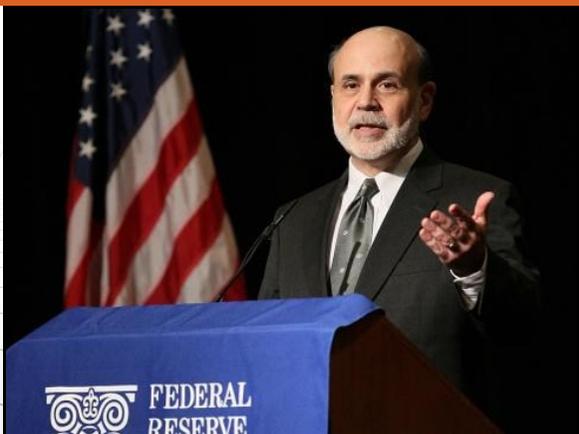


# LOOKING AHEAD

The Cornell Roosevelt Institute Policy Journal

Center for Economic Policy and Development

Issue No. 3, Fall 2012



# LOOKING AHEAD

## The Cornell Roosevelt Institute Policy Journal

Center for Economic Policy and Development

Issue No. 3, Fall 2012

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# About the Roosevelt Institute

The Roosevelt Institute at Cornell University is a student-run think tank that generates, advocates, and lobbies for progressive policy ideas and initiatives in local, university, state, and national government. Members write for our campus policy journals, complete advocacy and education projects in the local community, host research discussions with professors, write policy and political blogs, and organize campus political debates and policy seminars.

## **The Roosevelt Institute is organized in 7 policy centers:**

Center for Economic Policy and Development  
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Center for Energy and Environmental Policy  
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# Letter from the Policy Director

Dear Readers,

We are very excited to present this issue of *Looking Ahead* from the Center for Economic Policy and Development at the Cornell Roosevelt Institute. Over the Fall 2012 semester, our nine writers researched and crafted original solutions to various policy issues related to economic development. In this journal, you will find topics ranging from monetary policy, deficits, healthcare expenditures, public transit, tax deductions and real estate markets, all with an emphasis on improving America's economic outlook. We hope that you will enjoy our policy ideas and that they will make you think differently about the problems and potential solutions facing our country.

Sincerely,

**Isaac Rosenberg**

Policy Analysis and Management '13 (HumEc)

Policy Director

Center for Economic Policy and Development

Email: irr5@cornell.edu

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# Replacing the Employer Health Care Exclusion With Premium Support

By Victor Zhao '16, Major: Applied Economics and Management (CALs), Email: vz38@cornell.edu

*Replacing the employer health care tax deduction with a premium support plan will reduce health care costs and make the market fairer and more progressive.*

## Background:

Tax expenditures refer to government spending that occurs through exemptions, deductions, or credits in the tax code. The largest such expenditure in the tax code is the tax exclusion for employer-sponsored health insurance, costing about \$260 billion per year.<sup>1</sup> Under the exclusion, employees and employers do not pay income or payroll taxes on health benefits provided by the employer.

### Key Facts:

- 60% of Americans under the age of 65 today are covered by employer-sponsored health care.<sup>3</sup>
- 91% of all private health insurance sold to people younger than 65 is employment-related.<sup>1</sup>
- National health spending will total \$2.8 trillion, or 17.9% of the gross domestic product, in 2012.<sup>4</sup>

The current employer health care tax-deduction is unfairly regressive and promotes unnecessary health care coverage. Although employer spending on health insurance can be considered a form of compensation, it is exempt from taxation as income. Thus, higher-income earners receive a larger tax benefit because they would otherwise have had to pay a larger marginal tax rate on this additional income. Furthermore, the exclusion favors higher income workers because these individuals are more likely to receive insurance and more generous health care benefits through their jobs. Replacing this system with a premium support plan that provides beneficiaries with a set amount of money for purchasing health insurance would make the health care system more progressive.

## History:

Under the Patient Protection and Affordable Care Act (PPACA) of 2010, new health insurance exchanges will be created and operational by 2014. Plans purchased through these exchanges will be eligible for tax credits that cover a portion of the cost. Furthermore, a new tax will be levied on health insurance plans that exceed \$10,200 for individuals and \$27,500 for families.<sup>3</sup> Plans below these thresholds remain eligible for the tax exclusion.

The health care reforms initiated in Massachusetts in 2006 provide premium support to help low and middle income people afford private health insurance policies.<sup>6</sup> These reforms serve as an important case study for the effects of a premium support plan.

## Analysis:

To make the health insurance tax exclusion more progressive, the current tax deduction should instead be replaced with a premium support plan that provides a set amount of money to pay for health insurance. Because tax deductions only exempt income from taxation, implementing a premium support plan would make the benefit fairer. The revenue gained from the elimination of the current tax exclusion should be used to provide premium support to all Americans for the purchase of health insurance. The amount of money allocated under this program should initially be priced at the cost of the second-lowest health insurance plan in each region, with future increases calculated based upon market inflation and health care inflation.

The new premium support system would remove the incentive to buy higher-coverage and more expensive insurance plans, because any amount that is spent above the government subsidy would be taxed as personal income. This eliminates the incentive to purchase more care than is really needed, driving down overall health insurance costs. Furthermore, it expands consumer choice; workers no longer have to choose the health insurance plan offered by their employer.

### Talking Points:

- Premium support, rather than employer-provided health care, allows the individual to make the choice for which insurance policy to purchase and reduces wasted care, ultimately driving down costs.
- Health care costs are growing at 1.5 times the rate of GDP.<sup>5</sup>
- The Affordable Care Act and the Massachusetts Health Reform of 2006 already contain some elements of a premium support plan, and can be used as models for study and analysis.
- The current system of employer-provided health insurance is regressive.

## Next Steps:

The first step in a transition to premium support is already under way, with the PPACA set to be fully implemented by 2014. Under the PPACA, health insurance exchanges will be set up in each state offering plans to low and middle income earners that are eligible for tax credits.

A two year transition period should follow to give policyholders the time to make necessary adjustments to their insurance plans in order to prepare for a full transition to a

premium support system. During this period, the health insurance exchanges should make preparations for the expected increase in customers when a premium support plan is fully implemented.

By 2016, the tax exclusion for employer-provided health insurance should be completely eliminated, and a full transition to a premium support plan should be under way.

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# Stabilizing the Municipal Tax Base and Local Real Estate Markets through Public Finance

By Nicholas Toth '14, Major: Industrial and Labor Relations (ILR), Email: nct32@cornell.edu

*This policy proposal offers a plan to reduce the risk of future foreclosures. By establishing a Bridge Loan Trust Fund, which would extend credit to homeowners and help them remain up to date on mortgage payments, municipalities can fortify their tax base and mitigate the impact of downturns.*

## Background:

In total, an estimated \$19.2 trillion dollars was lost in household wealth during the recent financial crisis.<sup>4</sup> The Congressional Research Service (CRS) report titled An Analysis of the Distribution of Wealth Across Households, 1989-2010, stated that 63% of households experienced a loss in household net worth between 2007 and 2009. This reduction was largely attributed to a broad collapse in housing prices.<sup>5</sup> Throughout the same period, the Federal Reserve reported that total U.S. wealth fell by 38.8% on housing declines.<sup>6</sup> Falling home values have historically been a leading constraint on consumer spending, which makes up roughly 70% of GDP.<sup>7</sup>

### Key Facts:

- Increased foreclosure rates apply downward pressure on the local real estate market values.<sup>2</sup>
- Reductions in property tax revenue resulting from housing declines disrupt the municipality's ability to provide essential services.<sup>3</sup>

Housing crashes erase household wealth, reduce economic growth and lead to a drop in property-tax receipts. By establishing a Bridge Loan Trust Fund, the government can mitigate the risk of these events.

## History:

Homeownership, facilitated through the critical lender-borrower relationship, has defined the way Americans have lived since the 1930's when the Federal Housing Administration (FHA) was created under President Roosevelt's New Deal. This legislation gave birth to the 30-year fixed-rate mortgage and provided much needed insurance to investors who would purchase these mortgages.<sup>1</sup> Many scholars of the Great Depression argue that the lack of access to credit exacerbated and prolonged the depressed housing market. As we've seen in the past, it becomes very difficult for homeowners to gain access to credit during economic downturns because banks are reluctant to lend.

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## Analysis:

Bridge Loans, which are commonly used to fund short term financial obligations, could be used to help homeowners who risk falling behind on their mortgages. By establishing a Bridge-Loan Trust Fund (BLTF), municipalities can allocate a small percentage of property tax revenues to provide temporary loan assistance for middle-class homeowners experiencing a recent job loss, sickness, or death in the family. Under this plan, homeowners could apply for low-interest loans to remain up to date on mortgage payments.

The BLTF would be funded by a temporary property tax increase until a \$4 million cap is reached. The tax levy used to fund the trust would then be rolled back. The borrower will have a period of 5 years to pay back the entire amount of the loan plus all accrued interest (2% annually) over the duration of the loan period. The use of loan proceeds would be strictly limited to fulfilling mortgage payments.

The Town of Ithaca had approximately 5,274 taxable parcels and total tax revenue of \$17,075,825 in 2011.<sup>8</sup> Based on the current tax rate of 13.05% per \$1000 of assessed value, the average property owner pays approximately \$3238 per year in property taxes.<sup>9</sup> By increasing the tax rate to 13.59% or about \$134 per property owner, the BLTF would grow at a projected \$706,585.86 annually plus interest, depending on market conditions.<sup>10</sup> Assuming a 1% annual interest rate, the BLTF would grow to approximately \$3,618,108, including compounded interest of approximately \$85,179 over a 5-year period.<sup>10</sup> While the slight increase in taxes may have a small impact on disposable income and growth in the short term, the long term benefit of stable home values and reduced foreclosures would outweigh the temporary cost; by reducing the risk of a future housing market decline, we reduce the risk of a subsequent sharp decline in property tax receipts.

### Talking Points:

- Accrued interest and interest paid by the borrower can be allocated to the municipal budget to fund existing public programs or reduce taxes.
- In the event of a sudden job loss or a sickness, residents would have another financial option which could offset the risk of foreclosure.
- Every dollar will be paid back to ensure the future sustainability of the BLTF program.

Stringent eligibility standards would be implemented to ensure that aid would only be extended to those who demonstrate a justifiable need (i.e. job loss, sickness, or death). Applicants who are unable to substantiate such a need or those who are in the process of and/or have declared bankruptcy would be ineligible.

The BLTF program will act as a cushion for homeowners in tough economic times; reducing risks associated with market and business cycle fluctuations and protecting the

existing tax base from housing declines.

## Next Steps:

Municipal governments should support the development and implementation of a local Bridge Loan Trust Fund. In doing so, localities will be providing residents with a unique public program that would give households another option during times of financial distress.

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# Stimulating Economic Growth in Poor Communities Through Public Transportation Subsidies

By Michael Lemm '15, Major: Policy Analysis & Management (HumEc), Email: msl273@cornell.edu

*As low-income communities continue to fall behind with public transportation resources that have been proven to stimulate economic growth, it is important for Congress to create subsidies for public transit development in low-income communities.*<sup>1</sup>

## Background:

In the midst of a post-recession economy, the US wealth gap endures, and low-income areas continue to fall behind in access to basic resources that have been shown to help further their economic development. Among these problems is a lack of public transportation, which has been shown to increase access to education, decrease environmental hazards and stimulate job creation in areas where it is allocated.<sup>1</sup>

### Key Facts:

- 36,000 jobs are created for every \$1 billion invested in public transit infrastructure.<sup>12</sup>
- Low-income commuters account for 67% of total public transportation ridership.<sup>13</sup>
- Public transportation has been proven to stimulate economic growth, increase educational opportunities, and decrease environmental pollution.<sup>14</sup>

In order to best understand how insufficient public transit negatively affects communities, take, for example, a household in a low-income urban area located outside of the primary job sector of a large city, where analysts argue most public transit resources are underfunded. Among the disadvantages for the household are: 1) decreased travel access to the majority of job locations in the city, especially considering that low-income families make up 67% of public transportation users,<sup>2</sup> 2) increased environmental health hazards, as more people are forced to drive automobiles to work, driving up green-house gas emissions and reducing air quality in these areas, and 3) inferior access to education, as the expansion of charter schools has lengthened the daily commute to school.<sup>3</sup>

## History:

In 2011, it was estimated that an average of 36,000 jobs were created for every \$1 billion invested in public transit infrastructure.<sup>4</sup> In turn, every 36,000 jobs created by public transit investments generated nearly \$3.6 billion in private sector sales, as well as \$500 million in federal, state, and local tax revenues.<sup>5</sup> The gains from public transportation infrastructure have provided substantial benefits for all communities. How-

ever, there remain vast disparities in the distribution of public transportation resources between high-income and low-income areas. These public transit disparities primarily stem from differences in property tax revenue collections: state/municipal governments allocate more transit resources to higher-income communities, due to the greater amount of tax revenue the areas produce.<sup>6</sup>

## Analysis:

To curtail such disparities, one feasible policy the federal government can implement is to provide federal grants to incentivize state transportation departments to create public transit infrastructure in low-income areas. Especially considering Congress

pledged \$105 billion to creating public transit infrastructure for fiscal years 2013 and 2014 through the MAP-21 Act,<sup>7</sup> it is imperative to implement federal grants for low-income public transit development to ensure that the proposed funding is not solely allocated to higher-income communities.

### Talking Points:

- Federal grants will provide states with increased incentives to serve low-income communities' public transit needs.
- Federal grants have been especially effective in stimulating economic development in low-income communities through the CDBG.<sup>15</sup>

In order to understand how the use of federal grants can increase the development of public transportation infrastructure in low-income areas, consider the present decisions state transportation departments must make when allocating transit resources. Under the status quo, local governments must match all federal funding used to support public transportation, dollar-for-dollar.<sup>8</sup> In deciding where to allocate new public transportation infrastructure, it is more efficient for states to pursue projects in higher-income areas where local tax revenues are higher, as these areas are better able to take advantage of the matching grant. However, if the federal government assisted state governments by providing block grants to public transportation projects in low-income areas, states would have new incentives to supply these areas with adequate public transit resources. In fact, recent federal grants distributed to states to develop more public housing in low-income areas (through the US Community Development Block Grant Program (CDBG)) have led to the creation of nearly 5.1 million housing units for low-income families.<sup>9</sup> Both job growth and incomes in low-income communities have increased as a direct result of the federal grants.

It is important to recognize that state governments would gain from federal grants for low-income public transit development as well. Not only have past federal grants helped to economically revitalize low-income communities and stimulate job creation, but the resulting increase in average incomes have also boosted tax revenues.<sup>10</sup> Of course, states would still make the decisions in apportioning public transportation

funding since they are best able to assess local community needs. However, the proposed federal grants will encourage states to apportion more funding to public transit in the low-income communities that arguably need it the most.

## Next Steps:

With \$105 billion of federal spending pledged to public transportation over the next two fiscal years, low-income communities and state governments can make large gains from the implementation of federal block grants. Public transit ridership has increased by 34% from 1995 to 2011,<sup>11</sup> and considering most riders are low-income, it is certain that new transit resources in low-income areas will be utilized. In order to reduce the current wealth gap and help low-income communities recover from the recent financial crisis, federal grants for public transit development are the most feasible solution.

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# Quantitative Easing Has Played its Role – Now Let it End

By Austin Opatrny '14, Majors: Economics & Asian Studies (A&S), Email: abo27@cornell.edu

*Quantitative easing is an emergency procedure that negatively distorts the money supply and should permanently cease in May 2013. It should be replaced with a policy that targets a nominal GDP growth rate.*

## Background:

The reduction of interest rates stimulates the economy by making it cheaper for businesses and consumers to borrow. Interest rates are managed by the Federal Reserve, and are typically reduced by adjusting the federal funds rate, an interest rate offered by the Fed to commercial banks. Following the onset of the Great Recession, the Federal Reserve embarked on a series of unprecedented market interventions known as “quantitative easing.” The interventions were necessary because the funds rate could not be adjusted

lower. In the intervention, the Fed purchases securities (mainly Treasury bonds) on the open market, which injects a pre-determined quantity of money into the economy. This injection decreases the scarcity of money and reduces interest rates.

### Key Facts:

- Three rounds of Quantitative Easing:
  - QE1 lasted from November 25, 2008 to March 31, 2010.<sup>2</sup>
  - QE2 lasted from November 2, 2010 to June 30, 2011.<sup>5</sup>
  - QE3 was initiated September 13, 2012, and has no specific closing date.
- QE1 aimed to inject liquidity and prevent a credit freeze (emergency measure) and QE2 aimed to spur economic activity. QE3 also aimed to spur activity as well as boost home prices.
- The total liquidity injected has exceeded \$2 trillion. The combination of uncertainty surrounding monetary policy and healthcare costs, as well as potential tax increases, has impacted the pace of recovery, according to the chief economist of Daiwa Capital Markets.<sup>19</sup>

## History:

The federal funds rate was reduced to 0.25% on December 16, 2008, down from the 1% rate set on October 29th, 2012. It remains at 0.25% as of October 2012 – its effective rate (factored for inflation) has varied from a high of 0.22% to a low of 0.07%.<sup>1</sup> Since the funds rate cannot be lowered further, quantitative easing is one of the only options the Fed has. It has used this tool three times: November 25th 2008, November

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3rd 2010, and September 13th 2012. The first round, lasting through June 2010, aimed to prevent a credit market freeze in the aftermath of the Financial Crisis. The Fed purchased approximately \$2.1 trillion<sup>2</sup> of assets during this first round, and is generally thought to have met its goals - a report from Deloitte Consulting states, “without this [first round of] easing, the United States, and the global economy, could have slipped into a longer and deeper recession.”<sup>3,4</sup> The second round, which lasted through June 2011, was a “Hail Mary pass” that saw the Fed inject \$600 billion with the intent of reinvigorating the economy.<sup>5</sup> The success of this round is more ambiguous – Deloitte said it had “limited” success in accelerating the economy. The third round of QE3 has a similar objective to QE2. However, rather than injecting a pre-disclosed sum over a designated period, QE3 will function by injecting \$40 billion monthly until the Federal Reserve sees certain undisclosed economic indicators reached (for example, a certain level of unemployment or inflation).<sup>6</sup>

## Analysis:

Japan’s monetary policy presents an example of the long-term use of quantitative easing. Japan launched its eighth installment of quantitative easing on September 2012, eleven years after its first.<sup>7</sup> Ben Bernanke said on October 1st, 2012 that “we could draw on the

experience of Japan, where short-term interest rates have been near zero for many years.”<sup>8</sup> He failed to mention that Japan has also seen 16 years of deflation and near-flat growth: that is, real growth has been higher than nominal growth.<sup>9</sup> A survey conducted by Investment and Pensions found that nearly all fund managers felt markets were becoming “addicted” to monetary stimulus.<sup>10</sup> Bill Gross, who runs the world’s largest mutual fund, said in November 2012 that quantitative easing is simply “inflating asset prices, rather than spurring investment.”<sup>11</sup> Equity market capitalization is currently at 110% of GDP, a ratio also achieved in the boom periods of late 1990s/early 2000s and 2006-2007.<sup>12</sup> Morgan Stanley commissioned a study showing that previous monetary stimulus boosted the valuation of the stock market without boosting profits.<sup>13</sup> This is a dangerous direct consequence of quantitative easing - money is forced into assets (such as equities) riskier than treasuries, boosting their nominal value.<sup>14</sup> Should there be a downward adjustment of their valuation, consumers will experience a second shock to their wealth, causing another contraction in confidence, similar to that of 2008. This must be avoided through a managed come down of quantitative easing.

### Talking Points:

- The Fed should end QE3 in April or May of 2013.
- A large percentage of fund managers believe that markets have become “addicted” to monetary stimulus.
- Quantitative easing may have artificially inflated stock prices without boosting profits. A downward adjustment may be coming.
- Japan’s monetary policy should not be emulated.

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## Next Steps:

As the housing cycle naturally sees more activity and increased prices during the summer months,<sup>15</sup> the third round of QE3 should end in April or May of 2013. This way, increased market activity can help negate the impact of the withdrawal of Federal Reserve cash. The Federal Reserve should firmly state that it will not undertake any further rounds of quantitative easing. It should lay out its strategy for deleveraging its balance sheet, which should be done in a clear and structured fashion. This deleveraging has been identified by the CME Group as “extremely challenging to implement, with the potential, if not certainty, to delay a return to normal monetary policy, to the detriment of longer-term economic growth.”<sup>16</sup> Columbia University Economist Michael Woodford recently released a paper remarking that in a zero-interest rate environment, communication of long term objectives is more important than short-term actions.<sup>17</sup> This means that rather than continue to focus on short-term economic stimulus, the Fed should return to managing the long-term outlook for the economy – Michael Woodford suggests the Fed should shift from targeting long term inflation to instead targeting a certain nominal growth rate of the domestic product.<sup>18</sup> The Fed should follow Michael Woodford’s proposal, and target specific GDP growth rates, rather than rates of inflation.

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# Indexing the Gasoline Tax to Inflation

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*Congress should index the federal gasoline tax to inflation to save the struggling Highway Trust Fund, discourage excessive fuel consumption, and support mass transit programs.*

## Background:

While the current federal gas tax of 18.4 cents per gallon has stayed constant since 1993, gas prices have quadrupled within the same time frame. Because the federal gas tax is not indexed to inflation, price increases reduce the effective tax rate per gallon.<sup>1</sup> Revenues generated by the gas tax help to support the Highway Trust Fund, which pays for renovations and additions to interstate roads and freeways. The declining value of the 18.4 cent tax combined with the increasing fuel-efficiency of vehicles has placed a strain on the Highway Trust Fund.

### Key Facts:

- The highway trust fund is projected to bring in \$36.9 billion in revenue this year, largely from the gas tax, while Congress has authorized \$52.7 billion in highway and transit infrastructure spending.<sup>5</sup>
- If the gas tax were indexed to inflation, the rate would increase in the first year by about one half of one penny per gallon, assuming a two percent inflation rate.
- The current 18.4 cent gas tax would have been worth about 28 cents in today's dollars if it had been indexed to inflation in 1993.<sup>1</sup>

## History:

The gas tax was first established by the Revenue Act of 1932 and originally set to one cent per gallon under the Hoover Administration. The tax was raised several times over the next two decades, reaching 4 cents per gallon under President Eisenhower in 1959, which in today's dollars would equal 30.6 cents.

## Analysis:

According to a 2012 report from the Congressional Budget Office, the highway trust fund will be insolvent by the end of 2013 if revenues are not increased.<sup>2</sup> By 2016, the fund will be over \$50 billion in debt if no action is taken to increase revenue streams.

The slightly elevated cost of gas would incentivize consumers to drive less and purchase fuel-efficient vehicles. A study conducted by James Sallee on the impact of gas

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taxes on driving found direct fuel taxes to be more effective at reducing overall gasoline consumption than policies that subsidize the purchase of fuel efficient and hybrid vehicles.<sup>3</sup>

Attempting to raise taxes in this political and economic climate may seem ill-advised. However, noted economist Gregory Mankiw has argued that the drop in demand for gasoline that would result from higher gas taxes would cause the price of oil to drop in international markets, reducing the net tax increase to consumers, meaning that the total impact of the tax increase on gasoline prices could be minimal. The incidence of a slowly increasing gas tax would be shared by producers and consumers of gasoline, meaning that no single group would be crushed.<sup>4</sup>

## Talking Points:

- The gas tax has been raised under Republican and Democratic administrations. The issue tends to cut across party lines both in terms of its supporters and opponents.
- Indexing the gas tax to inflation has the potential to put a strain on the trucking industry and other industries that require long distance shipments; however reducing mandatory fuel efficiency standards in conjunction with the tax increase could neutralize the impact.
- The reduction in driving that would likely occur in the event of a rising gas tax could reduce traffic congestion on major freeways and commuter routes and encourage greater use of public transportation.

## Next Steps:

The idea of raising taxes in any form during a period of slow economic growth is politically unpalatable for many legislators who are concerned about losing support from consumer groups and auto companies. In order to reduce opposition, the tax increase could be implemented alongside increases in the hybrid vehicle tax credit and reductions in fuel economy standards to facilitate passage of the legislation.

Increasing tax credits for hybrid vehicles would work synergistically with increased fuel taxes, helping consumers adjust to slightly higher fuel prices by making hybrids more affordable. Reducing mandatory fuel efficiency standards for automakers would help win powerful support from the auto lobby and encourage bipartisan support.

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# A Pre-Commitment Mechanism as a Supplement to Obesity Tax

By Mary Eloundou Nekoul '14, Major: Economics (A&S), Email: mfe25@cornell.edu

*With roughly 2/3 of American adults overweight or obese, obesity has become a national concern. This proposal advocates a two-step approach to tackling obesity: taxes and pre-commitment contracts. This government program raises revenue, decreases negative externalities and is contingent on personal responsibility.*

## Background:

Today, 68.8% of US adults are overweight or obese, a rate that has increased rapidly over time.<sup>1</sup> From 2009 to 2010, the number of states with obesity rates higher than 30% increased from nine to twelve. Compare this to 2000, when no states fit this category.<sup>2</sup> Widespread obesity increases the risks of diabetes and heart disease and imposes significant negative externalities on society. One study found, “for 2006, the per capita percentage increase in annual costs attributable to obesity was estimated to be 36 percent for Medicare, 47 percent for Medicaid, and 58 percent for private payers.”<sup>3</sup> Moreover, medical problems associated with obesity can lead to reduced productivity in the workplace, further increasing costs.

### Key Facts:

- In the United States, 149.3 million are overweight or obese, of which 75 million are obese.<sup>14</sup>
- If current trends in the growth of obesity continue, health care expenditures attributable to obesity could reach \$861 to \$957 billion by 2030, or 16 to 18 percent of US healthcare expenditures.<sup>15</sup>
- Because of a higher risk for a host of medical conditions, obese workers are more often absent from work than their normal-weight peers. This absenteeism costs employers about \$6.4 billion a year.<sup>16</sup>
- Even when present, obese people can have lower productivity, due to shortness of breath or other obstacles. This “presenteeism” is estimated to cost employers about \$30 billion a year.<sup>17</sup>

Combining a national 1-cent per ounce tax on sugar-sweetened beverages (SBBs) with a national financial pre-commitment program for weight loss will help ameliorate the national obesity problem.

## History:

A pre-commitment contract sets a goal for an individual to meet over a period of time (in this case, weight loss), with rewards for success and consequences for failing to meet the goal by the end of the period. StickK, a weight-loss website, has participants

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sign a contract where they agree to pay out a sum of money if they fail to meet their weight goals in the future. The success rate for members with financial incentives is 71.5%, versus a 29% success rate for members without financial incentives.<sup>4</sup>

The cigarette tax hike, signed by President Obama on April 1st 2009, validates Pigouian taxation as a way to disincentivize unhealthy behavior; about 3 million fewer people smoked in 2011 than 2009 after the cigarette tax rose from \$0.39 to \$1.<sup>1</sup> A similar approach can be applied to SBBs.

Recent policy proposals aimed at combatting obesity have included programs promoting caloric awareness (e.g. the Menu Labeling Ordinance), laws banning the sale of junk food in some schools, and lifestyle initiatives such as the “Let’s Move” campaign.

## Analysis:

Participants (obese and overweight individuals over 20 years of age) choose the duration of the contract. During this time, the program offers \$250 a year for healthy groceries (Or 6.7% to 13.5% of an individual’s annual grocery bill) and a 50% discount on gym membership (\$27.5 per month, or \$330 annually, based on the average gym membership).<sup>5,6</sup> In the event of failure, participants pay a fee of \$60/month for the duration of contract.

About 85% of obese and 70% of overweight individuals would like to lose weight, an average of roughly 77.5%.<sup>7</sup> Since 67% of US gym membership holders never use the gym (people who want to be healthy, but don’t commit), we can reasonably estimate that 33% of obese or overweight individuals who want to lose weight would participate.<sup>8</sup> This relies on the assumption that the punishment in the event of failure is a strong deterrent for feebly committed individuals. Thus 25.8% of the remaining group, 38.5 million people, would participate. Assuming the 71.5% rate of success found with StickK, it’s reasonable to estimate that 27.5 million people would succeed, and 11 million would not.

Over one year, the government would pay \$15.95 billion to successful participants. Unsuccessful participants would benefit from the vouchers, but would be punished for failure. Over a year, the government would receive a net inflow of \$1.54 billion from this set of participants.

### Talking Points:

- The USDA has stated that a soda tax would reduce obesity.<sup>12</sup>
- There have already been soda tax proposals in California, Colorado, Hawaii, Philadelphia, New York, Baltimore, Washington D.C, as well as a national tax proposal. However, they have succeeded only in D.C. and Baltimore.<sup>13</sup>

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Along with this program, we would institute a penny-per-ounce tax on SBBs. We can estimate the revenue raised by a penny-per-ounce tax on SBB using the calculator provided by the Yale Rudd Center. Using beverage sales data from 2008, one can estimate that the nationally implemented tax would generate \$13,180,969,251 in one year.<sup>9</sup> Although the penny-per-ounce tax is estimated to reduce SBB consumption by 15% over the next 10 years, for the period from 2010-2020, average revenue from the tax would be roughly \$13 billion.<sup>10</sup> I assume for simplicity that this would continue to be the case for the years 2013-2023.

Over 10 years, total revenue amounts to: \$130 billion (tax revenue), \$15.4 billion (unsuccessful participant revenue), \$17 billion (medical savings), totaling to \$162.4 billion. The total cost would be \$159.5 billion.<sup>11</sup> The government would receive net revenue of \$2.9 billion, funds that can either be used to reduce the deficit or contribute to preventative measures for obesity.

## Next Steps:

There is ample literature supporting the potential of SBB taxes to reduce obesity. However, these taxes have mostly been voted down when proposed. While obesity may appear to be a problem only on the individual level, it is costing the entire nation billions in healthcare expenditures and lost productivity. While there are arguments that the current economic climate precludes further taxes, the growing cost of healthcare that will increase the national debt is not the better alternative. Instead, we must engage Americans in solving this crisis, on both the individual and government level.

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# Eliminate the Home Mortgage Interest Deduction

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*The regressive nature of the mortgage interest tax deduction disproportionately benefits wealthy Americans. Eliminating it will make capital allocation more efficient, increase the progressivity of the tax code, and reduce the deficit.*

## Background:

Under the current tax code, home buyers are allowed to deduct the interest paid on home mortgages.<sup>1</sup> Instead of using a standard deduction, taxpayers must use an itemized deduction on their federal income tax returns to be eligible.<sup>1</sup> Interest is

fully deductible if the total mortgage debt amounts to \$1,000,000 or less for married couples and \$500,000 or less for individuals.<sup>1</sup> The mortgage interest deduction (MID) can be used to finance up to two residential homes.<sup>1</sup> Interest is also deductible on home equity loans of up to \$100,000 for married couples and \$50,000 for individuals.<sup>1</sup> The equity mortgage must be classified as secured debt, where residential property serves as collateral.<sup>1</sup>

### Key Facts:

- MID subsidies disproportionately favor wealthy families.<sup>2</sup>
- More than half of annual MID subsidy expenditures go to the 12 percent of taxpayers with incomes of \$100,000 or more.<sup>6</sup>

The mortgage interest deduction is intended to lessen the burden of mortgage debt and promote homeownership among low- and middle-income families. Such a generous tax subsidy enjoys bipartisan support as a prized middle-class benefit that helps families realize the American dream of homeownership.<sup>9</sup>

However, many economists believe that the MID subsidies disproportionately favor wealthy families and individuals.<sup>2,3,4</sup> The MID is regressive because the amount of itemized deductions rises as income rises.<sup>5</sup> Wealthy individuals in the higher marginal tax brackets receive more of this tax deduction than those in the lower tax brackets.<sup>4</sup> It is estimated that only one fourth of all tax filers enjoy MID benefits.<sup>4</sup> It is also estimated that more than half of annual MID subsidy expenditures go to the 12 percent of taxpayers with incomes of \$100,000 or more.<sup>6</sup>

## History:

The sixteenth amendment was ratified in 1913, empowering Congress to levy a Federal tax on any source of income. The amendment allowed for the deduction of any type of interest.<sup>7</sup> It wasn't until 1986, when Congress passed major tax reform, that certain

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types of interest lost their deductible status.<sup>8</sup> For instance, one could no longer deduct interest on credit card balances, car loans and many other consumer loans. However, the mortgage deduction was largely preserved, although with new caps and restrictions.<sup>8,10</sup>

In the past, the mortgage interest deduction has been a touchy subject. Despite the fact that it disproportionately benefits wealthier Americans, the MID subsidy is regarded as a middle-class benefit.<sup>9</sup> Historically, the real estate industry has fiercely opposed elimination or adjustments to the MID subsidy.<sup>10</sup> The National Association of Realtors (NAR), one of the most powerful lobbying groups in the US, states on its website: “The mortgage interest deduction (MID) is a remarkably effective tool that facilitates homeownership. NAR opposes any changes that would limit or undermine current law.”<sup>11</sup> During the 2011 fiscal year, the NAR spent more than \$22 million on lobbying activities.<sup>12</sup> Other major lobbying groups include the National Multi Housing Council, the Mortgage Bankers Association and the American Land Title Association.<sup>12</sup>

## Analysis:

According to the Internal Revenue Service, itemized deductions cost the Treasury \$1.2 trillion of tax revenue in 2009.<sup>4</sup> The MID subsidy was the largest deduction, accounting for 35 percent

### Talking Points:

- Less than one-fourth of taxpayers claim MID benefits.
- MID subsidy leads to excessive investment in housing and minimal business investment.
- MID subsidy distorts the allocation of capital in the economy.

of the total.<sup>4</sup> Economists across the political spectrum regard the MID as an ineffective subsidy for increasing homeownership.<sup>2, 3, 4, 13</sup> Based on historical trends, less than one-fourth of taxpayers claim MID benefits.<sup>4</sup> Since higher income taxpayers are more likely to have expensive houses, larger mortgages and second homes, they claim the largest share of MID benefits. By contrast, low income families have lower homeownership rates and thus, fewer mortgages.<sup>4</sup> Even low and middle income households with home mortgages are more likely to opt for standard deductions.<sup>4, 10</sup>

The MID subsidy also distorts the allocation of capital in the economy. According to a study by the Government Accountability Office, the MID subsidy creates a lower marginal effective tax rate for housing in comparison to other investments; this, in turn, leads to excessive investment in housing and reduces business investment.<sup>13</sup>

## Next Steps:

Despite its political popularity, the mortgage interest deduction should be eliminated.

MID is an ineffective tool for boosting the homeownership rate. Its elimination will put an end to unfair tax breaks that high-income households enjoy, increase tax revenues, and lead to more efficient capital allocation in the economy.

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# Incentivizing Low-Income Workers to Save for Retirement

By Michael Wodka '13, Major: Economics (A&S), Email: msw233@cornell.edu

*Making the Savers Credit, a federal tax credit for low-income workers, fully refundable would incentivize 45 million more Americans to save for retirement and improve their current and future income security.*

## Background:

According to a 2012 retirement survey conducted by the Employee Benefit Research Institute, between 2009 and 2012, the percentage of workers with household income below \$35,000 reporting that they saved for retirement declined from 49 percent to 35 percent.<sup>1</sup> In addition, about 30 percent of all workers have \$0 in current retirement savings and nearly half of all workers—an estimated 78 million—currently have no employer-sponsored retirement savings plans.<sup>2,3</sup> These statistics represent a growing problem in U.S. retirement savings, especially among low-income workers. Social Security continues to play a large role in post-retirement income for many lifetime low-wage earners (replaced 55 percent of a 2011 worker's income who earned \$19,400 annually).<sup>4</sup> However, without additional savings, most low-income workers will likely become/remain impoverished once they enter retirement.

### Key Facts:

- About 30 percent of all workers have \$0 in current retirement savings and nearly half of all workers—an estimated 78 million—currently have no employer-sponsored retirement savings plans.
- Without additional savings, most low-income workers will become/remain impoverished once they enter retirement.

The Savers Credit allows low-income workers, who make voluntary contributions to a 401(K), a qualified IRA, or other qualified retirement plans, to take a tax credit of up to \$1000 (\$2000 if filed jointly).

To curb these retirement challenges, the government should enhance the Savers Credit, a federal tax credit that incentivizes low-income workers to save for retirement. This credit allows low-income workers, who make voluntary contributions to a 401(K), a qualified IRA, or other qualified retirement plans, to take a tax credit of up to \$1000 (\$2000 if filed jointly).<sup>5</sup> The credit is a percentage of the qualifying contribution amount, with the highest rate for taxpayers with the least amount of income. For example, a married couple who make \$30,000 annually, file taxes jointly, and contribute \$3,000 to a qualified retirement in 2012 would be eligible for a 50 percent tax credit, or \$1,500 off their tax bill (see chart on page 2 for Savers Credit tax rates).

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The problem with the Savers Credit is that it only incentivizes workers that pay federal income tax to save for retirement. According to a 2011 study by the Tax Policy Center, 46 percent of households owed no federal income tax.<sup>6</sup> As a result, almost half the workforce does not qualify for the credit. To solve this problem, the Savers Credit should be converted into a refundable tax credit, so workers whose incomes qualify for the credit but do not pay federal income tax could still receive the tax credit if they saved for retirement.

## History:

The Savers Credit evolved from a series of efforts in the late 1990s to expand pension coverage among low-and moderate-income workers and distribute tax-preferred retirement benefits more evenly along the income scale. It was enacted in 2001 under the Bush Tax Cuts and made permanent in 2006 under the Pension Protection Act. In President Obama’s 2010-2012 budgets, he proposed making the Savers Credit fully refundable and able to be deposited into low-income household’s retirement accounts, similar to an employer-matching contribution to a 401(K) plan.<sup>7</sup> However, his proposal failed to gain traction in all of his budgets.

## Analysis:

Making the Savers Credit fully refundable would significantly expand the scope of taxpayers that could benefit from the credit. According to the Brookings Institute Retirement Security Project, “more than 69 million taxpayers had income that was low enough for them to be eligible for the Savers Credit in 2007. However, nearly 45 million of these filers actually failed to qualify for the credit because they had no federal tax liability.”<sup>8</sup> If the Savers Credit was refundable, those 45 million taxpayers could have taken advantage of the credit and significantly increased their retirement savings.

### Talking Points:

- If the Savers Credit was refundable, about 45 million more taxpayers could take advantage of the credit and significantly increase their retirement savings.
- A refundable Savers Credit would also increase after-tax income of workers with less than \$10,000, \$10,000 to \$20,000, and \$20,000 to \$30,000 by 0.5, 0.4, and 0.3 percent respectively.
- Increased retirement savings would lead to more domestic investment in the economy which would increase economic growth.
- Expanding the Savers Credit could influence an American savings culture which is beneficial for everyone’s economic well-being and induces more personal responsibility.

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A refundable Savers Credit would also increase after-tax income of workers with less than \$10,000, \$10,000 to \$20,000, and \$20,000 to \$30,000 by 0.5, 0.4, and 0.3 percent respectively.<sup>9</sup> Moreover, increased retirement savings would lead to more domestic investment in the economy which would increase economic growth. Also, expanding the Savers Credit could influence an American savings culture which is beneficial for everyone’s economic well-being and induces more personal responsibility.

On the other hand, a refundable Savers Credit would add \$2 to \$3 billion to credit’s cost.<sup>10</sup> This could be politically problematic with many deficit hawks currently in Congress. In addition, opponents to this plan may view the refundable tax credit as a form of “welfare” which is viewed as undesirable and prone to fraud and abuse.

**2012 Savers Credit Tax Rates by Adjusted Gross Income**

Filing Jointly	Filing as Head of Household	All Other Filers	Credit %
Up to \$34,500	Up to \$25,875	Up to \$17,250	50%
\$34,501-\$37,500	\$25,876-\$28,125	\$17,251-\$18,750	20%
\$37,501-\$57,500	\$28,126-\$43,125	\$18,751-\$28,750	10%

\* Maximum Savers Credit is \$2,000 for married couples and \$1,000 for single taxpayers.

\* Source: ING Special Report, <http://www.wv457.com/Portals/WV457/docs/Savers%20Tax%20Credit%202012.pdf>

## Next Steps:

Implementing this reform would require Congressional legislation to change the current tax laws to make the Savers Credit refundable. The Internal Revenue Service (IRS) would then take care of administering the refund. Passing this legislation would also require a President and Congress willing to expand the Savers Credit, so the next election is vital. Changes to current tax laws are most likely to take place during the 2012 lame duck legislative session or sometime in 2013.

To pay for this reform, Congress would have to cut spending, increase revenues, or add to the federal deficit. Suggesting which fiscal avenue to take is beyond the scope of this proposal. To confront the “welfare” argument and potential abuse challenges to this proposal, supporters must make it clear that in order to qualify for the Savers Credit, an individual must make a contribution to a tax-preferred account, which is verified by third-party reporting (by the IRA trustee or plan administrator). In addition, to limit potential abuses, policymakers could require tax filers to have at least \$5,000 in earnings per person in order to claim the refundable credit.<sup>11</sup>

Expanding the Savers Credit is only one part of solving the low-income retirement savings problem. The government should implement additional policies to induce adequate retirement savings such as expanding universal coverage of 401(K) plans, auto-enrollment in IRA plans, improving financially literacy classes in high schools, colleges, and community centers, and creating a more accessible savings calculator for low-income workers.

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# Expand Participatory Budgeting in New York City

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*Participatory budgeting, a process that allows the whole community to formulate proposals on how to allocate funds and permits the whole community to vote on the implementation of the proposals, should be utilized more within New York City.*

## Background:

It is getting more and more difficult to administer programs that people need and want. New York City's neighborhood demographics have been changing rapidly, and there is not enough time and resources to investigate the nuanced needs in the communities. Additionally, New Yorkers distrust their elected officials due to a rash of scandals. In 2009, former Councilman Miguel Martinez was sentenced to jail after pocketing over 100,000 dollars of discretionary funding.<sup>1</sup> By allowing the public to regain control over some of the budget through an open process, it reestablishes the trust in the local representatives. By implementing participatory budgeting in all the Councilmembers' districts, it is possible to create public works programs that could address specific community's needs, and to encourage a more positive perspective of the government.

### Key Facts:

- Participatory budgeting, which found its roots in Brazil, is spreading across the globe, with Chicago being the first major US city to adopt its standards.
- Participatory budgeting allows ordinary people to decide how to allocate part of a municipal or public budget.
- Projects range from planting trees to fixing municipal restrooms.

## Legislative History:

Participatory budgeting originated in the 1980s from Brazil, but has since spread to more than 1,000 cities<sup>2</sup> and has been generally viewed as a "good" government practice. A nonprofit organization called Participatory Budget Project estimated that PB will grow across the United States, and states such as North Carolina, Connecticut, California, and Massachusetts are discussing implementing PB.<sup>3</sup> Chicago was the first city to utilize PB<sup>4</sup>. Recently Vallejo, California passed a council vote to use PB, and will be the third city in the United States to do so.<sup>5</sup>

In the United States, Chicago was the first city to try PB. However, the scale that it was used in Chicago is not nearly as large as New York City's PB program. It is three times larger in terms of population affected, and it also involves more than twice the amount

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of monetary allocations

Additionally, Chicago did not strive to have as much broader participation—Chicago created steering committees made of active organizations’ members, and not the average community members that New York City is attempting to do.

In 2011, New York City became the second city to utilize participatory budgeting, and to date has affected the most amount people and allocated the most funds in the United States.<sup>6</sup> Currently, four Council Members out of 51 in New York City have agreed to try PB.<sup>6</sup> The four Council Members are Melissa Mark-Viverto from District 8, Brad Lander from District 39, Jumaane Williams from District 45, and Erick Ulrich from District 32.<sup>6</sup> Each of their districts will receive at least 1 million of the Council Members’ discretionary capital funds; normally each councilman receives around 4 to 5 million dollars of discretionary funding.<sup>7</sup>

## Analysis:

Generally, PB has been successful in New York City in terms of engaging community members and formulating realistic and wanted project proposals. However, because each district had a slightly different experience with PB, it is essential that PB’s effect in the communities be examined. PB has resulted in mixed

outcomes in District 8’s due to its unique circumstance of being a part of two boroughs, Manhattan and Bronx. One Bronx resident Carmen Aquino voiced her worries in a neighborhood newspaper, the Mott Haven Herald—“How many of those projects [that Bronx residents propose] are really going to get funding?”<sup>8</sup> However, District 39’s experience with PB was successful-- through the community assemblies, city agencies learned of unfinished projects or problems that were later quickly fixed.

Additionally, there were efforts made to engage everyone in the community-- Councilman Lander attempted to attract all by printing flyers in Spanish and Bengali . District 45 also was positively affected by PB-- in an article focused on District 45 in *The Nation* magazine, author Elizabeth Whitman wrote that PB was “inclusive, especially remarkable in an age in which voting rights are ever more severely eroded.”<sup>9</sup> It encouraged younger civic engagement. For example, roughly 20 Tilden High School students, also once they learned of PB, advocated for new lights to be installed in a football field that their school and other nearby schools use. District 32 was also a success. Councilman Ulrich stated that “Participatory budgeting has been a great success in its first year in

### Talking Points:

- Participatory budgeting allows citizens to directly control certain local government expenditures.
- Currently only four out of 52 New York City Councilmembers use PB—this needs to be expanded to allow more residents of New York to control how money is spent in their community.

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New York City. We have seen such enthusiasm from our community, who are eager to be engaged and empowered in civic matters.”<sup>10</sup>

## Next Steps:

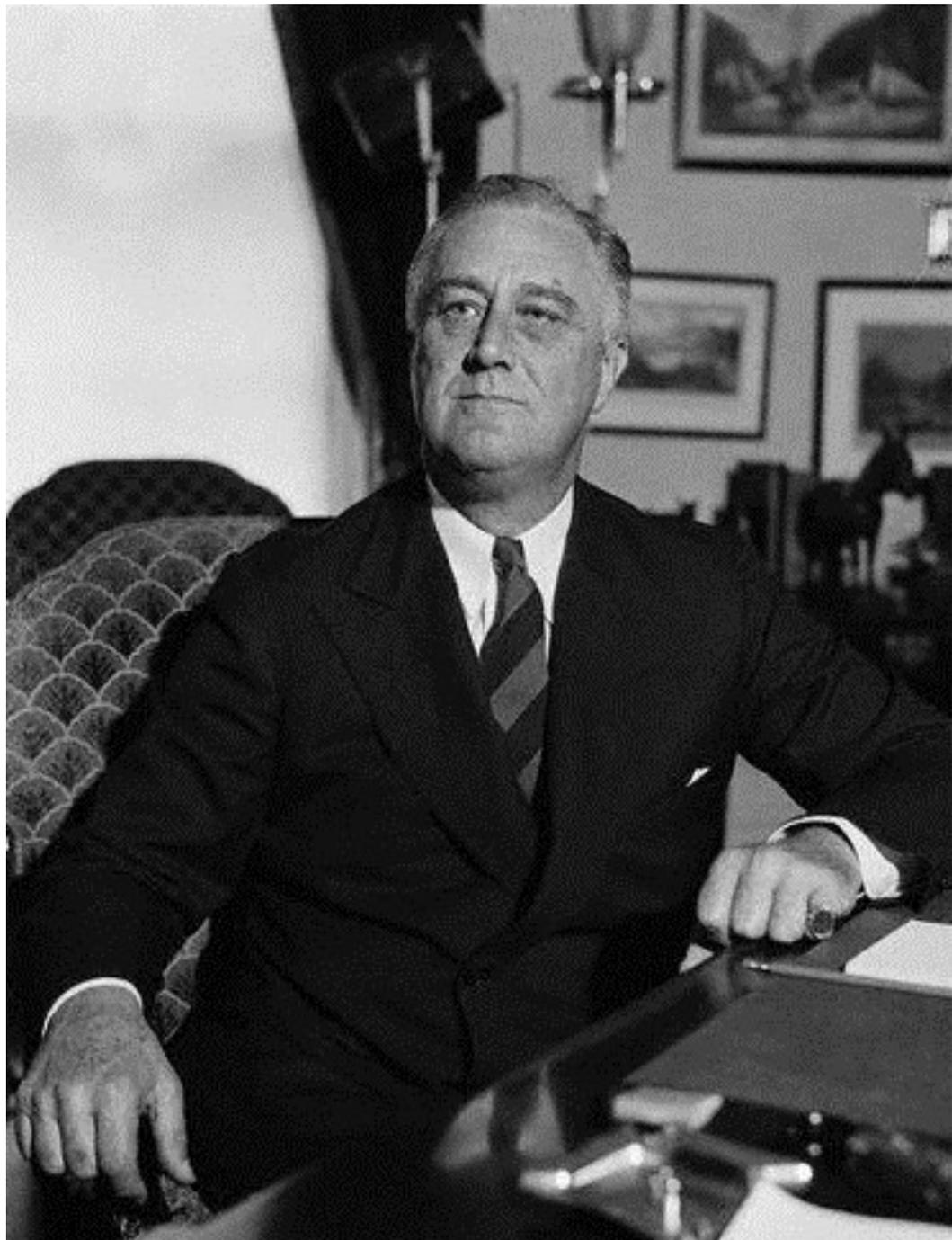
PB should be implemented in all of the Councilmembers’ districts, but with an emphasis on incorporating groups that are not typically engaged civically. The Community Development Project’s preliminary report of the participants in District 32 found that the majority of the participants in the PB meetings were White, and that the difference between PG voting and the NYC voters for Whites was 28%<sup>11</sup>. District 8 also suffered from the same lack of incorporation—in terms of income, high income voters, voters who made more than \$75,000 a year voted at a significantly higher rate than at local elections<sup>11</sup>. However, the councilmembers who tried PB liked the effects it had in their community. Mark-Vivertito said that PB is a “different approach” because it “allows neighbors to meet” and makes her residents “better constituents at the end of the day.”<sup>11</sup>

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