] The country is suffering from a growing cost-of-living squeeze. The new era of price instability confounds business plans and preoccupies the mindshare of households, further harming the real economy. There is a high price to pay for high prices.

Tipping Point

Amid dollar strength, US policymakers should avoid complacency. The US dollar has the advantage of incumbency. The advantage, however, is not necessarily permanent.[7] It's hard to judge precisely the degree to which the foundation that underpins the dollar is showing cracks. Weakness can be profound even if unobservable.

A currency reigns supreme until it doesn't. The British pound sterling was dominant through most of the 19th century until World War II.[8] The German deutsche mark suffered a similar fate during the fall of the Berlin Wall.[9] Tipping points cannot be identified with precision. They are best avoided by steering clear altogether. Instead, the United States seems tempted to touch the tipping point.

For some perspective, the dollar's share of international reserves declined significantly since the turn of the century. The money held as reserves by the world's central banks, however, has not migrated to the euro, the British pound sterling, or the Japanese yen. According to a recent International Monetary Fund paper, about one-quarter has migrated into the Chinese renminbi (RMB) and the balance to "nontraditional reserve currencies"—namely, the currencies of many smaller economies.[10] The allocators of reserves appear to be searching for an alternative—or, at least, hedging their bets on the dollar's status.

Significant threats to dollar dominance—economic, geopolitical, and technological—merit attention by market participants and economic authorities. I discuss each in turn.

Fiscal profligacy in recent years is worrisome. Federal spending is running 32 percent higher than its pre-COVID-19 level, 3.5 percentage points higher relative to gross domestic product (GDP) than in recent decades.[11] And high debt levels, which are now well in excess of GDP, are strongly correlated with lower levels of long-term economic growth.

High levels of inflation represent a clear and present danger to the US economy. If the central bank tolerates a prolonged period of high prices, the specter of stagflation rises, and the dollar could well lose its vaunted position. As events overseas remind us, the price of stopping a dictator goes up over time. The same is true of inflation.

High levels of intragovernmental transfers constitute financial repression, another economic risk to dollar dominance. In 2021, the US economy grew about 5.7 percent, and for reasons difficult to fathom, the Fed still purchased a majority of net new Treasury issuance. Quantitative easing was conceived in the global financial crisis as an emergency measure. It morphed into normal operating procedure. Wisdom is not the word for this sort of alchemy—when one part of government is the de facto long-term buyer of the nation's own debt—in all seasons and for all reasons.

Other troubling factors could also serve as catalysts for the dollar to be dethroned, especially if the United States fails to adapt to the changing environment. History teaches that currency dominance is not just about economics. Strong economic governance and military might are twin bulwarks to ensure America's benign power and currency strength.

America played the decisive role in ensuring a global economic and security commons since World War II. Threats to freedom by America's rivals, however, are not some relic of the past. The postwar global balance of power is being attacked on many fronts: Russia's invasion of Ukraine, Iran-backed terrorist attacks throughout the Middle East, and China's growing appetite to expand its sphere of influence. The swift and scarcely resisted takeover of Hong Kong is one glaring example. China's plan to assert greater influence over countries in the South China Sea and East China Sea is part of the strategy.

In response to new threats in the 21st century, the US accelerated its use of economic sanctions as a principal tool of statecraft. This development caused antagonists to look for new ways to make themselves less susceptible to Western, dollar-based sanctions regimes. China's leaders possess the means and will to build a new rival architecture, as they are wont to emphasize, with Chinese characteristics.

If a new geopolitical architecture prevails—by some imprudent mix of Chinese force and American fatigue—the dollar's globally dominant role could well be undermined. Decoupling the world's two largest economies would not be limited to trade and investment or munitions and might. It would most probably include the proliferation of a non-dollar reserve currency in a bipolar world.

During the past several years, China pushed for the broader adoption of the RMB in international commerce. Progress has been limited, even though China is among the world's most globally integrated economies. China is a strong economic force, but the lack of transparency, lack of liquidity, and unreliable rule of law has been a meaningful obstacle to broader use and adoption of its fiat currency.

I do not expect China's fiat currency to dislodge the US dollar on the world stage in the next decade. But the coupling of two powerful trends—the emergence of great-power rivalry and the technological revolution in financial infrastructure catalyzed by the creation of blockchain technology—represents a consequential threat to the extant American-led financial architecture.

Unless American policymakers recognize the new technology frontier, the US runs the risk of losing the privilege of currency dominance. The US should not sit on its laurels. Nor should it follow China's lead in creating a broadly available, end-to-end central bank digital currency (CBDC). Instead, I proffer a quintessentially American model, whereby the US would marshal the new technology to deepen the use case and profile of the dollar consistent with America's interests and values.

To understand the policy choice, I first discuss the essence of money. Then, I decipher the core attributes of cryptocurrency. Next, I lodge my concerns about the recent direction of policy. Finally, I propose an American-style, narrow CBDC, which should strengthen the profile of the US dollar and serve the national interest.

Money: A Primer

Money serves as a unit of account, store of value, and medium of exchange. The form of money, over time, has migrated from coins to gold-backed paper notes to fiat currency backed by sovereign nations.

But, what is money?

Put plainly, money is the obligation of another. And the principal question is what backstops the obligation. That is, what gives money its enduring value?

Some money, such as cash and the digital balances held by banks at the Fed, is backed directly by the central bank, which itself is backed by the strongest sovereign on the planet. If the central bank is credible, and the sovereign acts worthy of its elevated status, then its money is the safest and most liquid.

Most money used by the public sits in digital form in accounts at commercial banks. The safety of this so-called commercial bank money is predicated on deposit insurance, capital requirements, and the quality of supervisory and regulatory oversight. Its value is also a function of the commercial banks' access to central bank liquidity. When commercial bank money has a call on the central bank of the strongest sovereign in the world, it's deemed safe and sound.

The nexus between the commercial bank and the central bank is where the alchemy happens. But the magic is only believed when the central bank delivers price stability and serves as a source of strength. As Ravi Menon, the highly capable head of Singapore's central bank, stated: "The credibility of money is underpinned by this two-tier monetary structure where commercial banks create money and central banks preserve its value."[12]

Matters of money are often best not spoken about in polite company. But confidential discussions inside the marbled walls of the Federal Reserve are no place for politesse.

Believing that money plays an important role in the conduct of monetary policy didn't used to be blasphemy. The quantum and velocity of money have some important bearing on the price level. In recent years, however, money has scarcely received the attention it deserves at places such as the Federal Open Market Committee (FOMC). A review of the transcripts of FOMC deliberations in the past 20 years shows a paucity of references to money. Instead, the Fed canon elevates the role of the Phillips curve to forecast future prices and relegates the role of money. Money plays virtually no role in the dominant dynamic stochastic general equilibrium economic models the Fed uses to forecast output and inflation.

Sensing the crucial moment for the dollar and America's role in the global economy, the Biden administration recently ordered federal government agencies to make policy determinations on the future of money and the dollar's role in the world economy. The executive order is decidedly imperfect, but it is to be applauded for capturing the essential importance of money: "Sovereign money is at the core of a well-functioning financial system, macroeconomic stabilization policies, and economic growth."[13]

The Fed would be well served to pay more heed to money and the moment. If inflation moves higher and the central bank acts dismissively or belatedly about the price trajectory, confidence in the nation's money will dissipate. If the central bank's "lender of last resort" responsibility morphs into "purchaser of sovereign debt for all seasons and all reasons," confidence will take another hit. If the central bank's regulatory and supervisory functions fail to ensure prudential oversight, then the regime's credibility will be further undermined.

Institutions like the Fed and Treasury must act with competence, credibility, and faithfulness to their respective remits to ensure the dollar's strength and longevity.[14]

Cryptocurrency: A Primer

Cryptocurrency is a misnomer: It isn't secretive, and it isn't money. It's software.[15]

Bitcoin was the first cryptocurrency—that is, the first application of the revolutionary new open-source software. Its computer code was unveiled on January 3, 2009, by the pseudonymous Satoshi Nakamoto. It deftly allows participants, who do not know or may not trust one another, to complete transactions without having to rely on a third-party intermediary. Transactions are typically stored on a decentralized ledger, commonly known as the blockchain. Hence, value can be transferred cheaply, safely, and instantaneously.

Nakamoto made clear that the 2008–09 global financial crisis provided the rationale for the new technology to advance. In bitcoin's "genesis block," its creator inserted a curious bit of text, a headline from a UK newspaper that day: "Chancellor Alistair Darling on Brink of Second Bailout for Banks."[16] Bitcoin's founding spirit is amplified in what the founder wrote shortly thereafter: "The root problem with conventional currency is all the trust that's required to make it work."[17]

Bitcoin's founder understood the essential attribute of sovereign currency. And he sought to solve the problem of trust, such that those who don't know each other can be comfortable doing business.[18] The new technology could allow transactions to be executed with greater speed and security at lower cost.

In recent years, some of the most promising businesses are using the new software to create new business models (e.g., buying virtual goods in the metaverse), disintermediate middlemen (e.g., peer-to-peer communities in Web3), and disrupt incumbents in legacy industries (e.g., securities trading).

Some other new companies are hard at work building the rails and laying the infrastructure for the next generation of payments. At present, execution of a payment may appear instantaneous, but key processes—clearance and settlement—take days, sometimes weeks.

A final category of businesses has come onto the scene. They purport to create money. Plague and war in the past couple of years drove unprecedented fiscal spending and money printing, which exacerbated the problem of trust in governmental and private institutions. Amid the liquidity boom, the creators of this new money found a responsive market. Today, thousands of digital assets are masquerading as money in some form of circulation.

But money (as discussed in the prior section) is a special and different application of the new software altogether. The new money has a particularly high bar to meet—namely, to stack up favorably to the world's reserve currency. Some of the new money can be used as a medium of exchange; that is, it can be traded at lower cost with fewer frictions than fiat currency. But most forms of new money lack the other key indicia to survive and prosper: They aren't a sufficiently reliable store of value or stable unit of account.

To remedy these failings, so-called stablecoins emerged to make the revolutionary new software more money-like. Stablecoins purport to peg their value to a sovereign currency like the dollar. They are largely used as a kind of gateway currency to move money from traditional fiat form to facilitate the trading of other digital assets. They may serve as a useful proof of concept around blockchain-based settlement.

The principal question remains: Who or what backstops the liability?

Many stablecoins are backstopped by ambiguous or insufficient collateral. Others are backed by some sort of algorithm that works satisfactorily in ordinary times but are unlikely to be reliable when times get tough. Other stablecoins are backstopped with some mix of cash, Treasurys, and other assets.

Most of these stablecoins will be stable until they aren't.[19] Money shows its true colors in times of stress. A small number might become of great value by adding operational efficiencies. Most, however, will be worthless.

The China Factor

China bristles at US preeminence in the world's financial system. It believes the US uses its dollar hegemony to control global capital flows and extract value from others.

Beijing has long sought to promote the internationalization of its fiat currency. Strict capital controls, illiquidity, and uncertainty about the rule of law, among other obstacles, have limited more wide-scale internationalization of the Chinese currency. So, China is increasingly demanding the use of RMB by foreign businesses that want to sell goods and services into the vast domestic Chinese market.

Beijing is keen to build a new financial ecosystem to bolster its geopolitical position. Chinese authorities appear to have redoubled their efforts this year. The financial, economic, and geopolitical response by the United States and its allies was more robust than most expected. Beijing appears to be seeking greater resilience from the specter of Western economic sanctions and dollar dominance.

China, for example, is actively expanding use of its own payment messaging system—China's Cross-Border Interbank Payment System (CIPS)—an alternative to the US-backed SWIFT system.[20] In demonstration of the alliance, Russia and Turkey are using CIPS to conduct business outside the purview of Western sanctions.

Enter blockchain technology. China appears to view the new software—enabling a new form of record-keeping, transfer, and payment—as a once-in-a-generation opportunity to erode American hegemony. The new software is a significant potential hack of the American-led financial order. It's little surprise that China is the first major country to deploy a CBDC, which it calls e-CNY.[21] Capitalizing on its status as first mover, China is keen to become at least as formidable a force in international payments and money as it is in international economics and global trade.

The e-CNY could well lead to a more efficient Chinese payment system. When fully deployed, the underlying technology could mean a significant upgrade of the payment and settlement rails that have long moved money among domestic counterparties. At least as important, the new software could come to dominate payments among sovereigns and businesses that find themselves in China's sphere of influence. Benefits may include faster and more secure settlement at lower cost per transaction. That sounds like the basis of a new, promising medium of exchange.

But China's e-CNY is broader in scale, scope, and importance than broadly recognized. If foreigners want continued access to the Chinese market, they might well be compelled to use e-CNY. It might soon be the technology backbone for most wholesale transfers among the People's Bank of China, regulated banks, and foreigners. Given the broad desire for access to Chinese goods and financial markets, we could, in short time, see a parallel international payment network to that of the West.

Over time, e-CNY is also expected to be the de facto protocol for all retail and personal financial transactions, disintermediating to some significant extent China's fintech companies, including Alipay and WeChat Pay. The government would thereby be able to trace virtually all money flows. According to a new report from the Hoover Institution, *Digital Currencies: The US, China, and the World at a Crossroads*, "Transactions can be tracked, accounts frozen, and balances adjusted. With this power, e-CNY could become an important tool for punishing Chinese citizens for their social or political activism or criticism of the government."[22]

When fully implemented, China's central planners are expected to have a powerful new tool to monitor transactions and enforce compliance with government directives. Its leaders may well intend e-CNY to vault the RMB and accompanying financial system into the big leagues.

The underlying software represents a significant technological breakthrough, one that poses both promise and peril for the existing global financial architecture. The combination of a powerful, ambitious sovereign—working with a new disruptive technology—is a clear and foreseeable risk to the dollar. The implications for the great-power rivalry should not be underestimated. The US should make stronger and more immediate efforts to ensure that e-CNY does not undermine the national interest of the United States.

Policy Alternatives

Several of the leading policy paths under review by US authorities are of concern. I first critique three policies that are gaining particular traction in Washington. I then propose an alternative path forward.

First, the dominant Treasury and Fed strategy to date has been to abide by the status quo. According to Fed Chairman Jerome Powell, being a policy laggard bestows important advantages:

> We don't feel an urge to be, or need to be, first. Effectively, it means we already have a first-mover advantage because we're the reserve currency. So I think there are both benefits and potential costs and unresolved questions around CBDC.[23]

The status quo, in my view, is neither sufficient nor sustainable. US authorities should not take false comfort from recent dollar strength. The risk of squandering the privilege of the world's reserve currency is elevated. The Fed and Treasury should cease to play the slow game while China, among others, actively seeks to carve out a new monetary and financial architecture.

Every detail of a new money framework need not be fully determined. But US authorities should decide and announce the essential design features of the new financial architecture, including their plans for new technology-enabled wholesale payment rails and the outlines of the private sector's role and responsibilities.

Most of the United States' existing payment systems are antiquated, slow, and expensive. US authorities have made modest improvements in recent years to Fedwire and the National Settlement Service, two systems the Fed uses to move payments between banks. But the wholesale rails that connect the central bank and the regulated banks were built using mid- to late-20th-century technology and practices. Failure to embrace new, more capable payment systems, including those based on distributed ledger technology or blockchain, leaves the US a great distance from the efficient frontier.

Moreover, the Treasury market, which trades the most important asset anywhere in the world, needs fixing. It is not sufficiently robust or resilient.

And it's prone to bouts of illiquidity. Its vulnerabilities are indicative of risks to the dollar. As noted in a recent Group of Thirty report:

> A series of episodes, including the "flash rally" of 2014, the Treasury repo market stress of September 2019, and the COVID-19 shock of March 2020, have created doubts about its continued capacity to absorb shocks and focused attention on the factors that may be limiting the resilience of Treasury market liquidity under stress.[24]

The US must modernize the architecture for trading US Treasurys. Blockchain software should be part of the solution to make the Treasury market more liquid, complete, and resilient.[25] The benefits would include real-time settlement, greater ease of auditability, open application programming interfaces so better tools can be written atop open-source systems, and superior privacy protections.

Amid the great leap in technology—and increasing stresses in the global financial markets—the sovereign, which is "last mover," will have fewer good options. America's natural allies are unlikely to wait around while US authorities ponder reforms. Unless the US adjusts to the changing technology frontier, the privilege of currency dominance is at risk. The US should show greater urgency in responding to the prospective challengers to dollar dominance.

The rapid proliferation of private cryptocurrencies appears to have caught the Biden administration somewhat by surprise, which has given rise to a second policy prescription.

The Treasury and White House appear keen to promote private stablecoins as a linchpin of a new regime. In a report issued by the President's Working Group on Financial Markets, the administration made clear that it is working "to stabilize" the stablecoin market. The administration proposes that stablecoin issuers be regulated as "insured depository institutions." By subjecting stablecoins to supervisory and regulatory oversight, "interoperability" would be promoted. The President's Working Group believes that stablecoins should be treated as "systemically important."[26] The administration appears to believe that private stablecoins are the best, most effective way forward.

At the very least, if this policy were adopted, Congress and the regulators should insist that private stablecoins be backed dollar-for-dollar by Treasurys, cash, and other risk-free assets only. They would be wise to also require strong capital requirements for the stablecoin sponsor.

But, perhaps owing to the scars of the 2008–09 financial crisis, I worry that even these seemingly high standards would fall over time. Weaker collateral would be substituted, regulation would become less exacting, and private stablecoins would become more vulnerable to runs. That's how the political economy tends to operate.

The case of money market mutual funds is instructive. These funds, largely regulated by the Securities and Exchange Commission, were reasonably stable for long periods. But their stability and resiliency were tested in times of stress. Money market funds proved unable to withstand the macro-shocks of 2008 and 2020. Policymakers were compelled to provide extraordinary fiscal and monetary support to bail out the funds. They turned out to be considerably less stable and less resilient than promised, making them a poor substitute for US Treasurys.[27]

The stakes are even higher when considering private stablecoins, which would ostensibly serve as a proxy for the US dollar. Would demand by the foremost foreign governments and other sophisticated, institutional investors be as strong if the US chose to operate the world's reserve currency on a private company's IOUs? Would demand for the dollar remain as steadfast by virtue of the Federal Reserve serving as the regulator of the private stablecoins?

I am concerned that bank-like regulation of private stablecoins might not prove a sufficiently strong foundation from which a reformed American-led financial architecture should be established. "Proper regulation" may ultimately be insufficient to ensure the long-run stability of the US dollar. Moreover, labeling stablecoins "systemically important" risks connoting another implicit government guarantee.[28]

The policy the Biden administration is promoting could add private stablecoins and their sponsors to the growing category of products, activities, and firms that are quasi-backed by the US government. The world's reserve currency could hence be subject to a policy of so-called constructive ambiguity. That's not robust enough for the US dollar in a changing world.

There is only one true stablecoin, and it's the silver dollar (and its paper equivalent). I'd prefer a more robust response to the Chinese challenge than a multitude of privately issued stablecoins.[29]

A third policy preference is gaining considerable traction in Washington. Some are pushing the US to adopt an end-to-end CBDC, whereby the Fed would intermediate all payments, including serving as the direct counterparty to US consumers. According to a recent paper, the Fed describes a CBDC as a "digital liability of the Federal Reserve that is widely available to the general public."[30] That sounds like America's version of China's e-CNY. US authorities should not copy the Chinese model, not least in creating a cryptocurrency.

A retail-oriented, customer-facing CBDC would undermine the private sector's role as the direct counterparty to citizens' economic and financial lives. It's at odds with the American ethos of privacy from government intrusion. The specter of state surveillance of individual spending choices is not the American way. The interface with citizens should be with the private sector, conferring some substantial degree of competition, choice, and autonomy for individuals and businesses.

A wholesale-to-retail CBDC would also risk eroding the US financial system's resilience. It would threaten to crowd out commercial bank money with government-backed money, thereby altering the structure of the US financial system. The implementation of monetary policy—already more cumbersome than optimal—would be hampered. And it could give rise to a single point of failure of the US financial system.

No less important, Congress and the president have constitutionally sanctioned responsibilities in allocating and redistributing national resources. Imagine the political pressure if households held a direct claim on central bank cash. If the new CBDC were consumer-facing, the Fed would inevitably become more embroiled over time in decisions about fiscal transfers.

As I experienced during the panic of 2008 and observed in the 2020 crisis, the political class was tempted to bypass the legislative process, querying if the Fed would fill citizens' wallets. In my view, the Fed is not a repair shop for broken fiscal policy. It should have no role in direct payments to households and businesses. An end-to-end CBDC would risk increasing central bank power without democratic accountability.

For too long, the Fed has played an outsize role in our system of government. An end-to-end CBDC would expand further the scale and scope of the Fed's role. Now more than ever, the Fed must demonstrate complete focus and fidelity to its price stability mandate. Establishing an end-to-end CBDC would be a significant economic and geopolitical policy error.

The good news is that the policy choices need not be among these three alternatives: doing nothing, outsourcing the dollar's special status to private stablecoins, or adopting the Chinese model that impinges on citizens' rights and the private sector's responsibilities.

A Way Forward

The annual report of the Bank for International Settlements nicely captures the broad objective:

> The future monetary system should meld new technological capabilities with a superior representation of central bank money at its core. Rooted in trust in the currency, the advantages of new digital technologies can thus be reaped through interoperability and network effects.[31]

To achieve this goal, the US should take the lead in pronouncing the essential design features of a wholesale-only, dollar-based CBDC. The new wholesale digital dollar framework should be established to intermediate dollar payments between the US government and wholesale providers of banking services. The proposal has a powerful use case.

The existing wholesale payment system is slow, cumbersome, opaque, and expensive. The growth in the digital economy demands a fast, efficient, safe, and sound payments system. Modernizing the wholesale payment rails would deliver significant benefits.[32] Settlements would be made far faster. Payments would become cheaper. Cross-border transfers would be virtually seamless and considerably more affordable. And money creation would be made more transparent.

A narrow-purpose digital dollar would also strengthen the US leadership position in the world. The US leads the global economy, and the dollar is the linchpin of the financial system. But its standing is under threat. Absent a definitive leadership role by the US, other countries—with decidedly different views of the public good—are actively seeking to use new technology to erode America's standing.

A narrow, well-considered digital dollar regime is most conducive to monetary soundness, sovereign control, financial innovation and competition, and individual privacy.

Soundness. The wholesale-only digital dollar would be fully backed by the full faith and credit of the US government. There would be no ambiguity or implicit backing. The proposed architecture has another important advantage over an end-to-end CBDC: Each transaction would have its own ledger, so there would be no single point of vulnerability. The separation between wholesale and retail funding ensures continuity with the long-held distinction between central bank money and commercial bank money.

A wholesale digital dollar would also preserve an important role for an old-fashioned and credibility-enhancing form of money: cash. The option for individuals and businesses to continue to access cash is a design feature, not a bug, of the proposed reform.

Sovereignty. A digital dollar—for exclusive use by the central bank and the financial services system—would bolster our currency's role as a global public good. The proposed framework would give agency to other countries to make their own monetary choices and maintain their own sovereignty. They would not be compelled to be subservient to the demands of any other sovereign. The framework, however, would be designed to encourage interoperability with other foreign central banks and their financial systems. Sovereigns would establish their own home-host rules to govern how their own payment systems could interface with ease with the digital dollar.

Innovation and Competition. The framework would be designed to be pro-innovation and pro-competition. Private companies would serve as the exclusive interface to businesses and households. Financial institutions would face the consumer and, at the same time, connect seamlessly into the new wholesale digital protocol. Domestic financial institutions would compete to be the most efficient provider of retail payment intermediation and serve as the source of innovation. Smaller, regulated financial institutions would plug in to the new protocols as readily as the largest banks.

Economic rents imposed by legacy systems would be competed away. So the cost of money transfers and remittances to the end user would be expected to fall significantly. Cutting-edge payments, including micropayments, could well gain new traction.[33]

Privacy. Direct use of the wholesale-only digital dollar would explicitly be bounded: Individuals, households, and businesses would not be eligible holders. Americans have rightful concerns about government encroachment in their private affairs, including privacy in financial services transactions. The consumer privacy ethos would not just be maintained, but strengthened, under the new regime.[34] The new framework would give users not just privacy but also more control of their personal financial information.[35]

Conclusion

China is giving the US a run for its money. The advent of blockchain technology—combined with the ambition and assertiveness of the Chinese regime—represents a new front in the great-power rivalry with the US.

China has made its move, building out a fully integrated wholesale-to-retail CBDC. It reveals clear Chinese designs on an alternative, non-dollarized global network. Its use of carrots (fast and inexpensive transaction execution) and sticks (compulsory usage if wanting to do business in China) will be tempting to many sovereigns and enterprises.

A rigorous and timely response from US authorities is required, consistent with American values and traditions. The US payment system requires a significant upgrade, and a new wholesale digital dollar would improve America's economic and political standing. The US should announce the architecture of a new wholesale-only digital dollar, not a Chinese copycat.

Now more than ever, the US and its allies need sound and stable money to escape a period of weak output, high inflation, and geopolitical confrontations. A narrow, resilient, efficient digital dollar backed by the full faith and credit of the US should be an important part of the reformed US financial and monetary architecture.

Acknowledgments

I am especially grateful to Mark Carney, Jay Clayton, John Cogan, Avichal Garg, Alan Howard, Paul Ryan, and Eryn Witcher for their invaluable comments and suggestions. The errors are, of course, my own.

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Independence, and COVID-19," YouTube, January 14, 2021, https://www.youtube.com/watch?v=_6Vv1FWkWJ0.

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25. The problems in the Treasury market are about not just the payment rails but arbitrage. There should be one risk-free asset, and its liquidity should be as deep as the ocean. Instead, an excess of purportedly risk-free assets in segmented markets are competing for liquidity, especially in times of stress.

26. President's Working Group on Financial Markets, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Report Stablecoins," US Department of Treasury, November 2021, https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

27. Bitcoin, in contrast, does not purport to act as a stablecoin. I view the large daily swings in bitcoin's market value to be an important design feature. After 13 years of trading in the open market, the large variance in price may well make its value more enduring than if its price were fixed. Currently, bitcoin's market price appears to be highly correlated with other risk-asset markets. In the next phase, however, I expect bitcoin's market price to be more correlated with the perceived irresponsibility of the official sector. That is, when government policy is particularly imprudent, the price of a bitcoin may tend to rise.

28. Implicit guarantees from the federal government are multiplying. For example, before the 2008–09 global financial crisis, most policymakers and market participants thought Fannie Mae and Freddie Mac, two of the largest backers of mortgages, were safe and solvent. They were not, and the US government repeatedly felt compelled to act to make their bondholders whole. Another example of an implicit government backstop: Most policymakers and investors believed that the largest regulated banks were safe and sound. Many were not. The government felt compelled to backstop the debt of the biggest banks too.

29. Private stablecoins could be used as a short-term proof of concept as part of a concepted plan to a wholesale-only digital dollar such as I have outlined. It would require, however, clear, strong, unambiguous rules and dollar-for-dollar backing with a fixed transition period. Some authorities, including former Securities and Exchange Commission Chairman Jay Clayton, believe that private stablecoins are an important first step. He believes that clear rules that ensure that each stablecoin is the equivalent to a corresponding cash balance held by a bank, trust, or similar entity would accelerate the transition to a digital dollar. This proof of concept model may be worthy of further consideration.

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34. Existing anti–money laundering regulations and know-your-customer rules would still be applicable.

35. Zero-knowledge proofs could offer users a heightened level of privacy in their dealings with all stakeholders, including retail banks.

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Acknowledgments

The editors of this volume want to thank Peyton Roth for his outstanding research assistance and overall coordination efforts, without which this book would not have been possible. We want to thank all of the contributing authors for their expertise, dedication to conducting rigorous policy analysis, and willingness to share their views with others. We also want to thank the many individuals inside and outside the American Enterprise Institute who helped shepherd this project along, including Ted McCann, Kevin Seifert, Sarah Bowe and the entire AEI Editing Services team, Thomas O'Rourke, Melissa Pranger, Claude Aubert, James Desio, and Abigail Guidera, along with numerous research assistants, interns, and support staff. The completed project is far better because of your contribution. Finally, we want to thank the American Enterprise Institute and its leaders, including President Robert Doar and Director of Domestic Policy Studies Ryan Streeter, for supporting this project and creating an environment conducive to the competition of ideas.

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