National Small Business Network

Federal Budget Reform for Economic Sustainability

Policy Recommendations for The Joint Select Committee on Budget Process Reform
June 2018

It is time to put aside political rhetoric and re-focus on realistic long-term solutions for our fiscal problems. These recommendations suggest a broad-based strategy for Congress to re-invent an efficient and logical federal budget process and re-build a sustainable Federal fiscal policy.

In its first 15 months, the 115th Congress passed a Tax Cut Act that will increase the US Federal deficit by an estimated additional $2.2 Trillion, over 10 years, with no clear economic need for it, or broad long-term economic benefit for the increased debt . Then, under pressure from the continually postponed expiration of the Congressional borrowing limitation, Congress rushed, with little consideration, to pass a two-year Budget Resolution. That bill ignored prior net spending limits and will add another estimated $300+ Billion to the deficit. CBO is now forecasting a doubling of federal deficits as a percentage of GDP in the next few years, reaching 100% to 105% of GDP in just 10 years. Multiple CBO and GAO reports, and most economists, have concluded that "the Federal government's current fiscal path is unsustainable", even before the additional debt added by this Congress. This report outlines the current problems and suggests logical, information driven, strategies for rebuilding and maintaining the government's fiscal health.

Long-term economic data suggests that each 1% increase in the debt to GDP ratio may increase the 10-year Treasury interest rate by 3 to 5 basis points. In addition, the Federal Reserve's intent to stop buying massive amounts of Treasury debt to depress interest rates, and the inflationary effect of the short-term stimulus from the Tax Cut Act on an already health economy, will probably result in added inflation and higher borrowing rates both for the government and businesses. The rising debt will also probably result in a continued decline in the value of the dollar, which dropped 10% in 2017. Eventually rising interest rates will force more of the federal budget to go toward debt interest payments, less will be spent in the economy, and high interest rate expectations will deflate the US stock market and the retirement assets of millions of Americans. We are moving toward a possible "tipping point" where the level of debt and annual deficits can no longer be reduced without dramatic economic damage.

The priority now, for this Congress, and the next Congress, is to develop a long-term sustainable fiscal and budget process to address the country's needs with highly efficient federal programs and adequate tax revenue to fund them. This is Congress's primary responsibility in the Constitution.

-- Section 1 --

The Urgent Need for - Deficit Control and Progressive Debt Reduction

After years of deficit spending, almost 12% of last year's total federal budget, or 37% of the "discretionary budget", was spent just paying the $460B annual interest on debt from past spending, even at today's still historically low interest rates. Poor fiscal management with too much spending and too little tax revenue has put a burden of over $62,800 in Federal debt obligation on every American. Federal spending is currently about 21% of GNP, estimated by CBO to rise to 23% by 2026, but tax revenue is only about 17.8%. Last year's official deficit, alone, was over $666 Billion, for a total current sovereign debt of over $20.49 Trillion. This essentially equals our annual Gross Domestic Product and is over 11 times total annual Federal Income Tax revenues. Even these amounts do not include the large unfunded future obligations for federal retirement benefits, veteran's benefits, Social Security, Medicare, and Medicaid, which are currently estimated to be over $127 Trillion, or over 67 times total current annual Federal tax revenues. We are also facing massive unfunded costs of infrastructure repair and replacement, and climate change remediation.

The status of the dollar as the world's reserve currency for international transactions, particularly for oil, is also being challenged, with potentially severe devaluation consequences if it loses that function. Our sovereign credit rating was downgraded by a major rating agency, with warnings from others. The IMF has approved China's currency for international reserve transactions. The only thing that has protected us from significantly higher interest rates for our national debt was the weak demand for capital and the fact that other major countries had similar debt and fiscal problems. If the Treasury average interest rate rises to only 5.5%, the annual interest on the current debt would be over $970 Billion and could consume almost half of all current Federal Income Tax revenue.

Reform Objectives:

We support the recommendations of Senate Budget Committee Chair Senator Mike Enzi in the Committee's 2016 report on "Fixing America's Broken Budget Process". Its recommendations, which are even more valid today, are available on our website at www.NationalSmallBusiness.net/issues . We also share the general goals of the last, and apparently now forgotten, Presidential Commission on Fiscal Responsibility and other deficit reduction research groups for progressively returning to a sustainable federal fiscal policy. Most have suggested an initial 10 to 20-year plan to progressively eliminate annual deficits and reduce the federal debt to below 75% of GDP while keeping maximum total Federal tax revenues below 25% of GDP. We also share the conclusion of most other groups that deficit reduction will require both spending reductions and significant corrective revenue increases.

-- Section 2 --
Budget Process Reform Recommendations:

The purpose of government is to provide a stable structure in which people can live and work, and to provide important services, collectively, that individuals cannot effectively provide for themselves. Unfortunately, the federal budget has grown so large and complex that it is difficult for even the Congress to properly evaluate program effectiveness or understand the long-term economic impacts of spending policies. Realistic budget decisions are also made more difficult by a lack of transparent and consistent accounting standards, as required of private sector organizations. This includes the tendency of both Congress and the Administration to present expenditure and revenue estimates with time frames and baselines most favorable to their policy preferences. To assist Congress in making more realistic and sustainable budget decisions, we recommend these changes to the Federal budget process.

A. **Develop a more performance-based budgeting and appropriations process** similar to successful businesses and several state governments which have "re-invented" their budget processes. Congress should regularly re-evaluate program expenditures and agency budgets in relation to the value and efficiency of the services delivered. This approach rewards the program's current importance to citizens, rather than historical expenditure levels. Multi-level prioritization based on clearly defined performance measures should occur at the program level, the agency level and finally between agencies. The process should focus on minimizing "non-value-added costs" that do not significantly improve service delivery, and on prioritizing programs that provide the greatest benefit to taxpayers in relation to their cost. Prior to each appropriation cycle, agencies should be asked for detailed recommendations on how they can achieve their objectives with less funding. Current service level, "use it or lose it" budgeting, or "across the board" percentage reductions such as sequestration, often waste resources on in-efficient or unneeded programs, and under-fund more beneficial programs.

B. **When appropriating for agencies, Congress should demand increasingly efficient performance results**. Program funding, and state government, or private sector cost reimbursements, should be based on the use of the most efficient administrative processes and technologies. This should include improving economies of scale by combining existing agencies and administrative processes when possible and closely coordinating and partnering with state regulatory or social service programs.

C. **Convert to a biennial Budget process to allow more time for a detailed evaluation of agency programs and appropriations.** It has been more than 20 years since the Congress has completed the appropriations process prior to the start of the next fiscal year. This means decisions are often rushed and agencies often don't know what their budget is until well into the program year. Changing to a biennial process would allow more time to review agency programs and still have time to complete the adoption process prior to the start of the next fiscal period.

D. **Expand the roles of the Office of Management and Budget (OMB), the Congressional Budget Office (CBO), and the Government Accountability Office (GAO), to help the Congress better evaluate the comparative performance and cost efficiency of agencies and programs.** Detailed, and unbiased, evaluations of program performance and value are necessary for a successful performance-based budgeting process.

E. **Require JCT to provide broader longer-term revenue impact scoring for all tax legislation to reduce "scoring games" that distort revenue impacts.** Too often legislation is crafted to look revenue positive during the current 10-year scoring period without considering longer term revenue consequences. A perfect example was Congress using the short-term tax revenue from allowing the conversion of taxable IRAs to Roth IRAs to "pay for" the Bush era tax cuts, without considering the long-term loss of tax revenue. Revenue scoring also often focuses only on estimated federal tax revenue changes, without adequate consideration of the direct governmental program and administrative costs and additional private sector compliance costs which reduce economic productivity.

F. **Develop a stronger and more detailed 10 year running budget and revenue plan** for the federal government with a congressionally adopted policy to keep expenditures below projected revenues over the 10-year period. The goal should be to reduce the national debt below 60% of GDP by 2025. This is a better way to control expenditures than "Balanced budget Amendments" that restrict recovery options in true economic emergencies.

G. **Using the 10-year budget plan as a base, assure that biennial budget limits are adopted by each Congress for the <u>following Congress</u>.** This would allow the Appropriations committees to start work at the beginning of each session and more efficiently make transitions needed for future funding and program changes. Although politics, and the constant re-election cycle, can never be removed from the budget process, the experience and political independence of each Congress's retiring members should help when facing tough decisions. Doing this will require catching up on the budgeting and appropriations process and making it a top priority at the start of every congressional session. The repeated failure to pass budget agreements and agency appropriations until well after the start of the fiscal year demonstrates a basic lack of proper control over the budget and expenditure process. This encourages wasteful spending and program disruption. The government should also search for and reclaim unused prior year grants and revenue sharing expenditures and reapply the funds in current budgets.

H. **Develop a more coordinated and economically efficient Federal-State regulatory structure**. **The programs should also consider the non-value-added cost impacts on the private sector, on state governments, and on the economy, when evaluating the need for, and performance of, all regulatory programs.** The process should also include continuation and expansion of initiatives to work more directly with the states to coordinate taxation and regulatory programs and share reporting information and regulatory overhead costs. State government program partners and private service providers to federal programs should also be required to use <u>standardized</u> electronic reporting and accounting software to reduce duplicate development costs and improve program accountability.

I. **Replace, intergovernmental and private contractor "cost plus" State government reimbursement agreements, which reward <u>in-</u>efficiency, with fixed price contracts that reward cost reduction** and have penalties for poor performance.

J. **Change the Senate Rules to require that Budget and appropriation bills be passed under regular order and receive priority for floor consideration in each session. Prohibit the use of an omnibus budget reconciliation to pass budget bills that exceed CBO projected revenue for the period**. This would require at least 60 votes in the Senate to pass a deficit budget.

K. **There should be <u>NO</u> continuing off budget expenditures**, for military activity, disaster assistance, or any other purpose. <u>There is no value to having a budget for fiscal control unless all significant expenditures are included.</u> Congress should review and approve supplemental budget authorizations for any non-budgeted expenditures at least every year, including off-setting adjustments to other budget items, or providing additional revenue if necessary. Recurring "emergency" spending needs, such as disaster assistance, should be budgeted for, based on realistically expected expenditures for the budget cycle.

L. **When additional short-term economic stimulus or "emergency" deficit spending is needed to help the economy through cyclical downturns, wars, or natural disasters, Congress should provide a source of offsetting revenue later in the 10-year budget planning period.** The focus of any short term economic stimulus incentives should also be on creating long-term jobs that are likely to continue beyond the funding period.

M. **Congress must also prevent the growth of predictable unfunded future budget commitments such as federal employee retirement benefits, veteran's benefits, or other programs, by properly accounting for estimated future liabilities and providing adequate reserves in current program budgets.** For example, the VA indicates that almost 45% of the 1.6 million veterans from the Iraq and Afghanistan wars have sought disability compensation. When possible, convert new federal employee and military retirement benefits from defined benefit programs to <u>currently funded</u> defined contribution plans which will automatically prevent the growth of unfunded pension obligations.

N. **Reduce the political impediment to balanced budgeting by passing bi-partisan "Fail-Safe" budget balancing legislation <u>mandating</u> an automatic proportional increase in personal and corporate federal income tax rates needed to offset any CBO projected budget deficit, unless a deficit budget is approved by 66% of each house of Congress.** Because of the natural political resistance to both reducing program benefits and also to increasing taxes need to pay for them, it is very hard for our current Congressional process to develop balanced budgets need to reduce, or even stabilize the debt. The 2017 GAO Fiscal Health Report to the Congress states, "The current debt limit is not a control on the debt" and the Congress needs "alternative approaches that would better link decisions about borrowing…with decisions about spending and revenue <u>at the time those decisions are made"</u>. States have overcome this political process problem with Constitutional mandates to require balanced budgets, although they are still susceptible to not including the costs of long-term obligations. Although a Federal Balanced Budget Constitutional amendment has been proposed, it would take too long to implement, and might not provide enough flexibility for dealing with economic emergencies.

-- Section 3 --
Un-Accounted for Future Federal Costs
Recommendations for Preventative Action.

This section goes beyond the process related objectives of the Joint Committee on Budget Process Reform. It is important, however, that the Committee recognize in its report that even with an efficient and balanced annual budget, potentially massive unbudgeted expenditure needs are not being properly accounted for by the Congress.

A. Social Insurance Program Recommendations:

The funding deficits for our social insurance programs, Social Security and Medicare, deserve separate evaluation, because they are dedicated programs with a separate payroll tax funding source. Both programs are currently seriously underfunded for their projected future benefit payout and have a negative cash flow. This is a result of rapid growth in benefits paid out for the large number of "baby boomers" now retiring with substantially increased life expectancies, and a declining growth in the working population and average taxable wage base. The re-structuring of many businesses to reduce employment, at least in the US, will continue to reduce payroll tax revenues in relation to GDP growth. Chronic under-employment is also increasing the number of citizens relying on benefit programs such as Medicaid and many have had to start Social Security at 62 because of involuntary "retirement".

Making these programs sustainable is technically simple, as any insurance actuary knows, and should have been done years ago. There are only 3 options to restoring stability – increase the payroll tax rate or maximum wage limit; further limit benefits of those who do not need them; or provide additional funding for the programs from other revenue sources. In selecting a balanced solution from those alternatives, it is important to remember that the programs were originally intended to be "social insurance" safety nets for those who need them most, not pre-paid benefit programs for every citizen. People buy many kinds of insurance every year; even though most never collect any actual benefit from them. If current benefit levels are going to be continued with projected participant levels, payroll taxes would have to increase on current wage earners, with potential negative economic impacts. The current payroll tax base limits for social security are also regressive by limiting the tax contributions from higher income wage earners, while taxing all the wages of lower income workers.

1. **Increase the Social Security early retirement, and full retirement, ages** to better reflect current life spans and working patterns. Revise the Cost of Living Adjustment formula.

2. **Continue the current method of taxing Social Security benefits to reduce the net after tax benefit** to those with other income. The estimated value of the taxes paid on social security benefits should be credited from general revenues to the Social Security program.

3. **Remove the Social Security taxable wage limitation so it matches the Medicare program provisions** to increase contributions from higher income individuals.

4. **Investigate and reduce fraudulent Medicare reimbursement billings and invalid claims against the Medicare disability system and other government disability programs.** Require states or other agencies who administer federal programs to use the same reporting software and communication systems to process claims to help enable rapid detection of duplicate or fraudulent claims. Eliminate government payments to private attorneys who promote fraudulent claims.

B. Workforce Education and Immigration Policy Recommendations:

In the past, our technological innovation and high workforce skills increased individual productivity and were a major factor in our manufacturing and economic growth. Today, that advantage is rapidly declining as first the production, then the engineering, and now the research and development, of new technologies has moved to other countries. The quality of our education system and the skills of our workforce are also declining in relation to other countries, particularly in key science and engineering areas.

One potential cause of long term governmental deficit is a cost of governmental services that exceeds the economic productivity and tax revenue contribution of its citizens. As a result, an important factor in restoring economic sustainability is the composition and average economic productivity of the US population. Two hundred years ago we had a vast continent, with seemingly unlimited resources and a great need for people to develop it. In the last century, most businesses were highly labor intensive and economic growth depended on a growing population.

We now face a different world where technology advances in agriculture, manufacturing, and most other types of businesses, have reduced our need for simple human labor in relation to our GDP. The McKinsey Global Institute forecasts that half of all current work activity could be automated by 2055. This has been compounded by a "flatter world" which has caused many of our lower skill middle income manufacturing jobs to be "out sourced" to lower cost foreign workers in foreign economies. This reduces the domestic economic multiplier effect of our domestic consumption expenditures. Machines have replaced manual labor, computers have replaced administrative and managerial employees, and now intelligent robots are replacing many remaining domestic manufacturing and distribution jobs.

The percentage of our population, who are unemployed, under-employed, unemployable, or prematurely "retired", continues to grow. It is now estimated that over 40% of our total working age population is not employed. Many citizens simply do not have the skills needed for higher skill, higher economic value, jobs. This results in lower per capita productivity and personal income, and a greater need for governmental social program subsidies, but with less income tax and payroll tax revenue to pay for the government programs. Efforts to shift increased benefit costs onto employers, such as in the PPACA health care requirements, only increase the incentive to eliminate jobs wherever possible, and replace low skill, but high benefit cost, employees with technology, robotic machines, off-shore production, or increased use of part-time workers. This would further compound the long term under employment problem.

1. **Develop a bi-partisan, Strategic National Economic and Workforce Redevelopment Plan,** identifying the best potentials for future domestic and international traded sector economic growth. Target Federal tax incentives and education and training programs toward workforce skill areas needed in the economy, and that will be needed for the US to compete in the future world economy. This will also reduce the need for foreign workers to provide needed skills. The Congress should then support government programs, regulatory policies, and tax policies to encourage and support future economic growth in these key economic sectors, within the legal limits of international trade agreements.

2. Provide stronger incentives, in unemployment and social welfare programs to get more recipients into retraining and work experience programs. Partner with private businesses, trade groups, colleges and state employment departments to develop training programs to match specific regional workforce needs.

3. Provide significant, coordinated, and consistent incentives for businesses to hire and train military veterans, the disabled, the under educated, and other displaced workers.

4. Adopt strategic, 21st century immigration policy reforms. With a large number of "baby Boomers" retiring and our birth rate declining, economic growth will require immigration of workers from other countries. Many immigrant workers are also willing to do jobs such as agricultural harvesting, that most American workers decline. We should review and update US immigration laws to resolve long standing issues such as the quantities and skills of both permanent immigrants and short-term "guest workers" who are needed for the current economy, and the process for admitting them. We also need to resolve the status and permanent citizenship options of existing long-term illegal alien residents and their children, to better integrate them into our economy.
However, from a long-tern fiscal standpoint, we also must understand that much of the world's population would like to live in the US and benefit from our economy, governmental system, and social benefit programs. Climate change disasters, famine, and religious and nationalistic wars could create millions, or even billions of future refuges seeking a better life. At some point the US economy and social infrastructure could not survive this level of immigration. We need to do a better job of helping

other countries both financially, and with our leadership, to solve their national problems so they can meet the economic and security needs of their own citizens.

C. Infrastructure Deficit Recommendations:

Much of the infrastructure needed to sustain and grow our economy, such as roads, bridges, ports, the electrical grid, and other transportation systems is not being adequately maintained and improved. The Federal government, in coordination with the states, needs to develop a prioritized program of infrastructure repairs, replacements, and improvements along with long-term sustainable funding programs to pay for them.

The 2015 Transportation system funding bill did not provide an adequate or sustainable long-term funding solution for roads, bridges and public transit. The increase in the fuel taxes would not be a new tax. It is just a much overdue inflationary adjustment. The current relatively low cost of oil provides an opportunity for a needed correction now, without significant economic or political hardship.

With new vehicle technology, and decreased fuel use, we will eventually need a new transportation infrastructure funding system, which should be national, but any new system will probably take at least 10 years for technical testing, administrative development, and approval by 50 state legislatures and 2 branches of the Congress. In the interim, the lower tax collected on electric vehicles will provide an incentive for their use, which will further reduce carbon emissions. Higher fuel taxes will also provide an immediate market place incentive to remove old low gas mileage, high carbon emission, and increasingly unsafe, vehicles from the road.

1. **Congress should instruct the Congressional Budget Office to provide annual estimates of the level of Federal funding that would be needed under current joint funding agreements for maintaining and replacing the national infrastructure at current and projected future service levels.**

2. **To fund needed maintenance, the Congress should immediately pass an inflationary adjustment to the fuel tax on gasoline of at least 30 cents per gallon, with comparable rate increases for diesel fuel and other fuel alternatives. Similar user fee-based fees or excise taxes need to be increased or developed to adequately fund maintenance and improvement to our ports, air transportation system, and electrical and data networks.**

D. Health Care System Reform and Cost Control Recommendations:

Health care costs are a major expenditure for the Federal Government, state governments, and local governments who receive federal program dollars, as well as for individuals and businesses. This includes growing costs for Medicare, Medicaid, government employees, military and veterans' healthcare.

The ACA was never intended to be the final version of health care reform. Some provisions of the reform legislation were experimental, and many other logical cost control measures were not included in the initial reform provisions. Some provisions such as the elimination of coverage limits on pre-existing conditions and life time cost limits, actually added to health insurance costs. The 2017 Tax Cut legislation eliminated the insurance coverage mandates and incentives which were a critical health insurance cost reduction element. This will result in rising insurance costs for those who can afford health insurance and a loss of health coverage for about 30 Million other citizens, which will now push their emergency health care costs on to others. Although the ACA increased insurance coverage to over 91% of the population through mandates and public subsidies for low income individuals, it has not adequately reduced the growing total cost for health care. The US still spends almost 17% of GDP on health care compared to the second highest country, Switzerland at 11.5%, yet ranks well below the median of all OECD countries on life expectancy, infant mortality, obesity, and the percentage of population living beyond age 65. This is due to higher health care delivery system costs and unequal access of low income individuals to basic health services. Further changes are needed to make basic health care more affordable and accessible. **The Congress should now take the time needed to adequately consider evidence-based changes to reduce non-value-added costs and improve the health care system for all Americans.**

Any successful reform of the health care system should at least include these elements:

a. **Research, identify and quantify all the "non-value-added" costs** of the current health care delivery system, which add expense, but do not significantly improve the quality of health outcomes. This includes factors such as high marketing costs by competing drug companies both to doctors and end consumers; high malpractice insurance costs and un-necessary diagnostic costs to protect against liability; and very high cost "end of life" treatments with little effect on length or quality of life.
b. **Evaluate the real-world cost vs. benefit experience of different health care systems in other nations** and leading US states to identify best practices that could be incorporated into our national system, including negotiated pricing on drugs and services and utilization of economies of scale in treatment and administration.
c. **Use balanced, non-political, expert advisory groups to develop logical and comprehensive proposals** for reducing or eliminating each area of non-value-added cost based on actual data, so new legislation does not become politicized. Based on these recommendations, Congress should pass incremental legislation targeted at the highest potential cost reduction areas before taking more controversial actions or creating irreversible entitlements.
d. **Encourage disintermediation of health care services to lower cost providers who can provide appropriate care.** This may include greater use of nurse practitioners, pharmacists, immediate care clinics, and managed care organizations in the health care system. More use can also be made of computer technology for early diagnosis of problems and long-term treatment monitoring.
e. **Evaluate conversion from our current uncoordinated and duplicative systems of employer supplied, individually purchased, and publicly provided health insurance, to basic universal public health insurance, like "Medicare", for everyone.** It should cover, basic trauma care, preventative care, and basic care for longer term conditions. Cost control should be maintained by requiring annual appropriations and then basing the services covered on the relative value of each covered service in extending the life, or quality of life, of the individual or reducing long-term patient costs. Providers, should as much as possible, be paid based on patient health outcomes rather than fee for services. Optional private insurance should then be encouraged

for higher coverage levels or longer-term care similar to Medicare Supplemental Plans. Given the unlimited potential for healthcare costs with modern technologies, the program should not be allowed to become an unlimited entitlement program.

f. **Help consumers control system costs by making certain that all costs in the health care system are transparent** and that all recipients of health care have to pay some level of cost in relation to their income. As an incentive for cost control, patients should pay more for optional premium services, low health value services, and treatment of conditions caused by the patient's lifestyle.

g. **Make sure that the system is national, and not state based, and provides uniform funding, benefits and administrative systems nationwide.** If federal funding is used to support healthcare, it should be a uniform national program, such as Medicare, that allows citizens to receive equal benefits in all states and provides the greatest opportunities for efficiency and cost reduction. A national program removes duplicate non-value -added overhead costs, eliminates wasted administrative costs due to state variations, and provides uniform record keeping to improve treatment and prevent abuse.

E. Environmental Deficit Recommendations:

To help consumers make better long-term environmental decisions, Congress should enact a revenue neutral Carbon Emission Adjustment (CEA) fee on all fossil fuels produced in, or imported into, the United States, to provide a simple market based economic incentive for reducing carbon emissions to reduce the potential for climate change similar to those in 45 other nations.

Just as borrowing against the future is bad fiscal policy, compromising the country's physical environment and future economy for short term gain is bad national policy. Failure to protect the environment and climate would not only be a failure of our responsibility to future generations but could also present a very real threat to our economy and the lives of our citizens. Our current culture and governmental policies are creating an "Environmental Cost Deficit" which is growing year after year, particularly under the Trump Administration. Unless we act soon to identify and reduce potential damage, the long-term costs of paying off our "Environmental Deficit" may be even greater and more economically damaging than the consequences of our fiscal deficit. Recent studies by Stanford University projected the long-term economic cost of each ton of carbon emitted could be as much as $200. Research by UC Berkley suggested that "unmitigated climate change could reduce global GDP by over 20% by 2100". Some economic costs may also be immediate, since the European Union, our largest trading partner, has voted to not offer favorable trade treaties to countries not in compliance with the Paris Climate Change control agreement.

Unfortunately, the problem with our "Environmental Deficit" is that there is no agreed, or comprehensive, accounting system to measure the growing future economic costs of our short term environmental decisions. We see some small pieces of the eventual cost in the costs of environmental cleanups, crop failures, abnormal storms, floods, and droughts, but there are no standard long-term cost projections to guide public policy decisions

The greatest potential long term economic costs could result from climate changes and rising sea levels caused by continued growth of atmospheric levels of carbon dioxide (CO_2), methane, and other greenhouse gases. There is clear long term scientific research to know that increased greenhouse gases will warm the earth and result in significant climate changes. The US alone emits about 1.5 Billion metric tons of CO_2 per year, or about 19 metric tons per capita. There may still be some debate about how much of the increasing greenhouse gas levels result from human activity, versus natural emissions which are estimated at about 4% of the total, but the issue is really moot, since <u>the only emissions we can hope to control are the human caused ones</u>

A Department of Defense Report concluded that climate change will result in a very real national security threat and high public costs. The report states that "rising global temperatures, changing precipitation patterns, climbing sea levels and more extreme weather events will intensify the challenges of global instability, hunger, poverty, and conflict. They will likely lead to food and water shortages, pandemic disease, disputes over refugees and resources, and destruction by natural disasters in regions across the globe."

If greenhouse gases were red, instead of colorless and odorless, so that we could see the millions of tons we are releasing into the atmosphere every year, we would probably have found ways to replace most carbon fuel use long ago. The problem is that we also can't "see" the true economic cost of fossil fuel use, because none of the long-term public or private costs of the environmental consequences are currently included in the market price of fuel and energy.

The Carbon Emission Adjustment fee would be collected from all producers or importers of fossil fuels at the time of domestic extraction or importation, based on the carbon content of the specific fuel. It is estimated that this would affect less than 2500 large businesses and would have little administrative cost since it could be combined with existing reporting and fee collection programs for coal extraction and petroleum production and importing. The cost effect of the adjustment would then pass throughout the rest of the economy without any administrative cost other than providing a potential fee offset for non-fuel uses, such as petrochemicals, or for types of significant carbon sequestration. The collection of the CEA fee should be kept as simple as possible, particularly in the early years when the adjustment amount is smaller. Carbon emission content varies by the type of fuel, but standard conversion rates already exist for most fuels and different units of measurement. The adjustment fee, based on the amount of Carbon Dioxide (CO_2) emitted when the fuel is burned, would provide a market-based incentive for reduced use of high carbon content fuels and conversion to lower carbon fuels or alternative energy sources. By more accurately reflecting the hidden costs of carbon emission impacts, the CEA would give consumers more accurate information when making energy choices. The fee also continues the political tradition of expecting those who cause public expenses such, as using public infrastructure, to pay part of the cost.

To reduce any initial economic or political issues we suggest the CEA fee start at only $30 per metric ton of CO_2 ($108/ton of carbon) emission content and increase by $5 per ton each year for at least 10 years, to a level typical of other countries emission taxes. This initially equates to a price impact of about $.27/ gallon of gasoline; $.30/ gallon of diesel, jet, or heating fuel; $ .58 /1000 cu. ft. of natural gas; or $.036/ kWh of electricity generated from coal. US per capita CO_2 emissions are about 19 tons per year, so the total initial CEA cost impact would only be about $2000 per person, for both personal and workplace fuel use and total fee revenue would be about $35 Billion. In coordination with other nations we should also support development of international carbon emission adjustment standards, along with provisions for crediting foreign carbon taxes already paid on imported fuels. To prevent overall economic effects, the CEA should also be revenue neutral, at least initially, by rebating about the same amount that is collected to individuals and businesses on a per capita or business size basis.

It is also important that the CEA adjustment, or any US carbon reduction program, be done at the federal level, not by individual states, to prevent wasted duplication of administrative costs, and disruption of free interstate commerce. A CEA adjustment on imported fuels is also practical to collect only at the US customs port of entry, not after fuels are distributed throughout the states.
A predictable and transparent carbon content adjustment fee is also likely to be more effective, and more equitable, than carbon emission trading schemes that encourage speculation and reward the large existing carbon polluters, not energy consumers. Some ask why should the United States adopt a carbon price adjustment system now, when global warming effects the entire earth and some other nations have not yet acted? We are the world's largest economy and largest CO2 emitter on a per capita basis. We also think of ourselves as one of the world's leaders in doing what is "right", as we have proven in many wars. The need to prevent climate related economic damage from increased carbon pollution is just as serious as a war, and just as threatening to our nation's future.

F. New Revenue Balancing Options

A Value Added Tax: The size of the national debt and annual budget deficits in relation to current income tax revenues makes it unlikely that Federal income taxes alone could pay down the debt, even if quickly returned to previous levels. Even if the House and Senate switch to Democratic control in 2019, the likelihood of any significant income tax increases overcoming a Presidential veto in the next 2 years is probably nil.

The only additional revenue generator with the potential to stabilize and reduce the deficit in conjunction with the income tax is probably a Value Added Tax. During the tax reform debate, many Republicans showed an interest in moving to a "consumption tax" and to also allow a refund of the tax on US exports, to promote international economic competitiveness. A VAT meets those requirements far better than previous Republican proposals, and even at low rates has the potential to generate significant revenue, with relatively low complexity and lower potential for tax avoidance in an increasingly less "traceable" and international economy. We recommend that the Finance and Ways and Means Committees start a bi-partisan review of value added taxation as a potential supplement to the income tax. Because consumption taxes tend to be regressive in impact, some adjustment may need to be made to income taxes to off-set the impact on lower income citizens.

Conclusion:

Our current Congressional budgeting process seems unable to confront and correct these fiscal problems, even though adequate information is available to recognize the problems and develop workable solutions. Although the scale is much larger, the government's problems of expense control, income generation, and maintaining credit worthiness are really no different than those faced everyday by America's businesses and families. If Americans can solve these problems as individuals, why can't we resolve our fiscal problem as a nation?

We opposed the unfunded 2017 Tax Cut legislation because it did not meet the goals of reasonable tax reform and will significantly increase the National Debt, with little long-term broad-based economic benefit. Because these tax changes, and the annual Federal revenue loss they will cause, will probably exist for the next 3 years, it makes developing an efficient, balanced, and sustainable fiscal budgeting process even more critical. We also opposed the 2018 unfunded budget agreement and retroactive one-year continuation of tax expenditures to 2017, because it lacked off-setting revenue, and wasted tax expenditure dollars on business decisions that had already been made.

These recommendations for action will not be politically easy to implement, but every year we fail to correct the problems, the consequences of inaction, and the costs of correction, grow larger. Collectively, these economic issues present just as much a risk to America, and our citizens' way of life, as any foreign military threat. Many members of the Congress served our country in the armed services. Overcoming these new economic threats will require the same patriotism, sacrifice, and a willingness to work together for the common good.

These policy recommendations are based on data from reports by the JCT, CRS, CBO, GAO, special Presidential Commissions, and other economic research organizations. Many of these background reports, and our companion recommendations for Tax Reform for Economic Growth, are available on the NSBN website at http://www.NationalSmallBusiness.net/issues.htm or on the organization's web site.

This Policy Paper was prepared for the National Small Business Network by:
Eric Blackledge and Thala Taperman Rolnick, CPA

The NSBN is a voluntary association that evolved from the 1995 White House Conference on Small Business Regional Tax Issue Chairs and does not represent the interests of any other organization or business.

National Small Business 4286 45th Street South St Petersburg, FL 33711

For our companion recommendations on further tax reform options, see our Policy Paper on "Tax Reform for Economic Growth" on our website at www.NationalSmallBusiness.net