REFORM PROPOSAL OF COMMISSIONER RICHARD L. TRUMKA

SOCIAL SECURITY, HEALTH CARE, AND TAX REFORM

A. SOCIAL SECURITY

The Social Security Trustees customarily evaluate the financing of Social Security over a 75-year period. According to their latest report, the program is on sound financial footing for the next 25 years, but a shortfall will develop sometime during the second decade of the next century. While no one can be sure about 50- to 75-year estimates, it makes sense to enact changes now that will take effect later to bring estimated income and expenditures into balance.

Enacting these reforms now will help restore the confidence of people of all ages in the future of Social Security. If it turns out that we have been overly cautious, some of the planned changes need not be put into effect.

There is clearly no crisis in Social Security, either in the short or long term. But the Kerrey-Danforth proposal does not acknowledge that the long-term imbalance can be resolved without imposing radical changes in the program.

In 1982, the Greenspan Commission confronted a real crisis in Social Security financing, but resolved to consider only those changes that would maintain the fundamental principles of the Social Security system. That Commission agreed to a set of principles that we should have adopted for our own deliberations. They wrote:

> The members of the National Commission believe that the Congress, in its deliberations on financing proposals, should not alter the fundamental principles of the Social Security Program. The National Commission considered, but rejected, proposals to make the Social Security program a voluntary one, or to transform it into a program under which benefits are a product exclusively of the contributions paid, or to convert it into a fully funded program, or to change it to a program under which benefits are conditioned on the showing of financial need.

To illustrate how the long-term financing needs of Social Security can be met without undermining the basic principles of the program, we should limit our consideration of reforms to the following options, with the goal being to eliminate the 2.13 percent of payroll deficit.

— The Commission Staff estimated that the Bureau of Labor Statistics (BLS) will revise the Consumer Price Index (CPI) to measure inflation more accurately so that the current CPI is lowered by 0.5 percent — for use in benefit and income tax calculations starting in 1996. This would save 0.7 percent of taxable payroll without a reduction in benefits.

— Crediting to Social Security, rather than to Medicare, the full amount of income generated by the partial taxation of Social Security benefits. This approach saves 0.35 percent of taxable payroll.

— If we treat Social Security income like private pensions for income tax purposes, this saves an additional 0.4 percent of taxable payroll.

— Eliminating the cap on employer contributions in 2015 saves 0.8 percent of taxable payroll.

— Increasing payroll taxes by 1 percentage point in 2020 for both employers and employees. This provides 1.12 percent of taxable payroll.

Social Security can and must be improved. For instance, poverty rates among older American women are among the highest in the world. While poverty among married elderly couples is very low, it is quite high among elderly widows. We should consider reducing couples benefits and increasing widow(er)s benefits, and this can be done at no additional cost to the system.

B. MEDICARE AND MEDICAID

Because expenditures for Medicare and Medicaid are inexorably tied to the private sector health care economy, simply reducing the funds available for them will not solve the problem. Further cuts in reimbursements to providers will just shift costs to the private sector and make more providers reluctant to provide service to government beneficiaries. Slashing the protection provided by these programs through large-scale increases in deductions and coinsurance would soon make the programs ineffective.

Some budget relief can be achieved by taxing general revenue subsidies now going to Medicare Part B beneficiaries or by reducing subsidies that go to higher-income beneficiaries. However, none of these options will make much of a difference in the long-term outlook for these programs unless we redouble our efforts to hold down the cost of care in our entire health care system — public and private.

C. TAX REFORM

The Kerrey-Danforth proposal took a one-sided view of the Commissions's mandate by including only spending cuts in its recommendations. Yet the U.S. tax code does not pass the basic tests of fairness or efficiency, nor is it raising sufficient revenues to finance the Nation's urgent, unmet public investment needs.

Corporations have shouldered a smaller proportion of the Federal income tax burden in each successive decade since the 1950s, and are taxed more lightly than their competitors in such highly successful industrial nations as Germany and Japan.

Closing unproductive tax loopholes could reduce by one-third the projected Federal deficit in 2030. Appendix I includes a list of tax proposals that can raise $88 billion in 1995 alone.

APPENDIX I:

1. ***Change the Foreign Tax Credit to a Deduction.*** U.S.-based multinationals are able to take a credit against their U.S. corporate income tax obligations for income taxes that they pay to foreign countries. This provides them with an incentive to invest abroad rather than in the U.S., costing the Treasury and shifting production and jobs overseas. The latest IRS estimates show that U.S.-based multinationals took nearly $25 billion in foreign tax credits in 1990. If the credit was treated as a deduction (as are corporate taxes paid to States) the Treasury would have raised an additional $16.5 billion.

   REVENUE GAIN = $16.5 billion

2. ***Eliminate Deferral of Income from Controlled Foreign Corporations.*** U.S.-based multinational corporations do not have to pay taxes on all of the profits earned by their operations in other countries. Instead, they are often allowed to defer these taxes until the profits are "repatriated," meaning returned to the U.S. This encourages these companies to reinvest abroad and costs the Treasury. The 1994 Federal budget estimates that deferral costs $1.6 billion per year.

   REVENUE GAIN = $1.6 BILLION

3. ***Crack Down on Transfer Pricing Abuse by Multinational Corporations.*** During the 1992 campaign, President Clinton estimated that $13 billion per year could be raised by making foreign multinational corporations pay their fair share of taxes. Both U.S. and foreign-based multinationals are able to avoid taxes by shifting their costs of production on paper. For example, a firm can overcharge itself for an item produced by one of its subsidiaries in a low-tax country. That shifts its income out of the United States and into the low-tax location. A simple way to end this practice would be to adopt a formula approach, similar to that used by many States, for computing how income earned by multinationals should be allocated among nations. Professors John Zdanowicz and Simon Pak of Florida International University have developed a sophisticated method for estimating the extent of lost tax revenue due to such transfer price manipulations. Their most conservative estimate is that the Treasury lost $28.7 billion due to such transactions in 1992.

   REVENUE GAIN = $28.7 BILLION

4. ***Stop Misclassification of Employees as "Independent Contractors."*** Dishonest employers often misclassify their employees as independent contractors in order to avoid paying for Social Security, employment taxes, and various benefits. The House Committee on Government Operations has estimated that such abuse of independent contractor status costs about $2 billion per year in lost revenues.

   REVENUE GAIN = $2 BILLION

5. ***Tax All Corporate Income at 35 Percent Rate.*** Corporate income taxes accounted for over 30 percent of Federal revenues in the early 1950s. Today they pay for less than 10 percent of the U.S. Budget. Other Organization for Economic Cooperation and Development (OECD) countries rely more on corporate income taxes to raise revenue than they did in past years. Today, only corporations that earn in excess of $10 million pay at the full 35 percent statutory rate. Below that they face marginal rates of 15, 25, and 34 percent, depending on their profit levels. Congressional Budget Office (CBO) estimates that eliminating the lower bracket and taxing all corporate income at the same rate would raise an additional $1.9 billion in 1995 and $3.7 billion by 1999. Noncorporate small businesses would not be hurt by this provision, because it would not apply to sole proprietorships, partnerships, or subchapter S corporations.

   REVENUE GAIN = $3.7 BILLION

6. ***Amortize a Portion of Advertising Costs.*** Corporations that spend huge sums on advertising are able to deduct these amounts as a cost of doing business. But in many ways advertising is less a business cost than an investment in brand recognition. The benefits of this expenditure last many years beyond the year in which they are incurred. When firms invest, such as when they buy new equipment or facilities, they are not allowed to take an immediate deduction for such expenditures. Instead they must amortize the expenditures, and deduct the costs over time at the rate that their capital is presumed to wear out. Because advertising is at least in part like an investment, with benefits lasting for years, it would make sense to require firms to treat part of this expenditure as an investment rather than a deductible expenditure. CBO estimates that requiring 20 percent of advertising costs to be treated as capital expenditures and deducted over a period of four years would raise $3.3 billion in 1995 and $5.9 billion in 1996.

   REVENUE GAIN = $5.9 BILLION

7. ***Limit Mortgage Interest Deduction for Mansions.*** To encourage home ownership, the tax code has historically treated investments in a home more favorably than other investments. Such a policy makes sense for most home owners. But it would also make sense to lower the limit on the amount that is eligible for a deduction. Why should the tax code give preference to the purchase of mansions by the well-off? CBO estimates that, if the limit on the amount of principal eligible for a deduction was lowered from $1 million to $300,000, an additional $1.6 billion could be raised in 1995, increasing to $5 billion by 1999.

   REVENUE GAIN = $5 BILLION

8. ***Tax Capital Gains at the Same Rate as Ordinary Income.*** Taxing capital gains at the same rate as ordinary income would generate additional revenues of about $15 billion per year. Currently the top Federal income tax rate on capital gains is 28 percent, versus 39.6 percent for ordinary income. This

benefits the wealthy overwhelmingly, since most lower- and moderate-income taxpayers have little if any capital gains. To make matters worse, the gap in rates on ordinary income versus capital gains creates an incentive for wasteful tax shelters, devices used by the wealthy to convert ordinary income into capital gains for no economic purpose other than to reduce their taxes.

REVENUE GAINS = $15 BILLION

9. ***Tax Unrealized Capital Gains at Death.*** Taxing unrealized capital gains at death would yield revenues of $9.5 billion per year. Gains on assets that a spouse inherits would not be included, nor would gains on assets donated to charity. Safeguards could be included to prevent forced liquidation of assets, such as family farms, to pay taxes.

   REVENUE GAIN = $9.5 BILLION