The 100-Hour Agenda:
The New Congressional Majority's Uneven Proposals

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Introduction

Dani Doane

Incoming House Speaker Nancy Pelosi promises to spend the first 100 legislative hours of the 110th Congress pushing forward legislation based on policies trumpeted throughout the 2006 campaign under the banner "Six in '06." Patterned on the Republican's famously effective "Contract with America" in 1994, the Six in '06 agenda comprised bread-and-butter issues and promised that a Democrat-controlled Congress would "make our country safer; make our economy fair; make college more affordable; health care more accessible; move toward energy independence."[1] In addition, the Democrats promised to ensure "retirement security and dignity."

However, proposing ideas on the stump is far different than passing legislation through Congress. And so the Six in '06 agenda became "The First 100 Hours," a list of seven somewhat more specific policy proposals that the new House leadership hopes to pass within the first 100 hours of the session. The incoming majority promises to:

- "Break the link between lobbyists and legislation" and enact to pay-as-you-go budgeting (PAYGO);
- Implement the recommendations of the 9/11 Commission;
- Raise the minimum wage;
- Allow the government to "negotiate" prices in the Medicare Part D drug benefit and use any savings to fill the benefit's "doughnut hole" gap in coverage;
- Halve the interest rate on student loans;
- Raise taxes on oil companies to "achieve…independence;" and
- Preemptively resolve to oppose personal accounts in Social Security[2]

The incoming majority will find many bumps in the road ahead. For example, some have already called on the new leadership to scale back its proposal to fully implement the 9/11 Commission's recommendations. There is concern that some of the proposals based on those recommendations would burden homeland security without increasing the safety of the American people. Prudent legislating is more difficult than sloganeering.

The first real test of the new House leadership's commitment to its promises will come in its initial days as it crafts the rules package that will govern the 110th Congress. Incoming Speaker Pelosi promised fair and open debates on major issues, but in December the new leadership announced that it would bring several of its 100 Hours bills straight to the floor without the benefit of committee mark-up or full discussion.

Further, one of the new majority's signature issues, PAYGO budget controls, is targeted for inclusion in that rules package. Enacted as a rule in the past, PAYGO has been nothing more than a paper tiger. To keep its fiscal commitment the incoming leadership should enshrine PAYGO in statute, where it would have more bite. A PAYGO rule alone would not provide real protection against the growth of the federal government.

Debate over PAYGO and rules will provide an early indication of the Democratic caucus's seriousness about enacting its promises to voters and its willingness to break with business-as-usual legislating.

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1. Representative Nancy Pelosi, "What If Democrats Take Congress?," *Good Morning America*, ABC News, November 7, 2006.
2. Representative Nancy Pelosi, "100 Hours," at *www.housedemocrats.gov/bigpicture/jobs_and_economy/issue.cfm?level2id=102*.

In this Special Report, Heritage Foundation analysts review each of the incoming majority's major policy proposals, offering concrete recommendations and criticisms. Their conclusions are not uniform because the proposals are not of uniform merit. Several, if implemented properly, could improve government, such as in homeland security and budgeting. Others, however, are just ill-conceived. Medicare price negotiation, for example, will do no good and may even limit seniors' access to prescription drugs. As this Special Report makes clear, during the first 100 hours of the 110th Congress Members should strive to accomplish more than just check-the-box exercises and actually provide some useful, productive legislation.

Chapter 1
Getting the Rules Right

Andrew M. Grossman, Ronald D. Utt, Ph.D., and Alison Acosta Fraser

> We will start by cleaning up Congress, breaking the link between lobbyists and legislation and commit to pay-as-you-go, no new deficit spending.
>
> —Incoming House Speaker Nancy Pelosi (D–CA)

The incoming House leadership pledges that it will implement rules that curb the influence of lobbyists and discourage the use of wasteful earmarks. Spending-related scandals have tarnished Congress, sparked a national backlash against the growing influence of lobbyists in the federal budget, and brought new scrutiny to the arcane procedures of congressional deliberation and legislating. Thus "ethics reform," particularly as concerns spending and earmarking, is an essential part of the incoming majority's pledge to voters.

As a promising downpayment, the incoming House and Senate leadership have vowed to cancel the approximately 10,000 earmarks in the last session's unfinished appropriations bills. But they will need to do much more. Cosmetic changes that leave the earmarking process and the lobbying community essentially untouched would be a breach of their pledge to voters. In addition, Congress should not loosen rules that now constrain it from raising taxes on the American people and unfairly penalizing taxpayers by raising taxes retroactively.

Strong Rules Matter

The rules the incoming House leadership chooses to put in place will have far-reaching effects. Such rules govern all activity in Congress by specifying, among other things, how and when legislation may be brought to a vote and what is required for its passage. Some of these procedures are set in statutory law, while others are part of the rules package that Congress enacts at the commencement of its sessions. If the new leadership truly wants to "clean up Congress" and promote fiscal responsibility, it should start by putting in place strong rules and sticking to them.

The previous Congress had rules that nominally restrained excessive spending but in reality accomplished little. For example, fiscally conscious representatives could raise a point of order against a legislative provision that would surpass the spending limits, but this happened only rarely. When it did, however, the House leadership was still able to bring to the floor appropriation bills that exceeded spending limits by using a rule to waive the point of order and the vote that it would require. If the new Congress is serious about fiscal discipline, it needs to take a tougher approach.

Rules, Earmarks, and Ethics

While most of the reform legislation introduced in the last Congress was merely cosmetic, two exceptions were Senate bills that mandated extensive reporting and transparency of the entire lobbying/earmark process and provided a remedy against some of the more wasteful earmarks included in appropriations bills. These bills contained four promising reforms that could be substantially implemented in Congress's rules. Such rules would:

- Require lobbying firms, lobbyists, and their political action committees to disclose their campaign contributions to federal candidates and office holders;

- Mandate disclosure of fundraisers hosted, co-hosted, or otherwise sponsored by these entities and disclosure of contributions for other events involving legislative and executive branch officials;
- Allow Members to oppose earmarks by raising a point of order, which if sustained would delete the earmark from the bill; and
- Require recipients of earmarked funding to disclose the amount of money that they spent on registered lobbyists to obtain the earmark and to identify the lobbyists.

The new Congress should consider these changes as a first step, but it should do far more to improve the integrity of the legislative process:

- **Revise the House and Senate ethics codes.** As currently written, existing congressional guidelines are too lax, permitting many types of gifts from lobbyists including meals, travel, and entertainment and excluding many congressional employees from key prohibitions. The guidelines possess enough loopholes to render many of the restrictions irrelevant. The House and Senate should revise their ethics codes to conform with the *Standards and Ethical Conduct for Executive Branch Employees.* There is no compelling reason why employees of one branch of government should be exempt from the strict ethical standards that govern the other two branches. By eliminating these unnecessary privileges, Congress and its staff will be taking an important step in freeing themselves from the taint and suspicion that now cloud the reputation of this distinguished body.
- **Require disclosure of family relationships.** With so many close family (and family-like) connections among Members of Congress, staff, and the registered lobbyists, the rules should also require registered lobbyists to disclose blood and marital relationships (including in-laws) with Members of Congress, senior congressional staff, and senior executive branch officials.
- **Create a reasonably precise definition of "earmark."** Any successful effort to limit Members' propensity to earmark spending and other federal privileges requires a reasonably precise definition of what is and what is not an earmark. A good definition would also help to prevent the congressional abuses that transfer valuable public resources to other interests for reasons based solely on influence and privilege.

Tax and Spend

The incoming House leadership has also pledged to bring spending under control by returning to, and sticking with, pay-as-you-go budgeting (PAYGO). PAYGO is by no means a comprehensive solution to the budget problem, nor is it the best tool. But if implemented correctly, however, it can be an effective tool.[1]

While PAYGO could be a good step towards increasing fiscal discipline, the new House leadership may consider some harmful changes that would actually lower the bar for tax increases. These changes would remove or water down two current rules: the requirement of a three-fifths majority to raise taxes and the prohibition of retroactive tax increases. Easing these rules is bad policy and runs counter to the new majority's expressed principles. Requiring only a bare majority to raise taxes on the American people violates the spirit of PAYGO, which requires a three-fifths majority to raise spending or cut taxes. Tax increases should be subject to at least the same, or preferably tougher, scrutiny.

Moreover, this would be a backdoor way to ratchet up federal spending by making it easier to bring in new revenue. Making it easier to raise taxes now would create the wrong incentives for Congress when it should be looking to restructure entitlement programs like Medicare and Social Security before their massive spending increases hit the budget. Finally, this change would put investors and entrepreneurs on notice that higher taxes are likely,

1. For an extended discussion of PAYGO, see Chapter 2 of this Special Report.

increasing their uncertainty for investment and harming growth. Actually raising taxes would put today's strong economy at risk of a slowdown or downturn.

Allowing Congress to raise taxes retroactively is blatantly unfair. Businesses, investors, entrepreneurs, and individuals should be able to plan for the future with certainty and without having to worry about arbitrary or even punitive changes to the past. Imagine a family of four being presented with a $1,000 bill from the I.R.S. because Congress decided to eliminate the $500 increase in the "child tax credit" passed in 2003. Imagine that this bill included not just last year, but also 2003 and 2004. Clearly, this would be unfair to the parents of the estimated 47 million eligible children.[2] Retroactive tax increases aimed at businesses—a more likely target than families—are equally punitive and could diminish investment and production in crucial sectors such as energy, reducing future economic growth as companies struggle to meet any unforeseen bills from the federal government.

If the new Congress is serious about restoring fiscal integrity, it will not relax its rules on raising taxes.

The Arcane Is Important

Before even a single piece of legislation is debated or passed, the new Congress will have a chance to demonstrate its commitment to ethics reform and responsible budgeting when it enacts its rules package. A package that does not address earmarking and the ethical complications of the practice will fall far short of the new House leadership's promises to voters.

2. See Rea S. Hederman, Jr., "One Cheer for the Tax Extender Package" Heritage Foundation *WebMemo* No. 572, September 23, 2004, at *www.heritage.org/Research/Taxes/wm572.cfm*.

Chapter 2
Making PAYGO Discipline the Federal Budget

Alison Acosta Fraser and Brian M. Riedl

> We will start by cleaning up Congress, breaking the link between lobbyists and legislation and commit to pay-as-you-go, no new deficit spending.
>
> –INCOMING HOUSE SPEAKER NANCY PELOSI (D–CA)

> No new deficit spending, no new bridges to nowhere, heaping mountains of debt on our children.
>
> – INCOMING HOUSE SPEAKER NANCY PELOSI[1]

> If you want to have a new program, figure out a way to pay for it without raising taxes.
>
> –INCOMING SENATE MAJORITY LEADER HARRY REID (D–NV)[2]

Americans sent a strong message to Washington in November: Continued runaway spending is unacceptable. The incoming House Speaker has stated clearly that she intends to put tough budget controls in place, including a return to pay-as-you-go budgeting (PAYGO). PAYGO requires that new or expanded entitlement spending be fully paid for by reductions in other mandatory spending or with tax increases. She has also pledged to stop increases in the deficit from other spending.

To be sure, PAYGO is not a comprehensive solution to the budget problem. If done right, however, it is an important tool. Because it is the one that the incoming House leadership has chosen as its first decisive step towards budget discipline, implementing PAYGO should be the first legislative initiative in the new Congress. The House should enact a form of PAYGO that fixes previous versions' weaknesses so that it is not a phony budget tool and a veil for new deficit spending. If the House leadership does not bolt the budget door shut with a potent form of PAYGO, the American people will know that the new congressional majority's pledge to get the budget under control was not serious.

Americans want Congress to bring discipline to the budget process for good reason. Federal spending has grown by over 42 percent since 2001. Last year alone, spending increased over 7 percent, and over half of this increase was due to entitlement programs such as Social Security and Medicare. These "mandatory" programs are not appropriated in the annual budget but grow on autopilot according to provisions of their governing laws. Without reform, these programs are projected to push long-term spending from 20 percent of the economy today to nearly 50 percent by 2050.[3] The only way to get the budget under control is to put in place strong controls on spending.

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1. Representative Nancy Pelosi, Interview with Brian Williams, MSNBC, November 8, 2006, at *http://www.msnbc.msn.com/id/15627215/*.
2. Senator Harry Reid, Interview with Bob Schieffer, CBS News, November 12, 2006, at *http://www.cbsnews.com/htdocs/pdf/face_111206.pdf*.
3. Brian M. Riedl, "Entitlement-Driven Long-Term Budget Substantially Worse Than Previously Projected," Heritage Foundation *Backgrounder* No. 1897, November 30, 2005, at *www.heritage.org/Research/Budget/bg1897.cfm*.

How to Make PAYGO Meaningful

Because PAYGO is the budget restraint tool that the incoming leadership has proposed, it must ensure that its PAYGO will be meaningful and properly instituted. Any lawmaker seriously concerned about spending control, therefore, must insist on five key features for PAYGO:

1. **PAYGO must be enforceable.** The Senate's current PAYGO rule is weak because it is not self-enforcing. While any one senator can offer a point of order against any offending spending, this often does not happen. If a point of order is offered, it can be waived with 60 votes, in which case there is no additional enforcement such as sequestration (which imposes automatic across-the-board entitlement cuts to pay for any new entitlement spending or tax cuts that Congress does not offset.)

   A PAYGO statute, rather than a porous rule, would require lawmakers to vote to offset new spending. If PAYGO is breached, the statute should require the Office of Management and Budget (OMB) to sequester all excess entitlement spending. The most effective form of PAYGO would include both a statute, enforceable by sequestration, and a Senate point of order rule to keep the 60-vote threshold.

2. **PAYGO should apply to all new policies.** Previous versions of PAYGO applied to all tax and entitlement changes that altered projected budget deficits relative to the Congressional Budget Office's baseline. However, the current Senate PAYGO rule actually exempts all tax and entitlement changes written into Congress's annual budget resolution. This massive loophole made possible the huge 2003 Medicare drug entitlement and would allow Congress to enact an unlimited number of entitlement expansions and tax changes each year without any PAYGO enforcement, simply by writing them into the budget resolution. If the new congressional majority is serious about PAYGO, it must eliminate this loophole.

3. **PAYGO should apply to "emergency" spending.** Another large PAYGO loophole is the exemption of any new spending that is called "emergency." Congress has frequently reclassified regular mandatory and discretionary spending as "emergency" spending in order to bypass PAYGO and budget limits. Lawmakers should create a separate emergency fund and require a supermajority vote for any additional, non-offset emergency spending. True emergency spending will be able to secure supermajority support.

4. **Congress should not stymie PAYGO enforcement.** Not a single sequestration took place during PAYGO's 12 years as law. Instead, lawmakers repeatedly passed legislation that forbade OMB from enforcing PAYGO at all. Creating a budget control and then refusing to enforce it undermines the rule of law and faith in government. If the new congressional majority believes that PAYGO is the proper way to discipline the budget, then the incoming House leadership should pledge to enforce it.

5. **PAYGO sequestration should apply to all mandatory spending.** The PAYGO law that existed from 1990 through 2002 exempted from sequestration Social Security, net interest on the debt, nearly all Medicare spending, and several other entitlement programs. Overall, 97 percent of all mandatory spending—all but $31 billion—had been statutorily exempted from any PAYGO sequestration, according to 2002 OMB figures.[4] This loophole capped sequestration at this small amount and unfairly imposed all the pain of sequestration on a few small programs. Creating a PAYGO law and then blocking its enforcement is inconsistent and hypocritical.

Creating an Effective PAYGO Statute

While a tough PAYGO law would be an important tool to constrain undisciplined budgets, it is only one tool, and others are needed. For instance, PAYGO applies only to new or expanded entitlement spending and does not limit either discretionary or total spending. Moreover, because PAYGO exempts the growing cost of current entitlement programs, it does nothing to deal with the tsunami of already scheduled and largely unfunded entitlement benefits

4. Bud Newman, "House Passes Bill to Avoid PAY-GO Sequestration But Daschle Says Senate May Not Take It Up," *BNA Daily Report for Executives*, November 18, 2002.

that will accompany the retirement of the Baby Boom generation. Under the current budget rules, Congress does not even have to consider the trillions of dollars in unfunded obligations already enacted.

One small, urgently needed step is to include a measure of the unfunded obligations of the federal government in the annual budget process. At the very least, a highly visible indication of how a proposal would affect these obligations could be a political brake on undisciplined budgeting.[5]

To address the steep growth of current entitlement programs, analysts at the Government Accountability Office (GAO) and elsewhere have suggested supplementing PAYGO with a trigger for current entitlement programs.[6] Congress would set multi-year spending targets for entitlement programs covered by PAYGO. If OMB projects that spending will exceed these targets, the President would have to submit reform proposals as part of the annual budget request, and Congress would have to act on those proposals. A similar trigger for Medicare spending was included in the 2003 Medicare prescription drug legislation, and expanding the concept could help Congress address current entitlement spending growth.

PAYGO also focuses on only the budget deficit, rather than the size of government. A strong PAYGO would ensure that new or expanded programs are balanced with other spending cuts or tax increases, but it would not prevent the government from taking a steadily larger share of citizens' paychecks. PAYGO would allow escalating entitlement program costs to push the size of the federal government to nearly 50 percent of GDP by 2050. PAYGO would also promote the expiration of all Bush tax cuts and force millions of Americans to pay the Alternative Minimum Tax. As a result, tax revenues would rise from the historical average of 18.3 percent of GDP to a record 23.7 percent by 2050.[7] The slow-growth economies of Western Europe show that such levels of spending and taxation cause serious long-term economic damage.[8] Therefore, PAYGO must be supplemented with serious caps on the growth of spending and taxes.

Conclusion

If PAYGO is the new congressional majority's preferred tool to end irresponsible budget policy, then it must pass a statutory PAYGO that covers all mandatory spending and is seriously enforced. Making this the new House leadership's first legislative accomplishment will show the nation that it is serious about reining in the budget. The House should then take steps to strengthen controls on total spending and address the tsunami of future entitlement costs.

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5. Alison Acosta Fraser, "Federal Budget Should Include Long-Term Obligations from Entitlement Programs," Heritage Foundation *Executive Memorandum* No. 1004, June 22, 2006 at *www.heritage.org/Research/Budget/em1004.cfm*. See Representative Jim Cooper (D–TN), *Financial Report of the United States* (Nashville: Nelson Current, 2006), pp. ix-xxvii.
6. Susan Irving, "Budget Process: Extending Budget Controls," Testimony before the House Budget Committee, April 25, 2002, at *www.gao.gov/new.items/d02682t.pdf*.
7. Daniel J. Mitchell, Ph.D., and Stuart M. Butler, Ph.D., "What Is Really Happening to Government Revenues: Long-Run Forecasts Show Sharp Rise in Tax Burden," Heritage Foundation *Backgrounder* No. 1957, July 28, 2006, at *www.heritage.org/Research/Taxes/bg1957.cfm*. This is based on data from Congressional Budget Office, "The Long-Term Budget Outlook," December 2005, at *www.cbo.gov/ftpdocs/69xx/doc6982/12-15-LongTermOutlook.pdf*.
8. See Daniel J. Mitchell, "Fiscal Policy Lessons from Europe," Heritage Foundation *Backgrounder* No. 1979, October 25, 2006, at *www.heritage.org/Research/Budget/bg1979.cfm*.

Chapter 3
Implementing the 9/11 Commission's Recommendations

James Jay Carafano, Ph.D.

> We will make our nation safer and we will begin by implementing the recommendations of the independent, bipartisan 9/11 Commission.
>
> —Incoming House Speaker Nancy Pelosi (D–CA)

In 2004, the National Commission on Terrorist Attacks Upon the United States, popularly known as the 9/11 Commission, made over 40 recommendations for improving America's homeland security and counterterrorism efforts. Incoming House Speaker Nancy Pelosi (D–CA) pledged to bring up the 9/11 Commission's recommendations during the first 100 legislative hours of the new Congress. Congress addressed many of the Commission's recommendations when it passed the Intelligence Reform and Terrorism Prevention Act of 2004. In other cases, such as pre-screening for domestic airline passengers, border and critical infrastructure security, and information-sharing among law enforcement agencies, the administration has ongoing programs. Legislation that piles on more unrealistic mandates, requirements, or reports in order to check the box that the new Congress has touched on every Commission recommendation will not make these programs more efficient or effective. But Congress should pass prudent legislation to improve emergency management communications, target homeland security grants based on need, and modernize the Coast Guard.

Unfinished Business

Congress should act on the issues where it has failed to legislate decisively in the past.

Interoperable Communications: Since 9/11, Congress and the Bush Administration have wrestled with the challenge of improving emergency management communications. An unprecedented federal spending spree has yielded scant progress, however, and Washington's programs should be scrapped. They will never be able to achieve, either efficiently or effectively, the goal of creating the kind of emergency communication systems the nation needs to respond to national disasters. The right approach should include a set of policies that promote effective public–private sharing of the emergency management electromagnetic spectrum, the creation of a national capability to deploy a wide-area emergency management communications network for catastrophic disasters, and the establishment of coherent national leadership for emergency response communications.

Grant Reform: The 9/11 Commission warned that homeland security grant funding was in danger of becoming another "pork barrel" handout. The formula established for distributing grants under the USA Patriot Act mandated that a specific percentage of each year's funding go to each state. But grants are not entitlements. Local governments bear the primary responsibility for public safety. Federal dollars support the federal government's unique responsibilities: integrating state and local assets into a national preparedness and response system and building the capacity to respond to catastrophic disasters that would overwhelm any state or local government. Allocation of grants should be based on national priorities, not a formula.

Maritime Security: To the exclusion of important maritime security issues, Congress has fixated on container security, doling out pork to ports, and a wrong-headed effort to block foreign investments in the U.S. These priorities represent the least effective security measures and are targeted at the least plausible dangers. Inspecting every container that is shipped into the U.S., for example, makes no sense. Doing so would cost billions of dollars and drown authorities in useless information. Meanwhile, Congress continues to drastically underfund modernization of the U.S. Coast Guard, whose operations affect every component of maritime security, from ports overseas to waterways inside the U.S. Congress has also paid scant attention to international programs for enhancing maritime security.

Recommendations for Homeland Security

Congress should pass legislation that will:

- **Improve emergency management communications** by revising federal policies and laws to open dual-use spectrum for commercial and emergency management use, as well as facilitating the sharing of spectrum among local, state, and federal users. This legislation should require the administration to set national standards to promote open, non-proprietary systems that are compatible with commercial standards. It should establish services that can provide an emergency wide-area wireless system to support existing responder communications equipment and emerging capabilities like VOIP. And it should assign specific missions and responsibilities to agencies for the implementation of critical policies.[1]
- **Enhance homeland security grants** by reducing or eliminating the requirement that a minimum of .75 percent of funding go to each state. This mandate commits 40 percent of state grant funding without respect to risks or needs. Congress should also eliminate special categories of grants that direct money to specific interests, such as cities, ports, and firefighters. All grants should be allocated based solely on national priorities.[2]
- **Improve maritime security** by fully funding the Coast Guard's modernization program at $1.5 billion per year and making the Coast Guard the lead federal agency for international maritime assistance initiatives. Putting the Coast Guard in the lead position must include budgetary authority.[3]

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1. For details and analysis, see James Jay Carafano, Ph.D., "Talking Through Disasters: The Federal Role in Emergency Communications," Heritage Foundation *Backgrounder* No. 1951, July 17, 2006, at *www.heritage.org/Research/HomelandDefense/bg1951.cfm*.
2. See James Jay Carafano, Ph.D., and Jamie Metzl, "Homeland Security Grant Reform: Congressional Inaction Must End" Heritage Foundation *Backgrounder* No. 1971, September 15, 2006, at *www.heritage.org/Research/HomelandDefense/bg1971.cfm*.
3. See James Jay Carafano, Ph.D., and Martin Edwin Andersen, "Trade Security at Sea: Setting National Priorities for Safeguarding America's Economic Lifeline," Heritage Foundation *Backgrounder* No. 1930, April 27, 2006, at *www.heritage.org/Research/NationalSecurity/bg1930.cfm*.

Chapter 4
Minimizing the Harm of the Minimum Wage

James Sherk

We will make our economy fairer, and we will begin by raising the minimum wage.

–Incoming House Speaker Nancy Pelosi (D–CA)

The federal minimum wage has not increased from its current level in over nine years. Since September 1997, inflation has eroded what workers can buy with $5.15 an hour, and 28 states and the District of Columbia have raised their minimum wages above the federal level. Today only 32.1 percent of Americans live in states where the federal minimum wage applies.[1] Many policymakers, citing the plight of workers struggling to support their families on the minimum wage, support raising the federal minimum in order to raise the earnings of low income workers and fight poverty. It will not work because the minimum wage harms poor, disadvantaged workers. If Congress must raise the minimum wage, it should allow states to set lower minimums in line with local economic conditions.

A Mistargeted Proposal

The minimum wage is an extremely ineffective anti-poverty measure. It does not help the poor, low-income workers its supporters often invoke.

Contrary to the stereotype, most minimum wage workers do not need government assistance. Less than one in five live below the poverty line, and the average family income of a minimum wage earner is almost $50,000 a year.[2] Very few minimum wage workers support a family with their earnings—fewer, in fact, than in the population as a whole.[3] Minimum wage workers are far more likely to be teenagers or college students than single parents working full time. The majority of minimum wage workers are between the ages of 16 and 24, and over three fifths work part time.[4]

Most minimum wage earners also earn raises quickly without government intervention. Minimum wage jobs are entry-level positions that help unskilled workers gain work-related experience and skills. The ability to productively interact with customers and coworkers or to accept direction from a boss can be gained only through actual on-the-job experience. Minimum wage jobs provide workers with the opportunity to gain these skills and become more productive. Once workers have done so, they earn raises. Two-thirds of minimum wage workers earn a raise within a year.[5] Congress does not need to raise the minimum wage in order for minimum wage workers to increase their earnings.

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1. Heritage Foundation calculations based on Bureau of Labor Statistics, Current Population Survey, Outgoing Rotation Group, 2005.
2. James Sherk and Rea S. Hederman, Jr., "Who Earns the Minimum Wage—Single Parents or Suburban Teenagers," Heritage Foundation *WebMemo* No. 1186, August 3, 2006, at *www.heritage.org/Research/Economy/wm1186.cfm*.
3. *Ibid.*
4. *Ibid*.
5. James Sherk, "Minimum Wage Workers' Incomes Rise When the Minimum Wage Does Not," Heritage Foundation *WebMemo* No. 1181, July 28, 2006 at *www.heritage.org/Research/Economy/wm1181.cfm*.

Unintended Consequences

Though Congress can raise the minimum wage, it cannot ensure that low-wage workers will get raises or even end up better off. Many will lose their jobs. As it become more expensive to hire workers, companies hire fewer of them. The bulk of research on the minimum wage confirms this: Two-thirds of recent minimum-wage studies, and 18 of the 19 most reliable of these studies, show that the minimum wage costs jobs.[6] Some workers get a raise, while others lose everything.

Worse, the workers most likely to lose their jobs are the especially vulnerable workers that the increase is intended to help. A higher minimum wage makes hiring unskilled workers particularly unattractive to businesses.[7] Employers will not hire low-skilled, inexperienced workers for $7.25 an hour when they can hire more skilled and experienced workers at the same rate. The minimum wage puts the workers who most need to gain experience and skills at a disadvantage.

Higher minimum wages can also cause teenagers to drop out of school. Rather than hire an unskilled adult, many businesses hire teenage workers.[8] Higher wages make dropping out of school to work full time at a minimum wage job more attractive to teenagers, and research shows that increases in the minimum wage lead to increases in the high school dropout rate.[9]

Less experience and education reduce workers' incomes far into the future. An increase in the minimum wage reduces workers' incomes and chances of holding a job for over a decade after the hike.[10] A higher minimum wage can hurt workers years after it is implemented.

No Impact on Poverty

For all the harm it causes, the minimum wage does not even help disadvantaged workers. Research shows that higher minimum wages do not reduce poverty rates or improve the lives of low-income workers.[11]

This is unsurprising because low wages are not a primary cause of poverty. Most poor Americans do not work for the minimum wage. In fact, most poor Americans do not work at all, for any wage.[12] Over three-fifths of individuals below the poverty line did not work during 2005, while only 11 percent worked full time year-round. The median family with children living below the poverty worked only 20 hours per week.[13] Families are not poor because they earn low wages but because they do not have full-time jobs. If at least one parent in every poor household worked full-time year round, the child poverty rate in the United States would plummet by over 70 percent.[14] Raising the minimum wage does not address this problem.

Further, the structure of government anti-poverty programs ensures that even those low-income workers who do work full time gain little or nothing when the minimum wage rises. The government provides generous medical,

6. David Neumark and William Wascher, "Minimum Wages and Employment: A Review of the Evidence from the New Minimum Wage Research," NBER *Working Paper* No. 12663, November 2006, p. 115, at *www.aei.org/docLib/20061201_NeumarkWascherPaper.pdf*.
7. James Sherk, "Minimum Wage Hikes Hurt Unskilled and Disadvantaged Workers' Job Prospects" Heritage Foundation *WebMemo* No.1294, January 2, 2007, at *www.heritage.org/Research/Labor/wm1294.cfm*.
8. *Ibid.*
9. James Sherk, "Raising the Minimum Wage Hurts Vulnerable Workers' Job Prospects without Reducing Poverty," Heritage Foundation *WebMemo* No. 1176, July 25, 2006, at *www.heritage.org/Research/Economy/wm1176.cfm*.
10. *Ibid.*
11. James Sherk, "Raising the Minimum Wage Will Not Reduce Poverty" Heritage Foundation *Backgrounder*, forthcoming.
12. *Ibid.*
13. Rea S. Hederman, Jr., and Robert Rector, "The Role of Parental Work in Child Poverty," Heritage Foundation *Center for Data Analysis Report* No. 03-01, January 29, 2003, Table 1, at *www.heritage.org/Research/Family/cda-03-01.cfm*. Twenty hours per week is equivalent to 1,040 hours per year.
14. *Ibid.*, Chart 2.

child care, food, and housing benefits to low-income families, as well as direct income supplements. However, these benefits phase out as workers' incomes rise. In most states, a single parent supporting two children on a full-time minimum wage job would lose almost as much in government benefits as she would gain from higher wages.[15] For truly needy low-wage workers, the benefits of a higher minimum wage are offset by reduced benefits.

Recommendations

The minimum wage does not do what its supporters intend it to do. Raising the minimum wage will not reduce poverty because it does not target needy workers, reach the poor who do not work, or overcome the loss of generous government benefits for those who do. It makes employers less likely to hire workers who need jobs to gain skills and become more productive so that they can move up the career ladder. Because of its ineffectiveness and harm to unskilled workers, Congress should not increase the minimum wage.

If Congress nonetheless decides to raise the minimum wage, it should minimize the harm by allowing states the freedom to set their minimum wages below the federal level. No one disputes that a very high minimum wage would cost large numbers of jobs; thus supporters push for modest increases, not excessively large ones. The cost of living varies substantially across the country, however, and so a modest boost to the federal minimum wage could be excessive in some regions. For example, $7.25 buys far more in Shreveport, Louisiana, than in Los Angeles.[16] While $7.25 may be below the market rate for unskilled workers in Los Angeles, it could price many out of the market, and out of jobs, in Shreveport.

Raising the minimum wage to $7.25 per hour would be particularly harmful in states that have low costs of living, such as Texas, Mississippi, and Oklahoma. These states should have the ability to set their minimum wages below the federal level if their local economic conditions call for it. This would return control to local officials and ensure that a one-size-fits-all national minimum wage does not impose disproportionate harm on certain states.

15. Rea S. Hederman, Jr., and Sam Hyman, "Low Income Workers May Be Worse Off if Congress Increases the Minimum Wage," Heritage Foundation *WebMemo* No. 1187, August 3, 2006, at *www.heritage.org/Research/Economy/wm1187.cfm*.
16. James Sherk, "Easing the Pain: Let States Opt Out of a Minimum Wage Hike," Heritage Foundation *WebMemo* No. 1295, January 2, 2007, at *www.heritage.org/Research/Labor/wm1295.cfm*.

Chapter 5
Preserving Successful Private Drug Negotiations

Greg D'Angelo and Robert E. Moffit, Ph.D.

> Democratic Prescription for Change: Help close the "donut hole" by dedicating the cost savings from price negotiation toward ending the coverage gap.
>
> —OFFICE OF INCOMING HOUSE SPEAKER NANCY PELOSI (D–CA)

The new congressional leadership intends to strike the "non-interference" provision of the Medicare Modernization Act of 2003, potentially allowing the government to fix drug prices for Medicare beneficiaries through "negotiations" with pharmaceutical companies. By providing for the Part D drug benefit to be delivered by private plans, Congress initially chose the mechanism that best balances the competing considerations of drug costs and drug access. Initial data from the first year of the program indicate that seniors' access to needed pharmaceuticals has been expanded and the massive cost of the benefit has been restrained somewhat. Further, research from the government's Centers for Medicare and Medicaid Services shows that allowing government "negotiation" is unlikely to reap savings. Rather than risk limiting seniors' broad access to prescription drugs, Congress should reconfigure Part D's benefit design to save money while better meeting seniors' needs.

Better than Expected

It is true that the new Medicare Part D benefit was an unwise creation that further exacerbates America's massive entitlement spending problem. But its design offers proof that market-based solutions can trump government-run programs.

Congress included the "non-interference" provision when it created the new Medicare Part D prescription drug entitlement as part of the Medicare Modernization Act of 2003 (MMA). The provision explicitly prohibits the government from interfering with price negotiations between drug makers, pharmacy benefit managers (PBMs), and sponsors of prescription drug plans.

The Centers for Medicare and Medicaid Services (CMS) has noted that average monthly premiums for the first year of the program were nearly 40 percent less than originally projected, or around $24 instead of $37. Also, according to CMS, "Medicare Part D expenditures are now projected to be $34 billion lower over five years (2006–2010) than in the President's Budget."[1] It is true, however, that not all of that difference is due to price negotiations by PBMs and private Part D plans. CMS acknowledges that some of the projected savings result from the difference between actual enrollment and previous enrollment projections.

However, CMS also projects that "State payments for a portion of the costs for drug coverage for Medicare–Medicaid 'dual eligible' beneficiaries that the states would have incurred under Medicaid are projected to be more than 25 percent lower than had been projected one year ago." Under MMA, dual-eligible seniors previously receiving drug coverage through Medicaid began receiving their drug coverage through the new Medicare Part D program this year. As part of that transfer, MMA provided for the anticipated savings to state Medicaid programs to be "clawed-back" through offsetting payments by the states to the federal government. CMS's projection that those offsetting state payments will be *less* than originally anticipated indicates that the private Part D plans are doing a better job than

1. Centers for Medicare and Medicaid Services (CMS), "Medicare Part D Spending Projections Down Again, Part A and Part B Increases Highlight Need for Further Reforms," July 11, 2006, at *www.cms.hhs.gov/apps/media/press/release.asp?Counter=1895*.

Medicaid of restraining drug prices and managing drug utilization. If true, this would mean that the Part D approach of relying on private plans to deliver the benefit is performing significantly better than the Medicaid system of government-administered drug benefits coupled with a mandatory "best price or 15 percent rebate" on drug prices.

This experience tends to confirm the Congressional Budget Office's (CBO) 2004 conclusion on non-interference:

> [S]triking the [non-interference] provision would have a negligible effect on federal spending because CBO estimates that substantial savings will be obtained by the private plans and that the Secretary [of HHS] would not be able to negotiate prices that further reduce federal spending to a significant degree. Because they will be at substantial financial risk, private plans will have strong incentives to negotiate price discounts, both to control their own costs in providing the drug benefit and to attract enrollees with low premiums and cost-sharing requirements.[2]

This is significant. There is good evidence that were Congress to apply the Medicaid approach of government purchasing and statutory price restrictions to Part D, it would be unlikely to achieve additional savings.

An Erroneous Assumption

Congressional champions of government price negotiations say that Medicare could leverage its bargaining power on behalf of 42 million beneficiaries to secure lower prices. With government's monopsony clout, they assert, it could generate real savings, enabling Congress to close existing gaps in drug coverage.

But Medicare does not, in fact, have market power that is greater than existing private-sector pharmacy benefit managers and thus will be ineffective at securing prices lower than those already achieved through existing private-sector arrangements. PBMs cover approximately 217 million individuals, or 76 percent of the population, with the largest, Caremark, covering 80 million. Medicare could cover 42 million at most, but today only covers 22.5 million in Part D.[3]

By allowing Medicare beneficiaries to buy private plans that contract with PBMs, Congress enables Medicare beneficiaries to take advantage of the large market clout of the private sector, where PBMs are already successfully providing drug benefits for millions of Americans. Moreover, market clout is less important than market positioning and negotiating power when attempting to assure optimum prices and access to pharmaceuticals.

Among the incoming House majority's policy priorities is to re-enact, and stick to, pay-as-you-go budgeting (PAYGO), which makes it difficult for Congress to enact new entitlement spending without offsetting the expense elsewhere in the budget. However, the new Congress also hopes to close the "doughnut hole" gap in Part D coverage, an expensive proposition that it hopes to offset with savings from lower drug prices due to government negotiation. But if these savings are not forthcoming, as is likely, Congress will have to try a tougher approach.

Denying Seniors Access to Drugs

If it is allowed, government "negotiation" with drug makers would not be negotiation in the common meaning of the term but rather fixing prices below those reductions already achieved in the market in order to get, on paper at least, larger discounts than PBMs do today. To achieve those additional savings, Congress would need to wield a hammer that is unavailable to PBMs. And the only real tool the government has that private plans do not is the abil-

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2. Congressional Budget Office, "Estimate of the Effect of Striking the 'Noninterference' Provision as Added by P.L. 108–173, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003," at *www.cbo.gov/showdoc.cfm?index=4986&sequence=0*.

3. Centers for Medicare and Medicaid Services (CMS), "Part D Enrollment Data," June 14, 2006, at *www.cms.hhs.gov/PrescriptionDrugCovGenIn/02_EnrollmentData.asp*.

ity to deny all seniors access to specific drugs if the manufacturers refuse a government-set price. This would be, in effect, a price control scheme, enforced by denying patients access to drugs. The effectiveness of this approach would depend on Congress's willingness to deny seniors access to some, or even many, prescription drugs.

Price controls—that is, fixing prices below the equilibrium price obtained in the market—are indisputably counterproductive. In this case, it would surely mean fewer drugs available to seniors, fewer innovative drugs developed in the future, and higher drug prices for consumers in the non-controlled private markets, who would be on the receiving end of the cost shifting that always accompanies government price control strategies. It could even result in higher overall program costs due to the substitution of less effective drugs and would impose new costs on seniors who would have to obtain denied drugs themselves.

A Better Policy

There is a much better way to save money and close the gap—the "doughnut hole"—in coverage. First, however, Congress should retain the current cost-saving benefits of private-sector negotiation and avoid the unintended complications associated with a scheme of government price-fixing that promises to repeat the same painful lessons of past attempts at price-fixing.

Second, Congress should provide seniors with a more rational benefit design. Congress can reconfigure the minimum Part D benefit design so that the doughnut hole is replaced with a higher front-end deductible and 50/50 cost sharing up to the existing catastrophic limit. These changes can be structured so that seniors experience no greater total out-of-pocket costs than they do under the present benefit design, while also better targeting financial assistance to those who need it most.

Moreover, Medicare drug costs could be further reduced by making coverage subsidies less generous for seniors above 150 percent of the official federal poverty line. Heritage Foundation analysts have developed a model of different options for deductibles and co-payments which shows the savings of different options over a ten-year period.

Finally, Congress should encourage even more seniors to enroll in Medicare health plans that integrate the drug benefit with other benefits. This integration ensures greater efficiency and can generate savings in the overall costs of the program itself by encouraging, as appropriate, the substitution of drug therapies for other Medicare-covered services, such as doctor visits and hospitalization.

Conclusion

Congress is right to look for savings in the new Part D drug benefit. Eliminating private negotiation with pharmaceutical firms, however, will not save money and risks denying seniors access to crucial drugs. Instead, Congress should retain the benefits of private-sector negotiation and rethink Part D's benefit design in order to eliminate the doughnut hole and to better target needy seniors.

Chapter 6
Halving Student Loan Interest Rates Is Unaffordable and Ineffective

Brian M. Riedl

> We will broaden college opportunity, and we will begin by cutting interest rates for student loans in half.
>
> —INCOMING HOUSE SPEAKER NANCY PELOSI (D–CA)

Incoming House Speaker Nancy Pelosi (D–CA) has pledged that the House of Representatives will vote on a proposal to halve the 6.8 percent interest rate on subsidized student loans during the first 100 hours of the 110th Congress.[1] Parents and students can surely appreciate Congress's concern about the rapidly increasing cost of a college education and the importance of access to higher education, but this proposal is unaffordable and ineffective. The measure could cost $18 billion over five years, at a time when federal student financial aid spending has already surged 400 percent since 2001 and loan consolidation costs are set to soar. Federal grant and loan limits have recently increased, and interest rates are at historically low levels. Worse, increases in federal student aid often lead to tuition hikes, leaving college equally unaffordable. Most importantly, reducing interest rates does not increase college access for prospective students, but merely subsidizes loan repayments after college. Enhancing college affordability and access will require different solutions—ones that recognize that boosting federal subsidies is counterproductive.

In addition, the current budget context is daunting. Federal spending has surged by 42 percent since 2001 to over $23,000 per household, and spending is projected to drive the budget deficit to approximately $800 billion within a decade.[2] The coming retirement of 77 million baby boomers threatens to push Social Security, Medicare, and Medicaid spending to levels that, without reform, could force lawmakers to either double income tax rates or eliminate every remaining federal program. Defense, homeland security, K-12 education, and health research also must compete for funding.

The loan proposal will intensify that competition. Halving the interest rates on student loans is estimated to cost $18 billion over five years. Representative Pelosi's pledge to re-implement pay-as-you-go budgeting rules (PAYGO) means that taxpayers will expect the cost of the rate change to be offset elsewhere in the budget so as to not increase the budget deficit.

Six Problems with Halving Student Loan Interest Rates

1. **Federal spending on student financial aid is already skyrocketing.** The myth of education budget cuts is perhaps the most persistent budget myth today. Since 2001, federal education spending has grown a staggering 167 percent from $35 billion to $95 billion. Most of this new spending goes to financial aid for college students, which has skyrocketed *400 percent*, from $9.6 billion $48.0 billion (plus $10 billion per year in related tax breaks).[3] A temporary surge in student loan consolidations is respon-

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1. Subsidized student loans have the interest costs subsidized by taxpayers until the student leaves college and begins paying back the loan. With unsubsidized loans, by contrast, the student begins accruing interest costs while in school.
2. Brian M. Riedl, "Federal Spending: By the Numbers," Heritage Foundation *WebMemo* No. 989, February 6, 2006, at *www.heritage.org/Research/Budget/wm989.cfm*.

sible for a large part of this new spending. However, student aid spending is expected to level off at nearly $25 billion—nearly *triple* the 2001 spending level. The education budget's growth rate since 2001 is not only the fastest in the federal budget, but is also nearly unprecedented for any Cabinet department in American history.

In line with spending, the total amount available for grants and loans has more than doubled since 2001, from $66 billion to $136 billion—or, excluding consolidation loans, from $52 billion to $78 billion. During this period, the number of students receiving aid increased from 7.6 million to 10.1 million, and the number of annual loans and grants provided to those students leaped from 15.4 million to 24.7 million.[4]

2. **Students already have many options for federal grants and low-interest loans.** Today's college students are offered more grants and loans with lower interest rates than in the past. True, the maximum Pell Grant of $4,050 is just $300 over the 2001 cap. However, the 2005 Deficit Reduction Act created SMART Grants of up to $4,000 annually for students majoring in math, science, engineering, or a foreign language critical to U.S. security. This effectively doubles the Pell Grant for many students.[5]

   Today's students can also borrow more. The Deficit Reduction Act increased subsidized student loan borrowing caps for freshmen and sophomores from $2,625 and $3,500, respectively, to $3,500 and $4,500. Graduate student loan limits were increased from $10,000 to $12,000 annually.[6]

   Further, student loan interest rates, the target of the House Democrats' 100-hour agenda, are low by historical standards. This school year, as required by 2002 legislation, the variable interest rate was replaced with a fixed 6.8 percent rate. While this is above last year's 5.3 percent rate under the variable rate formula, such low student loan rates were a temporary anomaly due to the economy's low interest rates. In fact, were the variable rate formula still in effect, student loan interest rates would have jumped to 7.14 percent this year. By locking in the 6.8 percent rate, lawmakers actually lowered student interest rates. Furthermore, this 6.8 percent rate is lower than the student loan interest rate was in all but six of the past 42 years.[7]

   Altogether, today's students are eligible for as much as $8,050 in grants and increasing levels of student loans. Most loans accrue no interest until graduation and even then are locked in at a low interest rate. Students can even deduct student loan interest costs on their tax returns.

3. **Student aid subsidies are already set to increase much further.** A large portion of the recent surge in student aid comes from the 2.2 million college graduates annually consolidating their existing student loans—up from 676,000 in 2001. Consolidation loans allow students who borrowed at variable interest rates as low as 3.5 percent to lock in those low rates permanently by converting to long-term fixed loans. This could become enormously expensive for the federal government. Washington promises a certain rate of return to banks that make guaranteed student loans, and if market interest rates rise up above these very low fixed rates, the federal government pays banks the difference to protect their profits. Kevin Hassett of the American Enterprise Institute has calculated that if interest rates spike, the

3. Education spending for 2001 located at the Office of Management and Budget, *Historical Tables, Budget of the United States Government, Fiscal Year 2007* (Washington, D.C.: U.S. Government Printing Office, 2006), pp. 55–72, Table 3.2. Estimates for 2006 come from the U.S. Treasury Department Office of Public Affairs, "Preliminary Statement of Budget Results for Fiscal year 2006," October 11, 2006, at *www.fms.treas.gov/mts/10-11-06-Budget-Results.pdf*. The tax expenditure figure comes from George Krumbhaar, "Losing Out on Higher Education Costs," Gallerywatch.com, June 26, 2006.
4. Data from 2001 located at the Office of Management and Budget, *Appendix, Budget of the United States Government, Fiscal Year 2003* (Washington, D.C.: U.S. Government Printing Office, 2002), pp. 363–365. Data from 2006 located at the Office of Management and Budget, *Appendix, Budget of the United States Government, Fiscal Year 2007* (Washington, D.C.: U.S. Government Printing Office, 2006), pp. 360–362.
5. P.L. 109-171, The Deficit Reduction Act of 2005, as summarized by the Congressional Budget Office at *www.cbo.gov/ftpdocs/70xx/doc7028/s1932conf.pdf*.
6. *Ibid.*
7. "2002 Student Loan Law Takes Effect, Lowers Interest Rates," Senate Budget Committee *Budget Bulletin*, August 4, 2006, at *http://budget.senate.gov/republican/analysis/2006/bb08-2006.pdf*.

cost to taxpayers could be tens of billions of dollars.[8] Furthermore, locking in current and future students at reduced 3.4 percent interest rates could add another generation of expensive consolidation loan candidates. Addressing these costs, which could potentially rival those of the savings and loan scandals, should be a top education policy priority.

4. **Tuition costs rise with financial aid.** Students and parents are well aware that tuition is soaring. The average college tuition, adjusted for inflation, has leaped 86 percent for public colleges and 52 percent for private colleges since the 1991–92 school year.[9] However, endless student aid increases may not only fail to deal with rising tuition; evidence suggests they actually *contribute* to tuition increases. Richard Vedder, among other economists, has shown that college tuition increases follow student aid increases.[10] Colleges, like businesses, charge as much as their customers are able to pay. So when student aid increases, colleges raise tuition accordingly to capture the additional aid. This suggests that increases in federal student aid effectively subsidize colleges, not students.

   Unfortunately, students, taxpayers, and policymakers are often unable to determine the real reason for increasing tuitions. "Institutions of higher education, even to most people in the academy, are financially opaque," according to the National Commission on the Cost of Higher Education. "Academic institutions have made little effort, either on campus or off, to make themselves more transparent, to explain their finances."[11]

5. **Lower interest rates will not increase access to college.** The House Democrats propose to cut student loan interest rates as a means of "making college more accessible." This does not make sense. College accessibility depends on whether current and prospective students can fund their tuition and other expenses, not the interest rate at which they will repay the loans after leaving college. Telling students who currently cannot afford college that they will receive lower post-graduation student loan interest rates is putting the cart before the horse.

   It is true that society has an interest in making sure qualifying prospective students can access sufficient student aid to enroll in college. This is accomplished by ensuring that borrowing caps are in line with the amount necessary to afford tuition, room, and board. The 2005 Deficit Reduction Act already addressed this issue by raising the borrowing caps by about 30 percent. Such policies help students afford college without shifting large costs to taxpayers (as with grants) or merely subsidizing college graduates (as with reducing interest rates). However, Congress should take care to ensure that these policies do not continue to induce tuition increases.

6. **Most college graduates can afford to repay their student loans.** The effect of reducing student loan interest rates will be to subsidize college graduates while leaving current college students no closer to affording their tuition. Today, college graduates enter the workforce with an average student loan debt of $17,500. This is not a crisis worthy of federal handouts. That debt level, consolidated into a 30-year loan at a 6.8 percent interest rate, represents a monthly payment of only $114, $12 of which is recouped through the student loan interest tax deduction.[12] Halving the interest rate would shave just $36 off the monthly payment but also reduce the tax deduction to $5 per month. A college degree raises an individual's lifetime earnings by over $1 million, on average, and so $114 per month is clearly an affordable payment on a very profitable educational investment. Furthermore, it is unclear why Congress would

8. Kevin Hassett, "Tales Out of School: The Financial Disaster Everyone Missed," Tech Central Station, March 10, 2004, at *www.tcsdaily.com/article.aspx?id=031004J*.
9. College Board calculations cited by Jay Mathews, "Spike in College Price Tags Not So Sharp," *The Washington Post*, October 25, 2006, at *www.washingtonpost.com/wp-dyn/content/article/2006/10/24/AR2006102400524.html*.
10. "College Access: Is Government Part of the Solution, or Part of the Problem?" Testimony of Richard K. Vedder, Committee on Education and the Workforce, U.S. House of Representatives, April 19, 2005, at *www.house.gov/ed_workforce/hearings/109th/fc/collegeaccess041905/vedder.htm*.
11. National Commission on the Cost of Higher Education, "Straight Talk about College Costs and Prices," American Institutes for Research, 1998, p.6.
12. Tax deduction savings are based on a taxpayer filing in the 15 percent marginal income tax bracket for the first 15 years and in the 25 percent tax bracket for the final 15 years. Total tax savings are then averaged over the 360-month length of the loan.

burden the population as a whole (76 percent of whom do not have college degrees[13]) with the costs of subsidizing the minority of adults who have college degrees and so can expect higher lifetime earnings.

A Better Proposal

Rather than providing billions in new federal subsidies, Congress should instead focus on the fundamental problem of college affordability: out-of-control higher education costs. Congress should determine whether ever-increasing federal subsidies for higher education contribute to increasing college costs.

Conclusion

America's economic future depends on having an educated and productive workforce. The federal government has already invested unprecedented sums on financial aid for college students and created a system that provides large amounts of aid at low interest rates. Halving student loan interest rates will subsidize college graduates repaying their aid, without significantly improving current and future students' access to higher education. Importantly, halving student loan interest rates will not address the ever-increasing cost of higher education. Congress should instead examine whether federal subsidies are a part of this problem.

13. U.S. Census Bureau, "The Big Payoff: Educational Attainment and Synthetic Estimates of Work-Life Earnings," July 2002.

Chapter 7
Raising Taxes May Harm Energy Supplies

Ben Lieberman

> We will energize America by achieving energy independence, and we will begin by rolling back the multi-billion dollar subsidies for Big Oil.
>
> —INCOMING HOUSE SPEAKER NANCY PELOSI (D–CA)

In response to continued high oil and natural gas prices, the House of Representatives has pledged to "begin by rolling back the multi-billion dollar subsidies for Big Oil." Although it is not yet clear what this entails, Congress will likely try to amend or repeal several tax code provisions with the goal of raising the overall taxes paid by the energy sector. This is the wrong approach to meeting the energy needs of the American people because it will likely lead to reduced energy supplies and higher prices.

No Solution

Specifically, the House may consider changes to the treatment of so-called intangible drilling costs, the manufacturing deduction under the American Jobs Creation Act of 2004, the amortization of geological and geophysical costs under the Energy Policy Act of 2005, or other tax-related measures. The effect of these changes would be to reduce deductions against income and thereby raise taxes on energy companies.

This is not a solution to high energy prices. Simply put, the current tax code has absolutely nothing to do with the recent increase in energy prices, so tinkering with the code will at best accomplish nothing and at worst could prove counterproductive over the long term.

For one thing, the underlying assertion that the domestic energy sector is undertaxed is erroneous. By some measures, the sector's overall effective tax rates are actually higher than the market average. Furthermore, increasing taxes on U.S. companies would only give a comparative advantage to OPEC and other foreign suppliers that are not subject to such provisions.

Unintended Consequences

Worst of all, higher taxes may cause harm in the long run by discouraging investment in new domestic production of oil and gas. America's demand for energy is growing with its economy, so it needs more domestic oil and natural gas production in the years ahead, not less. However, higher taxes would move America in the exact opposite direction because they would leave the industry with less after-tax revenues to reinvest in new exploration and production. Higher taxes would also make new projects less economically attractive.

The bottom line is that the proposals to raise energy taxes would lead to lower domestic supplies of oil and gas, increased imports to fill the void, and ultimately higher prices for consumers.

Indeed, the lesson of the infamous windfall profit tax on oil imposed under the Carter Administration in 1980 and repealed under the Reagan Administration in 1988 is that energy tax increases can backfire and end up hurting consumers by reducing domestic energy supplies. In 1980, anger at "Big Oil" over high prices led to this punitive measure, but America learned the hard way that this approach does not benefit the American people. The new Congress should not repeat the mistakes of the Carter Administration.

Expand Domestic Energy Supplies

The answer to high energy prices is not to raise the effective tax rates on existing domestic energy supplies, but to expand domestic energy supplies so that more oil and gas is available. Recent Department of the Interior studies, conducted pursuant to the 2005 energy bill, confirm that the United States has substantial oil and natural gas deposits. These studies also show that much of these onshore and offshore resources are off-limits due to legal and regulatory constraints. In fact, America remains the only nation on earth that has restricted access to a substantial portion of its domestic energy potential. Streamlining or eliminating these restrictions on domestic exploration and drilling—not rewriting the tax code—will allow for greater supplies and lower prices in the years ahead. This should be the main focus of any genuinely pro-consumer energy policy from Congress.

Chapter 8
Improving Retirement Security Takes More than Posturing

David C. John

> We will guarantee a dignified retirement, and we will begin by fighting any attempt to privatize Social Security.
>
> —INCOMING HOUSE SPEAKER NANCY PELOSI (D–CA)

In its first 100 hours, the new House leadership hopes to pass a resolution opposing the "privatization" of Social Security. This would do nothing to address a real—and worsening—problem. Social Security has promised $6.5 trillion more in benefits to seniors and disabled workers than the program will be able to pay from its payroll taxes. The 2006 annual report of the trustees of the Social Security trust fund concluded that the program will require progressively larger transfers from general revenues to maintain its projected level of spending. However, Social Security's coming deficits are only part of an overall problem of retirement security. Among the 153 million working Americans in 2004, over 71 million worked for an employer that did not sponsor a retirement plan of any kind, and another 17 million did not participate in their employer's plan.[1] In order to provide Americans with real retirement security, Congress should make fixing Social Security a priority and take steps to improve the ability of all workers to build retirement savings.

Social Security's Growing Deficits

In present value terms, Social Security owes $6.5 trillion dollars more in benefits than it will receive in taxes. That number includes $1.9 trillion, in net present value terms, to repay the bonds in Social Security's trust fund and $4.6 trillion to pay benefits after the trust fund is exhausted in 2040.

Delay in dealing with these coming deficits only makes the problem worse. The total deficit grows each year because Social Security's financial position includes one year less of the current surpluses and one year more of the coming deficits. For instance, 2006's estimated deficit is $800 billion more than 2005's $5.7 trillion deficit, about a 12 percent increase.

Net present value measures reflect the amount of money that Social Security would have to have invested today in order to have enough money on hand to pay its future obligations. In other words, Congress would have to invest $6.5 trillion today in order to have enough money to pay all of Social Security's promised benefits between 2017 and 2080. This funding would be in addition to what Social Security receives during those years from payroll taxes.

Social Security will continue to collect more in taxes each year than it will spend on benefits until 2017.[2] Its trust fund will run out of money in 2040, a year earlier than the 2005 report projected, because low interest rates on

1. Craig Copeland, "Employer-Based Retirement Plan Participation: Geographic Differences and Trends: Employee Benefit Research Institute Issue Brief No. 286," October 2005, Figure 1, p. 7. Non-participants include those who are not eligible for their employer's plan and those who are eligible but who fail to participate. Among the subset of approximately 92 million full-time, full-year wage and salary workers between the ages of 21 and 64, 65 percent work for an employer that sponsors a plan, and 57 percent participate in an employer-sponsored plan.
2. For details about Social Security's fiscal condition, see Social Security Administration, *2006 Social Security Trustees Report*, May 1, 2006, at *www.socialsecurity.gov/OACT/TR/TR06/*.

government bonds will result in the trust fund earning less than previously expected. The projections also reflect a slight increase in the projected future birth rate and a slight increase in future productivity. Neither change significantly affected the program's projected future deficits.

What most reports about Social Security have missed is that Congress will have to start to deal with reduced surplus Social Security tax collections much sooner than it or the public expect. Starting in 2009, the roughly $100 billion annual Social Security surpluses that Congress has been borrowing and spending for years on other programs will begin to shrink. From that point on, Congress will have to find other sources to replace the money that it annually borrows from Social Security or reduce spending. The surpluses will end completely in 2017, the year when Social Security begins to spend more than it takes in.

In a little more than 15 years, today's $100 billion annual Social Security surplus will turn into a $100 billion annual deficit—a $200 billion change. From 2017 on, Social Security will require large and growing amounts of general revenue funds in order to pay all of its promised benefits. Even though these funds will technically come from cashing in the special issue bonds in the trust fund, the money to repay them will have to be found from other tax collections or borrowing. Moreover, the billions that go to Social Security each year will make it harder to find money for other government programs such as defense or Medicare.

Help Workers Save

The households that tend to be in the best financial position to confront retirement are the 42 percent of the workforce that participates in employer-sponsored retirement plans.[3] Employer-sponsored pension, profit-sharing, 401(k), and other plans can be particularly effective in accumulating retirement savings for employees. Traditionally, the take-up rate for IRAs (those who contribute as a percentage of those who are eligible) is less than 1 in 10, but the take-up rate for employer-sponsored 401(k) plans tends to be on the order of 7 in 10. The 401(k) programs make saving relatively easy by enabling employees to elect to have a portion of their pay deposited regularly and directly into a retirement account. These contributions are invested, accumulate on a tax-favored basis, and are often matched by employer contributions. In order to provide comprehensive retirement security, Congress should supplement existing retirement savings plans with innovations such as the Automatic IRA[4] so that all workers have the opportunity to build retirement nest eggs.

Recommendations

Passing a House resolution opposing Social Security "privatization" is at best unconstructive. While it indicates what the new Congress will not do, it says nothing about how to fix Social Security and provide all Americans with real retirement security.

Instead, Congress should consider a resolution stating that it places a high priority on developing a comprehensive solution to Social Security's future deficits that examines all aspects of the program and places a strong emphasis on increasing personal savings across all income levels. This approach would be the first step towards placing all entitlement programs on a sound financial footing and protecting our children and grandchildren from having to deal with those program's massive deficits.

In addition to stating its intention to deal with Social Security, Congress should indicate its bipartisan support for improving the ability of all workers to build retirement savings by improving 401(k) plans and developing retirement savings plans for the millions of workers whose employers do not provide any sort of retirement plan. Together, the two efforts would help to create real retirement security for all Americans.

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3. Copeland, "Employer-Based Retirement Plan Participation," Figure 1, p. 7.
4. For more information on Automatic IRAs, see J. Mark Iwry and David C. John, "Pursuing Universal Retirement Security Through Automatic IRAs," February 12, 2006, at *www.heritage.org/Research/SocialSecurity/wp20060212.cfm*.