



Advancing Opportunity,  
Prosperity and Growth

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## ABSTRACTS OF HAMILTON PROJECT PAPERS

### *PATH TO PROSPERITY*

#### **A HAMILTON PROJECT STRATEGY PAPER**

September 2008

Roger C. Altman, *Chairman*, Evercore Partners  
Jason E. Bordoff, *Policy Director*, The Hamilton Project  
Jason Furman, *Director*, The Hamilton Project  
Robert E. Rubin, *Director and Chairman, Executive Committee*, Citigroup Inc.

#### **Abstract**

Today, too many Americans are not fully sharing in our nation's prosperity. Real median wages have stagnated, income inequality has increased, and changes in the economy that have brought benefits have also brought new risks and insecurities. In response to these challenges, our nation needs to act now on three fronts. First, our nation must make the right long-term investments to promote economic growth that is both strong and sustainable. Second, it is necessary to put in place economic policies that will better achieve broad-based participation in that growth. Third, for growth to be sustainable, it is necessary to restore sound fiscal policy, moving on a multiyear path to a sustainable fiscal position. This paper elaborates on these challenges and suggests policy responses to address them. It considers the commonly held view that promoting economic growth, broad-based participation in growth, and economic security may be contradictory policy objectives but finds that these can be mutually reinforcing. It argues that while free markets are the cornerstone of economic growth, there is a necessary role for robust government action to support and supplement market forces and to help share the gains of growth more broadly.

### **ECONOMIC SECURITY**

#### ***A HAND UP: A STRATEGY TO REWARD WORK, EXPAND OPPORTUNITY, AND REDUCE POVERTY***

#### **A HAMILTON PROJECT STRATEGY PAPER**

December 2007

Jason E. Bordoff, *Policy Director*, The Hamilton Project  
Jason Furman, *Director*, The Hamilton Project  
Paige Shevlin, *Production Editor*, The Hamilton Project

#### **Abstract**

Poverty remains a pressing problem in the United States. Many of the 36 million Americans in poverty are working, but full-time work at the minimum wage does not provide enough income to escape poverty. This paper offers a three-part strategy to reduce poverty and strengthen growth across the income spectrum. First, the most effective antipoverty policy is to help people find a job that pays enough to support a family. This paper's principal focus is on programs to reward and facilitate work. Second, a broader set of policies is necessary to prepare people to succeed, by investing in human capital and other critical needs. Finally, public policies should provide a more robust safety net and a set of social insurance policies to help people rebound if they do experience economic hardship, and reduce the likelihood of their falling below a certain economic level at any point. Together, these policies can raise the living standards of struggling families and allow everyone to share in our nation's prosperity.

***A GROWTH-ENHANCING APPROACH TO ECONOMIC SECURITY***

**A HAMILTON PROJECT STRATEGY PAPER**

September 2006

Jason E. Bordoff, *Policy Director*, The Hamilton Project

Michael Deich, *Managing Director*, The Hamilton Project

Peter R. Orszag, *Director*, The Hamilton Project

**Abstract**

Overall macroeconomic growth is not translating into significantly improved economic well-being for most families. In addition to the well-documented stagnation in median wages during the past three decades, American families now face substantial new economic risks: The chance of family income dropping considerably from one year to the next has risen significantly. Workers are individually bearing more of the risk associated with health insurance and pensions. At the same time, the safety nets for those who are hit by economic shocks have frayed.

Government policies to help workers and families cope with these new risks must strike a delicate balance. On the one hand, shifting excessive economic risk to individuals can harm both economic growth and family well-being. On the other hand, poorly designed programs to protect against risks can distort economic incentives and impair overall economic performance. To date, most economic policy discussion has focused on this second potential problem. This briefing paper puts forward an alternative strategy for navigating between both potential problems, recognizing that well-designed policies can provide a basic level of economic security that is beneficial not only for families, but also for national economic growth.

***IF, WHEN, HOW: A PRIMER ON FISCAL STIMULUS***

**A HAMILTON PROJECT STRATEGY PAPER**

January 2008

Douglas W. Elmendorf, *Senior Fellow*, The Brookings Institution

Jason Furman, *Director*, The Hamilton Project

**Abstract**

Recent economic data provide the clearest signs that the problems in the housing and financial markets are affecting the economy as a whole. In December 2007 payroll employment growth fell nearly to zero and the unemployment rate rose 0.3 percentage points to 5.0 percent. The last time the unemployment rate climbed this much in one month was in the 2001 recession. Delinquency and foreclosure rates are rising and risk spreads in financial markets remain much wider than last summer. On the other hand, there are some reassuring indicators: net exports have been trending up, and consumer spending rose at a brisk pace in October and November. However, most forecasters are predicting a marked slowdown in economic growth for several quarters, and many put the odds of recession in the neighborhood of 50 percent.

***WEIGHING ALTERNATIVE POLICIES FOR TACKLING THE MORTGAGE MESS***

**A HAMILTON PROJECT POLICY NOTE**

February, 2008

Douglas W. Elmendorf, *Senior Fellow*, The Brookings Institution

**Abstract**

Without government action, mortgage foreclosures will rise steeply for the next several years, mainly because declining house prices will leave many property owners with negative equity. Proposals for addressing this problem can be grouped into four categories—improving mortgage-market functioning,

exhorting certain private-sector actions, forcibly reducing amounts owed, and using significant government funds. Policies enacted or suggested within the first two categories likely will have just a moderate effect on foreclosures. Policies advocated in the latter two categories could have a larger effect, but only through notable changes in the legal backdrop or government financial commitment to mortgage lending. In deciding how to proceed, policymakers should weigh the fairness of alternative approaches and effects on future mortgage credit together with the consequences of inaction for households and the overall economy.

***FUNDAMENTAL RESTRUCTURING OF UNEMPLOYMENT INSURANCE:  
WAGE-LOSS INSURANCE AND TEMPORARY EARNINGS REPLACEMENT ACCOUNTS***  
**A HAMILTON PROJECT DISCUSSION PAPER**  
September 2006

Jeffrey R. Kling, *Senior Fellow and Deputy Director*, Economic Studies

**Abstract**

This paper describes a revenue-neutral proposal to fundamentally restructure the system of social insurance after job loss in order to improve the protection against long-term effects of involuntary unemployment, provide a more progressive allocation of benefits, reduce incentives for firms to lay off workers, and encourage reemployment.

As part of this reform, the government would create a program of wage-loss insurance for reemployed workers that would augment the hourly wages of individuals who take jobs that pay a lower wage than was paid at their previous jobs. The reform proposal could reduce by half the share of laid-off workers who experience very large drops in wages at new jobs—from 14 percent to 7 percent.

In order to encourage return to work and to shift assistance toward those taking new jobs at lower wages (and away from those with new jobs at higher wages), traditional unemployment insurance payments would be replaced by withdrawals from temporary earnings replacement accounts (TERAs). As a complement to wage-loss insurance, TERAs would be structured to provide workers with the same ability to maintain living standards during unemployment as does the current UI system, while providing a mechanism through which workers could accumulate savings prior to unemployment and could borrow against future earnings if they subsequently exhaust those savings. One third of revenues that are contributed to the current UI system would be used for TERA withdrawals for those with very low wages and those who do not return to work after job loss. Revenues reimbursing these withdrawals would come from a more progressive payroll tax. Two-thirds of revenues that are contributed to the current UI system would be used for wage-loss insurance. Revenues for wage-loss insurance would be paid by firms based on the use of the system by their former employees. The proposal could be implemented by one or more states, or nationally.

The core principle of this reform is that smaller, short-term needs can be met through savings, borrowing, and repayment, so that the funds for insurance can be targeted to assist those facing larger, long-term losses. The proposed system would shift assistance toward workers experiencing significant long-term wage losses following reemployment, in comparison to the current UI system's focus, which is solely on short-term cash transfers to workers experiencing bouts of unemployment. The proposed system would provide equivalent access to funds needed to maintain living standards after job loss, and a significantly greater share of net program benefits to workers in the lower half of the income distribution when compared to the current system of UI benefits alone. This new system would also reduce unemployment by discouraging temporary layoffs and by creating stronger incentives for the worker to find another job quickly, and thus enhance economic growth.

***REFORMING UNEMPLOYMENT INSURANCE FOR THE  
TWENTY-FIRST CENTURY WORKFORCE***

**A HAMILTON PROJECT DISCUSSION PAPER**

September 2006

Lori G. Kletzer, *Professor of Economics*, University of California, Santa Cruz, and *Senior Fellow*,  
Institute for International Economics

Howard Rosen, *Executive Director*, Trade Adjustment Assistance Coalition, and  
*Visiting Fellow*, Institute for International Economics

**Abstract**

Despite significant changes in U.S. labor market, the basic structure of the nation's unemployment insurance (UI) program has remained unchanged since it was created in 1935. The current system is in need for reform in order to meet the needs of a twenty-first century workforce. Shortfalls in the current program fall into four categories: (1) overly restrictive eligibility criteria have resulted in low reciprocity rates; (2) benefit levels are low; (3) the federal tax system used to finance the program is regressive; (4) and the mechanism to automatically extend UI during periods of prolonged economic downturns is broken. As a result of these and other factors, only about one-third of unemployed workers currently receive assistance under the UI program, and that assistance falls short of the original goal of replacing at least half of previous earnings. In addition, the system provides no assistance either to the self-employed or to those who become reemployed at lower wages.

In this paper we propose three broad reforms, each designed to help the UI system better meet the needs of a twenty-first century workforce. First, we propose strengthening the federal role in UI by setting federal standards that would require states to harmonize their eligibility criteria and benefit levels. These new standards would aim to raise average national benefit levels and average national reciprocity rates. Expansions in the program would be financed by raising the FUTA taxable wage base over time to \$45,000 to adjust for inflation over recent decades. Second, we propose a wage loss insurance program, as part of the UI program, to provide an earnings supplement for those workers who become reemployed at a wage lower than the wage they earned at their previous job. Finally, we propose allowing self-employed workers, and perhaps others, to contribute up to 0.25 percent of annual income, up to \$200 per year, into Personal Unemployment Accounts (PUAs). These contributions would be matched by the federal government and could be withdrawn later to cushion severe income losses or to finance training or job search.

***UNIVERSAL INSURANCE: ENHANCING ECONOMIC SECURITY TO PROMOTE OPPORTUNITY***

**A HAMILTON PROJECT DISCUSSION PAPER**

September 2006

Jacob S. Hacker, *Professor of Political Science*, Yale University

**Abstract**

The economic risks faced by American families have increased dramatically over the past three decades. For example, while the share of families experiencing a drop in real income over any two-year period has remained steady at about half, the median income drop for such families has risen from approximately 25 percent of income in the early 1970s to around 40 percent by the late 1990s and early 2000s. Meanwhile, the volatility of family incomes—how much they fluctuate over time—has increased substantially. Several possible policy options need to be debated in response to this increase in economic insecurity. This paper puts forward one potential approach, focused on providing temporary and partial relief from severe economic shocks. This proposed program, Universal Insurance, would be available to the majority of American families and would build on, rather than supplant, existing social insurance programs. It would provide short-term, stop-loss protection to qualifying families whose income suddenly declined by 20

percent or more, or whose out-of-pocket health costs in one year amounted to 20 percent or more of their combined income for that year. Although most families would be eligible, the program would be most generous for lower-income families, which have the fewest resources with which to weather economic shocks. This type of broad-based, stop-loss insurance—covering a range of risks but focused on particularly dramatic cases to minimize incentive problems and target those most in need—could provide a flexible new platform for enhancing economic security in a world of rapidly changing risks. As the nation struggles with rising income insecurity, this proposal, along with other potential policy responses, should be actively debated.

***IMPROVING OPPORTUNITIES AND INCENTIVES FOR SAVING  
BY MIDDLE- AND LOW-INCOME HOUSEHOLDS***

**A HAMILTON PROJECT DISCUSSION PAPER**

April 2006

William G. Gale, *Senior Fellow*, Economic Studies  
Jonathan Gruber, *Professor of Economics*, Massachusetts Institute of Technology  
Peter R. Orszag, *Director*, The Hamilton Project

**Abstract**

Many middle- and low-income Americans retire without having accumulated sufficient savings to enjoy a comfortable retirement. Low retirement saving is not primarily due to a lack of eligibility for tax-favored retirement accounts, but rather to a lack of take-up. The low take-up, in turn, can be explained primarily by inertia and incentives. People do not enroll in a 401(k) or an individual retirement account (IRA) because such plans typically require specific actions to join and present a confusing array of investment and contribution choices. Under current rules, not making a decision usually means not enrolling. Furthermore, the financial incentive to enroll in an IRA or 401(k) plan is often weak or nonexistent because the value of contributing money, and thus excluding it from taxation, depends on a taxpayer's tax bracket—and the majority of households face a 15 percent or lower marginal tax rate.

We offer proposals to address both impediments to saving. First, we would require every firm (with possible exceptions for the smallest businesses) to enroll its new workers automatically in at least one plan: a traditional defined benefit plan, a 401(k), or an IRA. Businesses also would be required to set various features of the plans in a "pro-saving" manner, although workers always would have the option to override those "pro-saving" defaults. Second, our proposal would replace current tax deductions for contributions to tax-preferred retirement accounts with a new program providing universal matching contributions from the government for household deposits to 401(k)s and IRAs. Unlike the current system under which low-income households enjoy much weaker immediate incentives to contribute than high-income households, all households making a qualified contribution to a 401(k) or IRA would receive the same 30 percent match from the government. We also propose other changes to the retirement system to promote lifetime annuities.

***EMPLOYMENT-BASED TAX CREDITS FOR LOW-SKILLED WORKERS***

**A Hamilton Project Discussion Paper**

December 2007

John Karl Scholz, *Professor of Economics*, University of Wisconsin-Madison

**Abstract**

Families in low-income communities face three interrelated problems: unemployment rates are high, incarceration rates of low-skilled men are high, and a large fraction of children in low-income communities are being raised in single-parent households. To address these interrelated problems, I propose a two-part policy designed to increase the return to work. The first part of my proposal is an

expanded earned income tax credit that would apply to low-income, childless taxpayers. The second part of my proposal is a targeted wage subsidy for low-wage workers who live in certain economically depressed areas, whereby the federal government would pay subsidies of 50 percent of the difference between the worker's market wage and a target wage of \$11.30 per hour. The premise for adopting these policies is straightforward: increasing the return to work for childless low-skilled workers will lower unemployment rates and achieve the dual social benefits of reducing incarceration rates and increasing marriage rates, thus reducing the number of children being raised in single-parent households. The proposal would redistribute \$10.4 billion to poor, working individuals. Based on empirical estimates from the literature, I expect employment to increase by 850,000 jobs and crime to fall by over one million incidents. Conservative estimates of the social cost of crime indicate that the social benefit from reduced crime could cover 8 percent or more of the cost of the proposal. Many estimates of the cost of crime would claim much larger cost saving. The proposal would also increase marriage and improve the environments in which poor children are raised.

***NEW HOPE: FULFILLING AMERICA'S PROMISE TO "MAKE WORK PAY"***

**A Hamilton Project Discussion Paper**

December 2007

Hans Bos, *President and CEO*, Berkeley Policy Associates  
Greg J. Duncan, *Edwina S. Tarry Professor*, Northwestern University  
Lisa A. Gennetian, *Research Director*, Brookings Institution  
Heather D. Hill, *Visiting Scholar*, Brown University

**Abstract**

Despite the political rhetoric of "making work pay," in 2005 some 3.7 million households included a full-time worker and yet lived in poverty. Our paper makes the case for a national program offering the kind of work supports that were part of the New Hope program, a policy experiment that operated for three years in Milwaukee, Wisconsin in the mid- to late-1990s. New Hope was created by a coalition of community activists and business leaders. It provided a set of work supports for full-time workers—parents and nonparents, men and women—that would lift them out of poverty, ensure that they had access to quality child care and health insurance and, if needed, provide a temporary community service job to help get them on their feet.

A random-assignment evaluation of New Hope showed that the program reduced poverty, increased employment and, perhaps most importantly, boosted the achievement and positive behavior of children. We estimate that a scaled-up New Hope program would cost roughly \$3,300 per participant per year and that, with reasonable assumptions regarding the valuation of child impacts, would yield benefits well in excess of costs. Evidence from other states and two Canadian provinces suggest that New Hope could be implemented by states. Given the different ways in which states would likely implement the New Hope model to fit their unique needs and delivery systems, we propose a five year demonstration and evaluation in five states.

***BETTER WORKERS FOR BETTER JOBS: IMPROVING WORKER ADVANCEMENT IN THE LOW-WAGE LABOR MARKET***

**A Hamilton Project Discussion Paper**

December 2007

Harry J. Holzer, *Professor of Public Policy*, Georgetown University

**Abstract**

This paper proposes a new federal funding stream to identify, expand, and replicate the most successful state and local initiatives designed to spur the advancement of low-wage workers in the United States. In the Worker Advancement Grants for Employment in States (WAGES) program, the federal government would offer up to \$5 billion annually in matching funds for increases in state, local, and private expenditures on worker advancement initiatives. To gain funding, states would have to develop local advancement “systems,” which would provide career-oriented education and training to youth, working poor adults and “hard-to-employ” workers. Partnerships would be developed between local training providers (like community colleges), employer associations, and intermediaries. Additional financial supports for the working poor—including child care, transportation, and stipends for working students—would have to be funded as well. Initially, the WAGES program would require states to compete for federal grants, which would ultimately be renewable. The program would generate a “learning system” in which states would have an incentive to innovate and use information from other initiatives. The federal government would provide substantial technical assistance and oversight. Performance measurement and rigorous evaluation would be required for program renewal; states achieving substantial worker advancement would be awarded major bonuses and more rapid renewal of funding.

***IMPROVING THE MEASUREMENT OF POVERTY***

**A Hamilton Project Discussion Paper**

December 2008

Rebecca M. Blank, *Senior Fellow*, Brookings Institution

Mark H. Greenberg, *Professor*, Georgetown University

**Abstract**

The authors recommend the adoption of a new poverty measure, along the lines recommended by the National Academy of Sciences (NAS), in order to provide a more accurate measure of economic need in the United States. The current poverty measure relies on 1955 data and a methodology developed in the early 1960s. The current measure is not sensitive to changes in tax policy, in-kind benefits, work expenses, or medical payments; all of these have changed substantially over the years and affect the well-being of low-income families. The authors indicate why the NAS approach is superior to other possibilities and discuss the specific decisions that must be made to effectively implement a new poverty measure. They present data that indicate how such a change could affect poverty rates. They recommend a new NAS study to develop a measure for a “decent living standard” at a level above the poverty level, and recommend additional federal data collection and research.

***FROM PRISON TO WORK: A PROPOSAL FOR A NATIONAL PRISONER REENTRY PROGRAM***

**A Hamilton Project Discussion Paper**

December 2008

Bruce Western, *Professor*, Harvard University

**Abstract**

Around seven hundred thousand mostly low-income and minority men and women are released from prison each year. Returning to lives of low wages and high rates of unemployment, about two thirds will be rearrested within three years. I propose a national prisoner reentry program whose core element is up to a year of transitional employment available to all parolees in need of work. Transitional jobs are supplemented by substance-abuse treatment and housing after release, expanded work and educational programs in prison, and the restoration of eligibility for federal benefits for those with felony records. The program costs are offset by increased employment and reduced crime and correctional costs for program participants. By shifting supervision from custody in prison to intensive programs in the community, the national reentry program improves economic opportunity and reduces prison populations.

**EDUCATION**

***AN EDUCATION STRATEGY TO PROMOTE OPPORTUNITY, PROSPERITY, AND GROWTH***

**A HAMILTON PROJECT STRATEGY PAPER**

February 2007

Joshua Bendor, *Research Assistant*, The Hamilton Project

Jason E. Bordoff, *Policy Director*, The Hamilton Project

Jason Furman, *Director*, The Hamilton Project

**Abstract**

Investments in education yield large returns to both society and the individual. To better secure the benefits of education, The Hamilton Project outlines an evidence-based education strategy that emphasizes new investments in some areas (such as early education) and structural reforms in others (such as the teacher tenure system).

***IDENTIFYING EFFECTIVE TEACHERS USING PERFORMANCE ON THE JOB***

**A HAMILTON PROJECT DISCUSSION PAPER**

April 2006

Robert Gordon, *Senior Vice President for Economic Policy*, Center for American Progress

Thomas J. Kane, *Professor*, Harvard Graduate School of Education

Douglas O. Staiger, *Professor of Economics*, Dartmouth College

**Abstract**

Traditionally, policymakers have attempted to improve the quality of the teaching force by raising minimum credentials for entering teachers. Recent research, however, suggests that such paper qualifications have little predictive power in identifying effective teachers. We propose federal support to help states measure the effectiveness of individual teachers—based on their impact on student achievement, subjective evaluations by principals and peers, and parental evaluations. States would be given considerable discretion to develop their own measures, as long as student achievement impacts (using so-called "value-added" measures) are a key component. The federal government would pay for bonuses to highly rated teachers willing to teach in high-poverty schools. In return for federal support, schools would not be able to offer tenure to new teachers who receive poor evaluations during their first

two years on the job without obtaining district approval and informing parents in the schools. States would open further the door to teaching for those who lack traditional certification but can demonstrate success on the job. This approach would facilitate entry into teaching by those pursuing other careers. The new measures of teacher performance would also provide key data for teachers and schools to use in their efforts to improve their performance.

***SUMMER OPPORTUNITY SCHOLARSHIPS (SOS): A PROPOSAL TO NARROW THE SKILLS GAP***  
**A HAMILTON PROJECT DISCUSSION PAPER**

April 2006

Molly E. Fifer, *Graduate Researcher*, Princeton University

Alan B. Krueger, *Bendheim Professor of Economics and Public Policy*, Princeton University

**Abstract**

Even in early grades, a large gap in skills exists between students from economically advantaged and disadvantaged families. Evidence suggests that a substantial share of this skills gap emerges during the summer months, when school is not in session. Children from disadvantaged families experience greater losses in skills during summer vacations than do their more advantaged counterparts. Several studies provide evidence that summer school or summer enrichment programs are effective interventions for stanching this summer learning loss. Based on this evidence, we propose and design a policy of Summer Opportunity Scholarships (SOS), which will provide scholarships so that economically disadvantaged children in kindergarten through fifth grade can participate in a six-week summer school or summer enrichment program of their parents' choosing. SOS summer program providers will be required to use small-group, scientifically based instruction with a strong emphasis on improving basic reading and math skills, which are a particular area of concern for many disadvantaged children. Students and providers participating in SOS will be evaluated annually to assess the program's effectiveness. We provide budgetary estimates for a nationwide SOS program. In our budget, financial responsibility for SOS would be shared equally by the federal and state governments, with each responsible for \$2 billion per year once SOS is fully phased in. In view of the promising evidence on the effectiveness of summer school, we believe that SOS has the potential to make a lasting contribution toward narrowing the skills gap between advantaged and disadvantaged students.

***SUCCESS BY TEN: INTERVENING EARLY, OFTEN, AND EFFECTIVELY IN THE EDUCATION OF YOUNG CHILDREN***

**A HAMILTON PROJECT DISCUSSION PAPER**

February 2007

Jens Ludwig, *Nonresident Senior Fellow*, Economic Studies, Brookings Institution

Isabel Sawhill, *Cabot Family Chair and Senior Fellow*, Economic Studies, Brookings Institution

**Abstract**

The absence of a quality early education for many disadvantaged children represents an extraordinary waste of human potential. This proposal would help such children achieve success in school by age ten, while also providing economy-wide benefits, through an intensive early education program that starts shortly after birth and continues through grade four.

***COLLEGE GRANTS ON A POSTCARD: A PROPOSAL FOR SIMPLE AND PREDICTABLE  
FEDERAL STUDENT AID***

**A HAMILTON PROJECT DISCUSSION PAPER**

February 2007

Susan M. Dynarski, *Associate Professor*, Kennedy School of Government, Harvard University

Judith Scott-Clayton, *Doctoral candidate*, Kennedy School of Government, Harvard University

**Abstract**

The federal student aid system is ineffective at increasing college enrollment because it is too complex and delivers information to students too late. This paper uses detailed statistical analysis to show that the level of complexity is not necessary to target aid to those who need it most. It then proposes a dramatically simplified system that could significantly increase college enrollment.

**ENERGY & THE ENVIRONMENT**

***AN ECONOMIC STRATEGY TO ADDRESS CLIMATE CHANGE AND  
PROMOTE ENERGY SECURITY***

**A HAMILTON PROJECT STRATEGY PAPER PAPER**

October 2007

Jason Furman, *Director*, The Hamilton Project

Jason Bordoff, *Policy Director*, The Hamilton Project

Manasi Deshpande, *Research Assistant*, The Hamilton Project

Pascal Noel, *Senior Research Assistant*, The Hamilton Project

**Abstract**

The related issues of climate change and energy security are now generally accepted as major challenges. U.S. greenhouse gas emissions contribute to climate change while its reliance on oil reduces its economic and national security. To tackle both problems, the United States must substantially reduce its consumption of fossil fuels. This paper presents a three-part strategy for addressing climate change and promoting energy security. First, the government should price carbon and oil correctly so that the private sector has an incentive to reduce their use. Second, the government should increase and refocus public investments on basic research and on long-run speculative energy technologies. Finally, the United States should lead by example and engage major emitting nations in an international response to climate change.

***A PROPOSAL FOR A US CARBON TAX SWAP: AN EQUITABLE TAX REFORM TO ADDRESS GLOBAL  
CLIMATE CHANGE***

**A HAMILTON PROJECT DISCUSSION PAPER**

October 2007

Gilbert E. Metcalf, *Professor*, Tufts University

**Abstract**

This paper describes a carbon tax swap that is both revenue and distributionally neutral. The tax swap would levy a tax on greenhouse gas emissions. The revenue would be used to fund a reduction in the income tax, tied to earned income. Specifically, the proposal calls for a tax on greenhouse gas emissions at an initial rate of \$15 per ton of carbon dioxide equivalent and gradually increasing over time. A refundable tax credit would be offered for sequestered greenhouse gases and other approved sequestration activities. In addition, to offset the new carbon tax, the proposal would implement an environmental tax credit in the personal income tax equal to the employer and employee payroll taxes on initial earnings up to a limit.

This paper begins with a discussion of the problem of greenhouse gas emissions and provides a rationale for setting a price on carbon emissions. It then provides a distributional analysis of the proposal described above. Following this analysis, it makes a case for why carbon pricing through a tax should be considered a viable alternative to carbon pricing through a cap-and-trade system. It concludes with a response to various objections made to carbon pricing in general and a carbon tax in particular.

***A US CAP AND TRADE SYSTEM TO ADDRESS GLOBAL CLIMATE CHANGE***

**A HAMILTON PROJECT DISCUSSION PAPER**

October 2007

Robert N. Stavins, *Professor*, Harvard University

**Abstract**

The need for a domestic U.S. policy that seriously addresses climate change is increasingly apparent. A cap-and-trade system is the best approach in the short to medium term. Besides providing certainty about emissions levels, cap-and-trade offers an easy means of compensating for the inevitably unequal burdens imposed by climate policy; it is straightforward to harmonize with other countries' climate policies; it avoids the current political aversion in the United States to taxes; and it has a history of successful adoption in this country. The paper proposes a specific cap-and-trade system with several key features including: an upstream cap on CO<sub>2</sub> emissions with gradual inclusion of other greenhouse gases; a gradual downward trajectory of emissions ceilings over time to minimize disruption and allow firms and households time to adapt; and mechanisms to reduce cost uncertainty. Initially, half of the program's allowances would be allocated through auctioning and half through free distribution, primarily to those entities most burdened by the policy. This should help limit potential inequities while bolstering political support. The share distributed for free would phase out over twenty-five years. The auctioned allowances would generate revenue that could be used for a variety of worthwhile public purposes. The system would provide for linkage with international emissions reduction credit arrangements, harmonization over time with effective cap-and-trade systems in other countries, and appropriate linkage with other actions taken abroad that maintains a level playing field between imports and import-competing domestic products.

***A U.S. INNOVATION STRATEGY FOR CLIMATE CHANGE MITIGATION***

**A HAMILTON PROJECT STRATEGY PAPER**

December 2008

Richard G. Newell, *Professor*, Duke University

**Abstract**

Within a market-based economy, success is maximized if policies directly address specific market problems. For technology innovation relevant to mitigating greenhouse gases (GHGs), the two principal market problems are a lack of private incentive to reduce GHGs by adopting low-GHG technologies, and underinvestment by industry in research and development (R&D), especially basic research. The strategy thus has two main parts to directly confront these two market problems, thereby increasing both the demand for and the supply of GHG-reducing innovations: (1) inducing innovation in industry through a stable, long-term price on GHGs, reinforced by permanent R&D tax credits, and (2) complementing this innovation through increased public support for targeted climate mitigation research in universities, other research institutions, and in the private sector.

The innovation strategy specifically recommends gradually increasing federal spending for climate mitigation research to roughly \$8 billion per year over the next eight years, or roughly doubling energy research from 2007 levels by 2016. This increased funding should prioritize strategic basic research inspired by critical needs arising from efforts to develop new and improved GHG mitigation technologies,

and should invest in training the next generation of scientists and engineers. Increased resources need to be tied to an effective management and coordination strategy for research focused on climate mitigation technology to ensure these funds are employed efficiently. Finally, a portion of these funds should be targeted to inducement prizes that provide financial rewards for achieving significant advances in climate mitigation innovation. In doing so, these funds would engage a broad set of innovators.

## **GLOBAL ECONOMY**

### ***GROWTH, OPPORTUNITY, AND PROSPERITY IN A GLOBALIZING ECONOMY***

#### **A HAMILTON PROJECT STRATEGY PAPER**

July 2006

Peter R. Orszag, *Director*, The Hamilton Project

Michael Deich, *Managing Director*, The Hamilton Project

#### **Abstract**

International trade presents our nation with a complex and growing challenge. On the one hand, the global system of open trade has brought substantial and widespread benefits to the U.S. economy. On the other hand, trade has led to dislocation in certain industries and has introduced new risks and uncertainties into the lives of many American workers. Achieving an equitable distribution of the benefits and costs of trade will require strong, effective government policies. The need for such policies will only grow more urgent, as nations like China and India become increasingly dominant forces in the world economy.

Trade's pattern of widespread economic benefits and concentrated harm mirrors the broader process of "creative destruction" of a dynamic economy. Indeed, technological advances that produce overall economic gains but dislocate workers in specific sectors are very similar in effect to trade expansions. The invention of the automobile, for example, not only significantly reduced transportation costs and thus raised overall economic productivity, but it also displaced a variety of firms and workers associated with a transportation sector that was based on horses.

This briefing paper articulates a philosophy of embracing international competition while investing in workers and market-friendly insurance. The underlying goal of this philosophy is to boost overall productivity while also sharing more broadly both the benefits and costs of trade. Not surprisingly, given the similarities between trade and other forces contributing to creative destruction, this approach to trade is consistent with The Hamilton Project's overall economic strategy of embracing the dynamism of a modern economy supported by effective government programs that spread the benefits of growth more broadly. Indeed, the specific policy steps needed to raise overall economic productivity and achieve more broad-based economic growth—steps such as improving education, investing in research, and improving the social safety net—are the same, albeit perhaps more urgent, in a global context than they are in a purely domestic one.

Thus, rather than constructing programs designed to assist only those workers displaced specifically by trade, the government should build broad-based and market friendly forms of protection to help families experiencing economic hardship for any number of reasons. For the trade philosophy discussed here to be fully realized, the nation must take seriously the need to invest in education, basic scientific research, greater economic security for households, a world-class infrastructure, and effective government. To help advance this approach, The Hamilton Project will continue to release innovative policy ideas—based on experience and evidence, not ideology and doctrine—to restore broad-based economic growth and achieve a more inclusive distribution of the benefits and costs of trade.

## **HEALTH CARE POLICY**

### ***UNIVERSAL, EFFECTIVE AND AFFORDABLE HEALTH INSURANCE: AN ECONOMIC IMPERATIVE***

July 2007

Jason Furman, *Senior Fellow* at the Brookings Institution and *Director* of The Hamilton Project  
Robert E. Rubin, *Director and Chairman of the Executive Committee*, Citigroup Inc.

#### **Abstract**

In total 45 million Americans are uninsured and the Institute of Medicine estimates that 18,000 of them die prematurely each year as a result. But the problems are much broader than just the uninsured. The typical insured family pays, directly and indirectly, more than one-sixth of its income for health care. And this expensive care is far less effective than it should be: Americans get too little preventive care when well, and only 55 percent of proven effective therapies are administered when they are sick. At the same time, one-third or more of many major medical procedures are either inappropriate or of debatable value.

Moreover, the problems of uninsurance and expensive or ineffective care are interrelated. More medically effective care could also be more affordable, reducing the number of uninsured. Conversely, it is impossible to address fully the problems of affordability and effectiveness without covering everyone. Much of the health care the uninsured do get is costly and inefficient with the costs passed on to others. Insuring everyone would not just eliminate these uncompensated cost shifts, it would also enable the health system to function better by expanding risk pooling and reducing the fragmentation of financing. Responding to these interrelated health challenges is also critical for economic performance more broadly for four reasons:

1. Rapidly rising premiums put a strain on businesses, wages and jobs.
2. Ineffective care results in a less productive workforce
3. The rapid increase in public health spending is a central cause of the serious fiscal challenges
4. Health care security is an important piece of the broader question of economic security.

### ***THE PROMISE OF PROGRESSIVE COST CONSCIOUSNESS IN HEALTH-CARE REFORM*** **A HAMILTON PROJECT DISCUSSION PAPER**

April 2007

Jason Furman, *Senior Fellow* at the Brookings Institution and *Director* of The Hamilton Project

#### **Abstract**

Americans are frustrated with the unaffordability of health insurance, the effectiveness of health care, and the rising number of uninsured. One important contribution to all of these challenges is the increased insulation of Americans from the cost of their care. In 1965, roughly half of health-care expenses were paid out of pocket by patients; by 2006, that figure had declined to just 13 percent—lower than the average of other high-income OECD countries.

One-size-fits-all high deductible policies associated with Health Savings Accounts (HSAs) require costly tax breaks for the most affluent while unnecessarily increasing financial and health risks for low- and moderate-income families. Instead, any expansions of cost sharing should be based on the evidence, chiefly the RAND Health Insurance Experiment and subsequent research. The RAND experiment found that cost sharing, if related to a family's income, could reduce health spending by an average of 31 percent without any worse health outcomes. Subsequent research finds that the savings could be even greater.

This paper proposes a template for a progressive cost sharing plan that would require typical families to pay half of their health costs until they reached 7.5 percent of their income; low-income families would not have any cost sharing. The analysis shows that this template could reduce total health spending by 13 to 30 percent, reducing premiums by 22 to 34 percent without hurting health outcomes. Moreover, low- and moderate-income families would face less cost sharing than they do under typical plans today while the premium savings would be more than enough to compensate middle- and upper-income families for the modest increase in their exposure to small risks. Every family would have an affordable limit on their out-of-pocket payments, in contrast to the situation today, where many families have insurance policies that expose them to unlimited cost sharing. In addition, the paper suggests the potential inclusion of evidence-based exceptions for highly valuable preventive care and chronic disease treatments as well as other mechanisms to protect the chronically ill.

***MENDING THE MEDICARE PRESCRIPTION DRUG BENEFIT: IMPROVING CONSUMER CHOICES AND RESTRUCTURING PURCHASING***

**A HAMILTON PROJECT DISCUSSION PAPER**

April 2007

Richard G. Frank, *Professor of Health Economics*, Department of Health Care Policy, Harvard Medical School and John F. Kennedy School of Government

Joseph P. Newhouse, *Professor of Health Policy and Management*, Harvard School of Public Health, Harvard Medical School and John F. Kennedy School of Government

**Abstract**

The Part D prescription drug benefit has brought affordable drug coverage to millions of elderly Americans and is a valuable addition to Medicare. But several reforms are needed. To reduce complexity while retaining adequate choice, a set of standardized plans should be created within Part D. New participants should be automatically enrolled in a plan but allowed to opt out. To encourage price competition and discourage adverse selection, Medicare should allow competition for exclusive contracts to sell the standardized plans in each Part D region. To address the stresses on the federal budget, prices paid for drugs purchased on behalf of beneficiaries previously covered by Medicaid should be reduced to near their former Medicaid levels. To limit the ability of manufacturers to name their prices of therapeutically unique drugs, a standby mechanism for establishing temporary administered prices should be developed. Finally, the confusing distinction between Part B and Part D drugs should be ended and all prescription drugs covered under Part D.

***A WELLNESS TRUST TO PRIORITIZE DISEASE PREVENTION***

**A HAMILTON PROJECT DISCUSSION PAPER**

April 2007

Jeanne M. Lambrew, *Associate Professor*, The George Washington University, *Senior Fellow*, Center for American Progress

**Abstract**

A new set of health challenges confronts the United States at the beginning of the twenty-first century. Chronic and preventable diseases now account for most of the deaths and costs in the system, despite relatively low-tech and low-cost services that could limit them. The under use of preventive services stems from lack of awareness, low perceived value of such services, and a fractured financing system unable to align incentives from sickness toward wellness. This cannot be fixed through private insurance mandates or the public health system alone. Instead, a new system for health promotion and disease prevention in the United States is needed, and one such model is proposed in this paper. It would carve preventive services out of the existing health insurance system and would finance those services through the Wellness

Trust, a new agency under the Department of Health and Human Services. This Trust would set national priorities for prevention, employ innovative and effective systems for delivering them, and align payments with priorities. The Trust would be the primary provider of prevention priorities for all Americans, irrespective of insurance status, and would reconnect with the medical system through an electronic health record. While this proposal may not have immediate or, in some cases, overall budget savings, it has the potential to improve and extend lives.

This idea was originally sketched out as part of the Center for American Progress's comprehensive health reform plan and was described in an opinion piece and a shorter paper (Lambrew et al. 2005, Lambrew and Podesta 2006a, Lambrew and Podesta 2006b). This paper describes the idea of a Wellness Trust in greater depth and includes a discussion of its cost implications.

### ***EVOLVING BEYOND TRADITIONAL EMPLOYER-SPONSORED HEALTH INSURANCE***

#### **A HAMILTON PROJECT DISCUSSION PAPER**

May 2007

Stuart M. Butler, *Vice President*, Domestic and Economic Policy Studies, Domestic Policy, The Heritage Foundation

#### **Abstract**

For most working-age families, health insurance coverage is directly connected to the workplace. But because of structural weaknesses in this traditional form of coverage, it is steadily eroding, especially for workers in the small business sector. The health insurance system needs to evolve along a different path if it is to adapt to the goals and needs of today's workforce. Unfortunately, existing laws and insurance arrangements obstruct that evolution. Three key steps are needed to achieve a gradual transformation without disrupting the successful parts of the system. First, states should establish "insurance exchanges." Exchanges would offer an array of coverage options, and families could retain their chosen plan from workplace to workplace with the same tax benefits as those available for traditional employer-sponsored plans. Second, most employers should become facilitators, rather than sponsors, of coverage. While many large employers would continue to sponsor coverage, most employers would hand over sponsorship to an insurance exchange and focus on providing administrative support for their employees' insurance choices. Third, the federal government should reform the tax treatment of health to focus help on lower-income families.

### ***ACHIEVING UNIVERSAL COVERAGE THROUGH MEDICARE PART E(VERYONE)***

#### **A HAMILTON PROJECT DISCUSSION PAPER**

July 2007

Gerard F. Anderson, *Professor*, Johns Hopkins University  
Hugh R. Waters, *Associate Professor*, Johns Hopkins University

#### **Abstract**

Several principles govern the creation of our Medicare Part E(veryone) proposal. First, universal health insurance coverage is necessary. Second, there should be no gaps in coverage. Third, coverage should be provided at the lowest possible cost to individuals and society. Fourth, the private sector should be involved when it can add value. Fifth, the program should be easy to explain and built on the existing infrastructure so that it can be implemented quickly. Finally, although additional reforms to the health care system—including cost containment initiatives—are desirable, they should not be a prerequisite to universal coverage.

This proposal adopts Medicare rules and payment systems to provide the same benefits to the enrollees in Medicare Part E(veryone) as current Medicare beneficiaries receive today. Private health plans could

participate through Medicare Parts C and D, offer Medigap coverage, and continue to offer private health insurance coverage. Firms could buy into the Medicare Part E program for all of their employees, and they would contribute at least as much to the premium as their employees do. Those without employer-based coverage could enroll individually. The Part E premium, which would be the same for every enrollee, would be determined using Medicare actuaries to "break even" over each year. The federal government would use a sliding scale to subsidize the premium for individuals whose income is below 400 percent of the federal poverty level. This proposal estimates that Medicare Part E would initially enroll 121.3 million beneficiaries for a total net cost to the government of about \$94.4 billion. Coverage would be universal, continuous, and affordable.

***A COMPREHENSIVE CURE: UNIVERSAL HEALTH CARE VOUCHERS***  
**A HAMILTON PROJECT DISCUSSION PAPER**

July 2007

Ezekiel J. Emanuel, *Chair*, Dept. of Bioethics, National Institutes of Health  
Victor R. Fuchs, *Professor Emeritus*, Stanford University

**Abstract**

The Universal Healthcare Voucher System (UHV) achieves universal health coverage by entitling all Americans to a standard package of benefits comparable to that received by federal employees. Enrollment and renewal are guaranteed regardless of health status, as is the individual's right to buy additional services beyond the standard benefits with after tax dollars. Health plans would receive a risk-adjusted payment based on their enrollment. UHV is funded entirely by a dedicated value-added tax (VAT) with the rate set by Congress. A VAT of approximately 10 to 12 percent would insure all Americans under age 65 at a cost no greater than current public and private health care expenditures.

UHV offers true universality, individual choice, effective cost control, and competition based on quality of care and service. To foster accountability and efficient administration, the voucher system creates a National Health Board and twelve regional boards with a governance structure and reporting requirements similar to the Federal Reserve system. The National Board establishes the overall rules and procedures and sponsors an independent Institute for Technology and Outcomes Assessment, which will slow the rate of growth of expenditures by encouraging cost-effective innovations. In each region a Center for Patient Safety and Dispute Resolution replaces the dysfunctional malpractice system. UHV is relatively simple compared with other reforms that have similar objectives. Most importantly, it is congruent with basic American values: equality of opportunity and freedom to pursue personal goals.

***TAKING MASSACHUSETTS NATIONAL: AN INCREMENTAL APPROACH TO UNIVERSAL HEALTH INSURANCE***

**A HAMILTON PROJECT DISCUSSION PAPER**

July 2008

Jonathan Gruber, *Professor*, Massachusetts Institute of Technology

**Abstract**

The United States is in the midst of another wave of interest in universal health insurance coverage, this time inspired by efforts at the state level. In this article I review what we know about the uninsured and why we should care about covering them. I then discuss the issues that must be addressed to achieve universal coverage, and discuss the Massachusetts reform which tried to navigate between the right and the left on this important issue. I then lay out a plan for universal coverage at the national level which builds on the Massachusetts model. Such a plan would cost \$130 billion per year. I also show that such a plan could be readily financed by restructuring the exclusion of employer-sponsored insurance from taxation.

## **HOUSING**

### ***AN OPT-OUT HOME MORTGAGE SYSTEM*** **A HAMILTON PROJECT DISCUSSION PAPER**

September 2008

Michael S. Barr, *Professor of Law*, University of Michigan Law School  
Sendhil Mullainathan, *Professor of Economics*, Harvard University  
Eldar Shafir, *Professor of Psychology and Public Affairs*, Princeton University

#### **Abstract**

The current housing and financial crisis has led to significant congressional and executive action to manage the crisis and stem the harms from it, but the fundamental problems that caused the crisis remain largely unaddressed. The central features of the industrial organization of the mortgage market with its misaligned incentives, and the core psychological and behavioral phenomena that drive household financial decisionmaking remain. While the causes of the mortgage meltdown are myriad and the solutions likely to be multifaceted, a central problem that led to the crisis was that brokers and lenders offered loans that looked much less expensive and much less risky than they really were—and borrowers took them. It is time for common-sense reform to the mortgage market. This paper develops a new framework for understanding the mortgage markets as the interaction between individuals with specific psychological biases and firms that respond to those psychologies within specific markets. We argue that regulation needs to take account of that interaction. Our new framework leads us to propose a *sticky opt-out mortgage system*, under which lenders would be required to offer borrowers loans with standard terms. Borrowers could opt out for other loans, but only after heightened disclosure requirements, and lenders would face increased exposure to liability or other sanctions.

### ***FACILITATING SHARED APPRECIATION MORTGAGES TO PREVENT HOUSING CRASHES AND AFFORDABILITY CRISES***

#### **A HAMILTON PROJECT DISCUSSION PAPER**

September 2008

Andrew Caplin, *Professor of Economics*, New York University  
Noël B. Cunningham, *Professor of Law*, New York University School of Law  
Mitchell L. Engler, *Professor of Law*, Benjamin N. Cardozo School of Law, Yeshiva University  
Frederick Pollock, *Vice President*, Morgan Stanley Infrastructure

#### **Abstract**

If current trends continue, today's default crisis will soon be followed by an affordability crisis as an ever-increasing number of American households find themselves locked out of credit and unable to transition to homeownership. This reduction in homeownership will eventually create pressure to re-extend credit to marginal borrowers, in turn boosting house prices. As house prices rise, banks will likely relax lending standards even further. At some point, this credit extension will end as house prices stagnate or crash, just as they did in the current crisis. In short, the recent boom-bust cycle will repeat itself unless something is done to fundamentally change the structure of the mortgage market.

We argue that there is a simple way to prevent this dire scenario of boom-and-bust cycles from unfolding. Specifically, we argue that development of shared appreciation mortgage (SAM) markets in the United States would moderate the impending decline in homeownership and lower the risk of future housing crashes. SAMs can increase the affordability of homeownership by reducing the amount of monthly payments and spreading risk more broadly between borrower and lender. We present SAMs as both the

obvious workout vehicles in the current default crisis and a vital part of the housing finance system that should be available at any time to interested homebuyers.

Despite their high potential, tax barriers effectively prevent the development of SAM markets in the United States. We propose changing the tax treatment in a manner that would facilitate development of SAM markets through purely regulatory means, rather than more complicated legislative means. With this creative regulatory response, current disasters may at least serve the role of fomenting the birth of beneficial SAM markets.

***GETTING MORE FROM LOW-INCOME HOUSING ASSISTANCE***

**A HAMILTON PROJECT DISCUSSION PAPER**

September 2008

Edgar O. Olsen, *Professor of Economics*, University of Virginia

**Abstract**

This paper argues that the two most serious structural shortcomings of the current system of low-income housing assistance are (1) its excessive reliance on unit-based assistance and (2) its failure to provide housing assistance to all of the poorest eligible families who ask for help. Evidence on the performance of housing programs indicates that unit-based assistance has a much greater cost than tenant-based assistance for providing equally good housing, and it needlessly restricts recipient choice. Unit-based assistance has no advantage over tenant-based assistance to offset these disadvantages. The nonentitlement nature of the current system is inconsistent with plausible assumptions about taxpayer preferences. The paper argues for a transition to an entitlement housing assistance program that relies exclusively on tenant-based assistance. It describes concrete actions that would achieve this result without spending additional money, and it shows that the major objections to these proposals are inconsistent with the evidence on program performance. The proposed transition would benefit most current recipients of housing assistance, and the reforms would give those taxpayers who want to help low-income families with their housing more for their money. After the transition is complete, millions of additional families would receive housing assistance that enables them to occupy better housing in nicer neighborhoods, and to consume more of other goods. Millions of other families that would have received unit-based assistance with the continuation of the current system would live in housing, neighborhoods, and locations that they prefer to their units in subsidized projects.

**INFRASTRUCTURE**

***AN ECONOMIC STRATEGY FOR INVESTING IN AMERICA'S INFRASTRUCTURE***

**A HAMILTON PROJECT STRATEGY PAPER**

July 2008

Manasi Deshpande, *Senior Research Assistant*, The Hamilton Project

Douglas W. Elmendorf, *Director*, The Hamilton Project

**Abstract**

Infrastructure investment has received more attention in recent years because of increased delays from road and air congestion, high-profile infrastructure failures, and rising concerns about energy security and climate change. The United States now has the opportunity to channel public concern and frustration into a national infrastructure strategy that promotes infrastructure as a central component of long-term, broadly shared growth. While increased spending on infrastructure is likely to be needed, this paper emphasizes the large gains that could be reaped by using existing infrastructure more efficiently and by making better decisions about how to invest in infrastructure.

For physical infrastructure, we recommend establishing pricing mechanisms such as road congestion fees and air traffic control fees to make users bear the costs of their infrastructure use more fully. At least part of the revenues from these fees should be used to offset their potential adverse distributional effects. The federal government can also promote better decision making about new investments by removing distortions in its own policies and providing more flexibility in exchange for accountability by states and localities. For telecommunications infrastructure, we propose that the government make better use of the wireless spectrum by facilitating sales and leases of unused spectrum and by introducing more flexibility in its policy of interference prevention. Further, the government should consider targeted, cost-effective subsidies to encourage private firms to expand high-speed Internet access to unserved rural areas.

***PAY-AS-YOU-DRIVE AUTO INSURANCE: A SIMPLE WAY TO REDUCE DRIVING-RELATED HARMS AND INCREASE EQUITY***

**A HAMILTON PROJECT DISCUSSION PAPER**

July 2008

Jason E. Bordoff, *Policy Director*, The Hamilton Project  
Pascal J. Noel, *Research Analyst*, The Hamilton Project

**Abstract**

The current lump-sum pricing of auto insurance is inefficient and inequitable. Drivers who are similar in other respects—age, gender, location, driving safety record—pay nearly the same premiums if they drive five thousand or fifty thousand miles a year. Just as an all-you-can-eat restaurant encourages more eating, all-can-drive insurance pricing encourages more driving. That means more accidents, congestion, carbon emissions, local pollution, and dependence on oil. This pricing system is inequitable because low-mileage drivers subsidize insurance costs for high-mileage drivers, and low-income people drive fewer miles on average.

In this discussion paper, we propose and evaluate a simple alternative: pay-as-you-drive (PAYD) auto insurance. If all motorists paid for accident insurance per mile rather than in a lump sum, they would have an extra incentive to drive less. We estimate driving would decline by 8 percent nationwide, netting society the equivalent of about \$50 billion to \$60 billion a year by reducing driving-related harms. This driving reduction would reduce carbon dioxide emissions by 2 percent and oil consumption by about 4 percent. To put it in perspective, it would take a \$1-per-gallon increase in the gasoline tax to achieve the same reduction in driving. Unlike an increase in the gas tax, PAYD would save most drivers money regardless of where they live. We estimate almost two-thirds of households would pay less for auto insurance, with each of those households saving an average of \$270 per car.

Despite the large social benefits from PAYD, there are currently several barriers to its widespread adoption, including the cost to monitor miles traveled and some state insurance regulations. In order to facilitate the spread of PAYD, we propose a three-part strategy. First, states should pass legislation permitting mileage-based insurance premiums. Second, the federal government should increase the funding available to PAYD pilot programs by \$15 million over five years. Finally, since the monitoring costs may exceed the expected benefit of PAYD to insurance firms but are much smaller than the social benefit, the federal government should offer a \$100 tax credit for each new mileage-based policy that an insurance company writes, to be phased out once 5 million vehicles nationwide are covered by PAYD policies. In short, PAYD represents a win-win policy. What is good for drivers, in this case, is also good for society.

***AMERICA'S TRAFFIC CONGESTION PROBLEM: TOWARD A FRAMEWORK FOR  
NATIONWIDE REFORM***

**A HAMILTON PROJECT DISCUSSION PAPER**

July 2008

David Lewis, *Senior Vice President*, HDR Decision Economics, Inc.

A large and growing burden on the nation's economy, traffic congestion arises for various reasons, and more than one mechanism is needed to combat it. It is most unlikely, however, that serious inroads to address the problem will be made without fundamental reform in the way consumers are charged for their use of congested highways. *Congestion prices* are tolls that reflect the economic costs of congestion, including productivity losses from traffic delays, increased accidents, higher emissions, and more. Congestion prices would help reduce these economic costs and guide transportation investment resources to their highest and best use—which would include a better balance between highway and transit investment. In addition, such prices would generate revenues to help finance new investment and compensate low-income people and others for whom toll payments are especially burdensome. Requiring federal, state, and local engagement, such reform is a necessary step in the development of an effective, efficient, and sustainable highway system for the twenty-first century.

***BRINGING BROADBAND TO UNSERVED COMMUNITIES***

**A HAMILTON PROJECT DISCUSSION PAPER**

July 2008

Jon M. Peha, *Professor of Electrical Engineering and Public Policy*, Carnegie Mellon University

**Abstract**

Roughly one-third of households in rural America cannot subscribe to broadband Internet services at any price. This puts many rural communities at a disadvantage with respect to economic growth, job creation, educational opportunities, health care information, commerce, and more. Internet users in urban areas are also adversely affected by the exclusion of so many rural households. For example, e-commerce merchants can attract fewer customers, online universities can attract fewer students, and users of e-mail, Internet telephony, and videoconferencing can communicate with fewer friends and business associates. Government can facilitate the expansion of broadband infrastructure into unserved communities through a suite of interrelated policies. Appropriate changes in spectrum policy would reduce the cost of building new broadband wireless systems in rural areas. These potential new wireless providers could then compete with existing telephone, cable, and cellular companies and other organizations for the obligation to bring broadband to an unserved community in return for a one-time subsidy. Defining this obligation in a highly flexible form and making it tradable on an open market would minimize the cost of infrastructure deployment and thereby reduce the subsidies needed. Attaching very lightweight restrictions on subsidy recipients could protect consumers from monopoly providers that might be tempted to limit their customers' choice of content or applications. Allowing and encouraging local government agencies to play an active role could encourage providers to deploy infrastructure by guaranteeing future revenues and ensuring access to critical resources. Collecting better information on availability of broadband services nationwide would allow both policymakers and potential service providers to better identify the communities that need service. Together, these mutually reinforcing policy reforms would allow government to move the United States closer to the goal of universal access to broadband Internet by harnessing market forces without competing with market forces.

***AIR SUPPORT: CREATING A SAFER AND MORE RELIABLE AIR TRAFFIC CONTROL SYSTEM***  
**A HAMILTON PROJECT DISCUSSION PAPER**

July 2008

Dorothy Robyn, *Principal*, The Brattle Group

**Abstract**

Our nation's air traffic control system, run by the Department of Transportation's Federal Aviation Administration (FAA), has not kept up with the explosive growth in air travel. In 2007, flight delays cost passengers and airlines \$12 billion to \$14 billion in lost time and fuel. Flight delays are just a symptom of two fundamental problems with the way the federal government manages the air traffic control system. One problem is governance. As a traditional government agency constrained by federal budget rules and micromanaged by Congress, the FAA is poorly suited to run what amounts to a capital-intensive, high-tech service "business." Moreover, the FAA regulates as well as operates the air traffic control system, which represents a potential conflict of interest. A second problem is financing. The mechanism used to fund the system (passenger taxes, principally) encourages overuse of scarce capacity and deprives the FAA of feedback from its real customer: aircraft operators. Although the FAA plans to move to a next-generation, satellite-based system, the transition is currently scheduled to take nearly twenty years. Moreover, the severe and systemic problems that have plagued past FAA modernization efforts are almost certain to persist.

This paper argues for two major changes designed to improve the safety and reliability of the air traffic control system. The first would create a new modal administration within the Department of Transportation focused exclusively on delivery of air traffic control services and regulated at arm's length by the FAA. Most important, separation of the air traffic control operator from its FAA regulator would enhance safety by eliminating the potential conflict of interest that now exists. In addition, separation would help the air traffic control service provider clarify its mission, a key to improved performance, and make it easier to attract and retain outstanding senior leadership. The second change would replace excise taxes on passengers, cargo and fuel with cost-based charges on (most) aircraft operators themselves. Prices would give users an incentive to consume air traffic control resources efficiently and establish a direct link between users and the FAA ("user pay, user say"). I stop short of calling for moving the air traffic control system to a government corporation or some other (nonprofit) autonomous entity outside the traditional government bureaucracy. Although such a step would be highly beneficial, it does not appear to be politically feasible at this time.

***THE UNTAPPED PROMISE OF WIRELESS SPECTRUM***  
**A HAMILTON PROJECT DISCUSSION PAPER**

July 2008

Philip J. Weiser, *Professor of Law and Telecommunications*, University of Colorado

**Abstract**

The public "airwaves," or the radio spectrum, are a tremendously valuable asset that remains partially untapped by entrepreneurs and users. Over the past twenty-five years, the explosion of the cellular industry and wireless technology more generally has placed a premium on access to spectrum. Nonetheless, our spectrum policy has failed to facilitate an optimal and efficient use of this important resource—meaning that spectrum is often left unused at the same time that there is a great demand for access to it.

This paper sets forth a new direction for spectrum policy reform. At the broadest level, it calls on policymakers to judge the Federal Communications Commission's (FCC's) success by whether it can spur the more efficient use of spectrum. To advance this objective, this paper highlights the importance of measuring how spectrum is being used, identifying blocks of unused spectrum, and encouraging greater leasing arrangements to gain access to otherwise unused or underused blocks of spectrum. In particular, it calls on the FCC to begin measuring the use or disuse of spectrum, to establish an accessible database that profiles all spectrum licensees, to encourage greater amounts of spectrum leasing, and to invite the public to evaluate which spectrum licenses are not being used. In short, this set of initiatives would address the current policy failure to hold licensees accountable for their failure to use licensed spectrum and create incentives for licensees to lease unused or underused spectrum.

This paper also calls for regulatory reform to catalyze more efficient uses of spectrum by providing greater flexibility to spectrum license holders than what is allowed under today's antiquated regulatory regime. Under current regulations, restrictions on how license holders can use spectrum often delays or prevents firms from developing or deploying innovative wireless technologies. To change this dynamic, the paper outlines two directions for reform. First, it sets out a conceptual framework for enabling spectrum now dedicated to UHF TV broadcasting to be transferred to uses that are more valuable (e.g., wireless broadband). Second, it explains how the FCC should be reformed to oversee spectrum use through an increased emphasis on after-the-fact oversight (i.e., monitoring how the radio spectrum is used in practice) as opposed to its legacy of closely prescribed before-the-fact rules.

### **MISSING MARKETS**

#### ***MISSING MARKETS: WHY MARKETS THAT CAN REDUCE RISKS ARE MISSING AND WHAT CAN BE DONE ABOUT IT***

##### **A HAMILTON PROJECT OVERVIEW**

June 2008

Jason Furman, *Director*, The Hamilton Project

### **Introduction**

Markets are the central institution of the economy, allowing people to buy and sell goods and services in a manner that potentially makes everyone better off. Markets can also play a role in reducing the risks that individuals face by allowing them to purchase insurance such as health insurance, life insurance, or property insurance. Through insurance markets, households and communities can reduce the risks they face by pooling them, or sell these risks to entities that are better able to bear them. But in certain situations, markets that could potentially help to mitigate or reduce the risks faced by society and individuals are underutilized or even nonexistent, leaving households to face some of the largest risks without any protection. For example, while most Americans want to own a home, such a purchase comes inextricably linked to taking a major financial gamble on the value of the house. New ways of financing houses or insuring against lost property values could reduce this risk. Another major risk families face is outliving their assets in retirement and then being forced to have a dramatically lower standard of living in the final years of life—a problem that can in principle be addressed by the development of lifetime income products aimed at providing a long-term, reliable stream of income for retirees. The absence of markets to address societal risks can exacerbate these problems as well. For example, terrorist attacks, hurricanes, and other catastrophic events create major financial risks for individuals, businesses, local governments, and the economy as a whole. In principle, these risks should be insurable, but today many or most of them are not. Similarly, many communities face substantial risk as a result of shocks to local tax revenue, which can send them into a downward spiral of reduced revenue, spending cuts, outward migration, and further reduced revenue. Without adequate protection, the entire community becomes vulnerable to economic hardship. The ways in which markets can but often do not help people and

communities have been a thread running through many of the discussion papers released by The Hamilton Project. These papers identify a range of missing markets for both societal and individual risk, highlighting three specific reasons for the absence of these markets and proposing solutions to enable private markets to flourish or public markets to play a role.

***INCREASING ANNUITIZATION IN 401(k) PLANS WITH AUTOMATIC TRIAL INCOME***  
**A HAMILTON PROJECT DISCUSSION PAPER**

June 2008

William G. Gale, *Vice President and Director of Economic Studies*, The Brookings Institution  
J. Mark Iwry, *Senior Fellow*, The Brookings Institution  
David John, *Senior Fellow*, Heritage Foundation  
Lina Walker, *Research Director*, Retirement Security Project

**Abstract**

This paper proposes a policy that would increase the role of lifetime income products in future retirees' overall retirement planning. Over the next few decades, a substantial number of workers will retire with larger balances in their retirement accounts and have fewer sources of longevity protection than retirees today. They, therefore, must manage these resources to ensure they last throughout their retirement. Lifetime income products would be beneficial for many because payments are made for life and they mitigate the risk of running out of resources late in life. Despite the benefits of lifetime income, current retirees do not use lifetime income products very much and future retirees are unlikely to do so under current arrangements. The reasons may be that retirees already feel they have sufficient guarantees—for example, from social security benefits—against the risk of outliving their resources. However, evidence suggests also that the market for lifetime income products functions poorly and that people do not understand and are biased against the products.

Our strategy addresses market function by making it easier for a substantial number of retirees to purchase lifetime income plans; the increased volume of sales would reduce prices and make them a better value for the average consumer. Our strategy addresses the role of ignorance and bias by giving retirees an opportunity to “test drive” a lifetime income product, which would help overcome existing biases, reframe their view of lifetime income products and improve their ability to evaluate their retirement distribution option.

Specifically, we propose that a substantial portion of assets in 401(k) and other similar plans be automatically directed (defaulted) into a two-year trial income product when retirees take distributions from their plan, unless they affirmatively choose not to participate. Retirees would receive twenty-four consecutive monthly payments from the automatic trial income plan. At the end of the trial period, retirees may elect an alternative distribution option or, if they do nothing, be defaulted into a permanent income distribution plan. Employers and plan sponsors would be encouraged to offer the trial income plan and would have discretion over some of its structure and implementation. By making the proposal voluntary, we allow opting out by anyone who is not interested in purchasing guaranteed lifetime income. Several important questions would have to be resolved before this strategy could be implemented. The aim of this paper is to map out the first of several steps toward increasing the use of income products in 401(k)-type plans, with the ultimate goal of enabling improved retirement outcomes for workers.

***FINANCING LOSSES FROM CATASTROPHIC RISK***

**A HAMILTON PROJECT DISCUSSION PAPER**

June 2008

Kent Smetters, *Associate Professor*, Wharton School at the University of Pennsylvania  
David Torregrosa, *Analyst*, Congressional Budget Office

**Abstract**

Catastrophe insurance helps spread risks and increases the ability of policyholders and the economy to recover from both natural disasters and terrorist attacks. Government policies, however, may unintentionally limit the role of the private sector in insuring against catastrophic losses. Several such policies at both the state and the federal level reduce the amount of private capital supplied to insure or hedge against catastrophic risks. Although government policies are typically motivated by clear and reasonable objectives when initially implemented, they often become outdated as markets innovate. Policymakers have several different options to increase private-risk bearing capacity and improve the effectiveness of federal involvement. The benefits and potential costs of four options are examined: (1) an optional federal charter for insurers that would bypass states' regulation of rates; (2) regulatory reform of capital markets' risk transfer mechanisms that substitute for reinsurance; (3) changes in the taxation of catastrophic reserves to lower the cost of catastrophe insurance; and (4) and auctions of federal reinsurance for super-catastrophic risks.

***STABILIZING STATE AND LOCAL BUDGETS: A PROPOSAL FOR TAX BASE INSURANCE***

**A HAMILTON PROJECT DISCUSSION PAPER**

June 2008

Akash Deep, *Senior Lecturer of Public Policy*, Harvard University  
Robert Z. Lawrence, *Albert L. Williams Professor of International Trade*, Harvard University

**Abstract**

Local governments that are constrained to balance their budgets have been forced to deal with short-term revenue shocks by cutting spending or increasing taxes. These actions exacerbate rather than alleviate the effects of the shocks, posing a risk of long-term problems. Federal government policies to help local governments deal with such problems have been unreliable and poorly targeted. This study proposes an affordable federal instrument that could mitigate the adverse impact of tax-revenue shocks on communities by allowing them to buy tax-base insurance. With annual premiums of less than 1 percent of their tax revenues, local communities could use insurance to mitigate revenue shocks by taking advantage of risk-sharing opportunities. The strength of a tax-base insurance program is that it would predetermine eligibility, causes, and the value of compensation. It would also be dependable because it would establish a property right that communities would have already paid for.

**SCIENCE AND TECHNOLOGY**

***PROMOTING OPPORTUNITY AND GROWTH THROUGH SCIENCE, TECHNOLOGY, AND INNOVATION***

**A HAMILTON PROJECT STRATEGY PAPER**

December 2006

Jason E. Bordoff, *Policy Director*, The Hamilton Project  
Michael Deich, *Managing Director*, The Hamilton Project  
Rebecca Kahane, *Research Assistant*, The Hamilton Project  
Peter R. Orszag, *Director*, The Hamilton Project

**Abstract**

Americans are facing heightened economic pressures from the effects of globalization as workers from China, India, and other developing nations play a growing role in the world's economy. Advances in technology and transportation now mean that U.S. workers increasingly are competing with workers overseas—not just in manufacturing, but also in high-skill and high-wage sectors. Growth in information technologies, in particular, has facilitated deeper integration of economies across the globe while also posing both new opportunities and new challenges for the U.S. economy.

Maintaining our nation's economic leadership in the world and promoting broad-based growth at home will require effective policies to support research, innovation, and access to advanced information and telecommunications technologies. Innovation has long fueled economic growth, often giving rise to new industries and new jobs. According to the National Academies, "Since the Industrial Revolution, the growth of economies throughout the world has been driven largely by the pursuit of scientific understanding, the application of engineering solutions, and continual technological innovation". Numerous academic studies confirm that technological progress has accounted for a significant share of U.S. economic growth; a recent study shows that the share of economic growth directly attributable to research and development (R&D) investment has increased over time. What makes knowledge, innovation, and technology such powerful drivers of economic growth is that, unlike capital and labor, they do not suffer from diminishing returns. Indeed, in many cases the creation of knowledge and technological innovation actually increase the return to further knowledge and innovation, thus creating a powerful growth mechanism.

***INVESTING IN THE BEST AND BRIGHTEST: INCREASED FELLOWSHIP SUPPORT FOR AMERICAN SCIENTISTS AND ENGINEERS***

**A HAMILTON PROJECT DISCUSSION PAPER**

December 2006

Richard B. Freeman, *Ascherman Professor of Economics*, Harvard University

**Abstract**

There is widespread concern that the United States faces a problem in maintaining its position as the scientific and technological leader in the world and that loss of leadership threatens future economic well-being and national security. Business, science, and education groups have issued reports that highlight the value to the country of leadership in science and technology. Many call for new policies to increase the supply of scientific and engineering talent in the United States. While the reports differ in emphasis, the basic message is uniform: the United States should spend more on research and development (R&D) and increase the number of young Americans choosing scientific and technological careers. In his 2006 State of the Union address, President Bush announced the American Competitiveness Initiative that concurred with these assessments: "For the U.S. to maintain its global economic leadership, we must ensure a

continuous supply of highly trained mathematicians, scientists, engineers, technicians, and scientific support staff."

In 1957, faced with the analogous challenge of Sputnik, the United States responded with increased R&D spending and by awarding large numbers of National Science Foundation (NSF) Graduate Research and National Defense Education Act fellowships, which together induced a large number of young Americans to invest in science and engineering careers. In the early 1960s, the country gave about one thousand NSF graduate research fellowships per year. Forty-five years later, despite a more-than-threefold increase in the number of college students graduating in science and engineering and a global challenge from the spread of technology and higher education to the rest of the world, the United States still gives the same number of NSF fellowships. With so many more college students, current U.S. NSF fellowship policy gives less of an incentive for students to enter science and engineering than did policies in the earlier period.

***ALIGNING PATENT PRESUMPTIONS WITH THE REALITY OF PATENT REVIEW:  
A PROPOSAL FOR PATENT REFORM***

**A HAMILTON PROJECT DISCUSSION PAPER**

December 2006

Doug Lichtman, *Professor of Law*, The University of Chicago

**Abstract**

The United States Patent and Trademark Office is tasked with the job of reading patent applications and determining which ones qualify for patent protection. It is a Herculean task. One problem is resources. The Patent Office expects more than four hundred thousand new patent applications to be filed in 2007. To accurately evaluate the merits of all of those purported inventions would cost billions. Add to that the administrative costs of both interacting with all of the relevant lawyers and documenting the entire process, and the required budget is quickly beyond reach.

Information is a second significant impediment to Patent Office review. Patent applications are evaluated early in the life of a claimed technology, and thus at the time of patent review there is typically no publicly available information about, for example, how well the technology has been received by experts in the field, or whether consumers have deemed the technology to represent in some way an advance over existing alternatives. Worse, patent examiners cannot solicit these sorts of credible outsider opinions, not only because for many technologies it is unclear at the early stages who the relevant experts and customers might be, but also because patent evaluation is for the most part a confidential conversation between applicant and examiner, designed to keep an applicant's work secret just in case the patent application is ultimately denied.

Given all this, it is hardly a surprise that the Patent Office makes mistakes during the initial process of patent review, granting patents that, on their merits, should never have been issued. The real surprise is that these issuance mistakes are almost impossible to reverse.

***PRIZES FOR TECHNOLOGICAL INNOVATION***

**A HAMILTON PROJECT DISCUSSION PAPER**

December 2006

Thomas Kalil, *Special Assistant to the Chancellor for Science and Technology*, University of California, Berkeley and *Senior Fellow*, Center for American Progress

**Abstract**

Science, technology, and innovation are essential to America's continued economic growth, and can help achieve a wide range of national and global policy objectives. One currently underutilized tool for stimulating technological innovation is inducement prizes, which encourage efforts by contestants to accomplish a particular goal. A related policy instrument is an Advanced Market Commitment, under which governments commit to buy a given quantity of a product or service that meets pre-specified performance goals. This paper proposes expanding the US government's use of prizes and AMCs in five areas: space exploration, African agriculture, vaccines for diseases of the poor, energy and climate change, and learning technologies. Under certain circumstances, inducement prizes may act as a useful complement to grants and contracts as a way to encourage technological innovation. The government can establish a goal without determining who is in the best position to reach the goal or what the most promising technical approach is. The government only pays the prize money if someone is successful, and may be able to leverage additional funding from foundations, philanthropists, and contestants who value the reputational benefits of winning the competition. Prizes can also generate public excitement and enthusiasm for science and technology, and encourage more young people to pursue careers in science, engineering, or technology-based entrepreneurship. Inducement prizes and AMCs cannot substitute for robust research funding, protection of intellectual property, and development of a world-class workforce, but they can be a powerful complement to those efforts. Although the optimal level of investment in prizes is not clear, it is surely much larger than the government's current very modest investment. We still have much to learn about the strengths and limitations of prizes, but the time to start additional experiments is now.

**TAX POLICY**

***ACHIEVING PROGRESSIVE TAX REFORM IN AN INCREASINGLY GLOBAL ECONOMY***

**A HAMILTON PROJECT STRATEGY PAPER**

June 2007

Jason Furman, *Senior Fellow and Director*, The Hamilton Project  
Lawrence H. Summers, *Charles W. Eliot University Professor*, Harvard University  
Jason Bordoff, *Policy Director*, The Hamilton Project

**Introduction**

The progressive tax system, and the nation's fiscal system more broadly, have historically played an important role in expanding opportunities for all Americans while reducing inequality. But the same dynamic forces of technological change, financial innovation, and globalization that have contributed to rising income inequality also present new challenges for progressive taxation. Financial engineering, for example, has made it easier for the financially sophisticated—typically the wealthy—to take advantage of new financial instruments that shelter their gains from tax. And as capital is able to move ever more quickly and easily across borders, corporate income becomes increasingly elusive of taxation. These forces, together with deliberate policy changes, have led to an erosion of progressivity—the principle that higher incomes should face higher rates of taxation—and a dramatic reduction in the average tax rate facing very high-income households. More than half of that decline is the result of declining effective corporate tax

rates, as high-income households own disproportionate amounts of capital.

The tax code is not only a means of raising revenue to pay for government services. It also impacts an astonishing array of economic and social activities, from homeownership to education and child care to support for low-income workers. Taxes contribute, as part of the problem or as part of the solution, to many of the challenges our nation faces. The present tax treatment of health insurance, for example, pushes health spending upward while offering many of the uninsured little help in getting coverage. The tax treatment of retirement savings provides a windfall for high-income Americans who would likely have saved anyway, while offering scant encouragement to saving by low- and moderate income Americans, many of whom face the prospect of an insecure retirement. America's factories and cars continue to emit vast amounts of the carbon dioxide that drives climate change, a problem that would be remedied, in part, if the tax code imposed a cost for burning carbon-emitting fossil fuels.

There is broad agreement about many of the shortcomings of our current tax system, but little consensus about the solution. To make progress, lawmakers will, at a minimum, have to come together in good faith and agree on a broad approach. In an effort to define a common approach, this strategy paper offers six broad principles that reflect the new challenges facing our tax system in the twenty-first century. We believe these principles should command wide assent as policymakers consider tax reforms, whether incremental or far-reaching: Fiscal responsibility requires addressing both taxes and spending.

1. Rising inequality strengthens the case for progressivity.
2. The tax system should collect the taxes that are owed.
3. Tax reform should strengthen taxation at the business level.
4. Taxes for individuals should be simplified.
5. Social policy can and should often be advanced through the tax code—and it must be well designed.

***THE SIMPLE RETURN: REDUCING AMERICA'S TAX BURDEN  
THROUGH RETURN-FREE FILING***

**A HAMILTON PROJECT DISCUSSION PAPER**

July 2006

Austan Goolsbee, *Professor of Economics*, University of Chicago, Graduate School of Business

**Abstract**

The costs of complying with federal income tax requirements are large, and are particularly unwelcome to many middle-class taxpayers whose tax situations are quite simple. Indeed, the data show that the costs of complying are regressive—lower, as a share of income, for wealthier taxpayers.

This paper proposes a program known as the "Simple Return," which would make it much easier for the millions of taxpayers with a relatively simple tax status to file their taxes. The Simple Return might apply to as many as 40 percent of Americans, for whom it could save up to 225 million hours of time and more than \$2 billion a year in tax preparation fees. Converting the time savings into a monetary value by multiplying the hours saved by the wage rates of typical taxpayers, the Simple Return system would be the equivalent of reducing the tax burden for this group by about \$44 billion over ten years. A Government Accountability Office report estimated in 1996 that a plan similar to the one proposed here could save the IRS close to \$36 million per year by reducing the number of errors in tax filings and the subsequent need for investigations.

Around two-thirds of taxpayers take only the standard deduction and do not itemize. Frequently, all of their income is solely from wages from one employer and interest income from one bank. For almost all of these people, the IRS already receives information about each of their sources of income directly from

their employers and banks. The IRS then asks these same people to spend time gathering documents and filling out tax forms, or to spend money paying tax preparers to do it. In essence, these taxpayers are just copying into a tax return information that the IRS already receives independently. The Simple Return would have the IRS take the information about income directly from the employers and banks and, if the person's tax status were simple enough, send that taxpayer a return prefilled with the information. The program would be voluntary. Anyone who preferred to fill out his own tax form, or to pay a tax preparer to do it, would just throw the Simple Return away and file his taxes the way he does now. For the millions of taxpayers who could use the Simple Return, however, filing a tax return would entail nothing more than checking the numbers, signing the return, and then either sending a check or getting a refund.

***TAXING PRIVILEGE MORE EFFECTIVELY:  
REPLACING THE ESTATE TAX WITH AN INHERITANCE TAX***  
**A HAMILTON PROJECT DISCUSSION PAPER**

June 2007

Lily L. Batchelder, *Associate Professor*, New York University School of Law

**Abstract**

The repeal of the estate tax for one year only in 2010 creates vast uncertainty but also provides an opportunity to reconsider the taxation of gifts and bequests. This paper proposes replacing the estate tax with an inheritance tax. Heirs receiving lifetime inheritances greater than \$2.3 million would include in income and pay a 15 percentage point surtax on the excess. The proposal would also replace stepped-up basis with carryover basis for bequests. As under the estate tax, the fraction of heirs affected would be miniscule, falling from three to two in 1,000.

The proposal has a number of advantages relative to the estate tax. It would reward donors who give more broadly. It would enhance efficiency and reduce compliance costs by curbing tax planning and the rules needed to contain it. Cross-national experience also suggests it would be administrable. Most importantly, the proposal would lower taxes on heirs receiving smaller inheritances and those with moderate incomes, making the tax system better attuned to unearned advantage and ability to pay. At an individual level, the distribution of tax burdens would change considerably: only 5 percent of the estate tax rate for an heir is accounted for by her inheritance tax rate, and vice versa, and each tax would raise 14 percent of revenue from heirs facing no tax burden under the other. The proposal is revenue-neutral relative to 2009 law. A lower exemption would raise more revenue and bring the tax rate on inherited income closer to the income tax rate on non-inherited income, which is about three times higher.

***REFORMING CORPORATE TAXATION IN A GLOBAL ECONOMY:  
A PROPOSAL TO ADOPT FORMULARY APPORTIONMENT***  
**A HAMILTON PROJECT DISCUSSION PAPER**

June 2007

Kimberly A. Clausing, *Professor of Economics*, Reed College

Reuven S. Avi-Yonah, *Irwin I. Cohn Professor of Law*, University of Michigan Law School

**Abstract**

The current system of taxing multinational firms relies on separate accounting: firms account for earnings and costs in each location in which they operate. This system generates a large tax incentive to earn income in low-tax countries, and multinational firms respond by earning disproportionate profits in low-tax locations.

We propose a system of formulary apportionment for taxing the corporate income of multinational firms. Under our proposal, the U.S. tax base for multinational corporations would be calculated based on a fraction of their worldwide income. This fraction would simply be the share of their worldwide sales that are destined for customers in the United States.

This system is similar to the current method that U.S. states use to allocate national income. The state system arose due to the widespread belief that it was impractical to account separately for what income is earned in each state when states are highly integrated economically. Similarly, in an increasingly global world economy, it is difficult to assign profits to individual countries, and attempts to do so are fraught with opportunities for tax avoidance.

Under our proposed formulary apportionment system, firms would no longer have an artificial tax incentive to shift income to low-tax locations. This would help protect the U.S. tax base while reducing the distortionary features of the current tax system. In addition, the complexity and administrative burden of the system would be reduced. The proposed system would be both better suited to an integrated world economy and more compatible with the tax policy goals of efficiency, equity, and simplicity.

### ***REHABILITATING THE BUSINESS INCOME TAX***

#### **A HAMILTON PROJECT DISCUSSION PAPER**

June 2007

Edward D. Kleinbard, *Partner*, Cleary Gottlieb Steen & Hamilton LLP

#### **Abstract**

This paper introduces the Business Enterprise Income Tax (BEIT), a comprehensive and detailed proposal for reforming business income taxation. Current law fails to tax all business income consistently and comprehensively. It distorts economic behavior and diverts managerial effort toward tax avoidance.

In contrast, the BEIT achieves comprehensive and consistent taxation of capital income and reduces tax-planning incentives. The BEIT integrates taxes at the corporate and the individual levels, ensuring that all income is taxed once and only once.

The BEIT eliminates current law distinctions between debt and equity. Instead, the BEIT uses its cost of capital allowance (COCA) system to tax investors on the normal (risk-free) return to capital and to tax businesses only on risky returns and rents. Under the COCA system, businesses obtain a uniform deduction for a normal return on their capital and pay tax on the rest of their income; investors include an assumed normal return in their taxable incomes, whether or not received by them in cash. (Investors also pay a small tax on gains beyond normal returns for practical and ability-to-pay reasons). In practice, the COCA system functions as a business-level consumption tax plus an add-on investor tax on normal returns.

The BEIT proposal also rationalizes the tax system by applying a single set of rules to all forms of business enterprises and business acquisitions. As a result, all business income is taxed identically and consistently, regardless of niceties of form.