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ABSTRACT

Although the United States has the largest economy in the world, it has vulnerabilities. The growth rate of productivity has slowed. The U.S. net national savings rate is at an all-time low. The nation's educational system is performing well below the best international levels. A disenchanted electorate views federal institutions with increasing cynicism and mistrust. The Strengthening of America Commission proposes a specific blueprint for action to get the nation's fiscal house in order that combines budget deficit reduction with the replacement of the current tax code by a progressive consumption-based tax. The commission recommends three principal initiatives to support a human resources investment strategy: a new system of national standards at the secondary school level; expanded programs of training and apprenticeships for students who enter the work force directly after secondary school and expanded work force training programs; and a comprehensive effort to promote school readiness in young children. The commission also recommends that the government provide an economic environment that helps strengthen the U.S. industrial base. To help break the gridlock in government, the commission recommends structural reforms within the executive and legislative branches. (Appendixes include the following: meeting agendas; staff and working group lists; 128-item bibliography divided into sections concerning capital formation, fiscal policy, human resources, manufacturing and technology, and making Washington work; and separate opinions of commission members.) (YLB)

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THE CSIS STRENGTHENING OF AMERICA COMMISSION

FIRST REPORT

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The overall report represents the preponderant view of the Commission. In a bipartisan effort of this scope, it is not expected that each Commission member will endorse every specific aspect of the report. Additional views are published in the Appendix to this report.

The recommendations herein offered are those of the Commission, since CSIS, as a tax-exempt, non-profit institution, does not take positions on matters of governmental policy.

WHY THIS REPORT?

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For 30 years, the Center for Strategic and International Studies has surveyed developments around the globe that might affect the security of the United States. Our purpose has been to understand what was going on in the world so that we might help prepare our nation strategically to meet the future.

We know every trouble spot from Azerbaijan to Pyongyang. With the fall of the Soviet Union, however, CSIS has come to the conclusion that some of America's biggest trouble spots are not abroad but here at home. They are in manufacturing, capital formation, education, the federal budget, science and technology.

We are most vulnerable not on the Russian steppes or in the Persian Gulf, but in our factories, our classrooms, and our halls of government. It is in these places that we will either maintain or lose the strength to influence world affairs for the foreseeable future.

The global influence of the United States ultimately rests on the strength of the U.S. economy, and as the nuclear confrontation recedes, that strength will be an even greater determinant of international standing. Why do we still need global clout? Because our domestic welfare will be affected by events abroad. We want the rest of the world to listen to us in political negotiations, environmental negotiations, and trade negotiations.

Our own success in liberalizing world trade over the last five decades has exposed almost every U.S. industry to foreign competition and caused most U.S. producers to depend on export sales as well as domestic sales to grow and prosper. But, in critical ways, we are not yet ready to compete in that ultimate arena. Global competition requires that our plants, scientific and technical effort, products, and service meet world class standards — or ultimately, our own standard of living will decline. However, we have not developed an effective, unified strategy to meet these high standards.

The beneficial way to advance our interests is not by retreating into protectionism or isolationism, but by strengthening the sinews of America and continuing in our role as a world example and global leader. We cannot protect ourselves by withdrawing from the global economy any more than we could have protected ourselves by withdrawing from the communist threat.

There is more in our house that needs to be put in order besides issues concerning production and the economy. The tension that boiled over in Los Angeles is just a symptom of a festering unrest.

We need to learn from other societies that loyalty to one another and mutual responsibility are elements of competitiveness as well as of compassion. We build great freeways, but we cannot simply drive past our neighborhoods that have been allowed to decay. Woven into any program to strengthen America must be strategies to help all our citizens participate fully and effectively in our economic life.

The Soviet Union sought for many decades to undermine the strength, the vitality, and the will of the United States. What communism failed to wreak upon us, however, we may bring upon ourselves if we do not address with a sense of national urgency the weaknesses in our institutions and public policies. These weaknesses are not a product of one party's policies, one branch of government, or one industry. They are national weaknesses 20 years or more in the making. They may take years to correct.

These trends no longer can be ignored.

In January of 1991, CSIS created the Commission for Strengthening of America to develop an action plan to put the U.S. house in order. This is the first report of that effort. Other reports will follow. Co-chairs Senator Sam Nunn and Senator Pete Domenici have led this group of distinguished Americans — business and labor leaders spanning a wide range of sectors, experts from many different fields, respected members of academia, members of both houses of Congress, and state and local government officials — in looking strategically at our country's problems. Senator Nunn and Senator Domenici are leading this Commission toward practical action, not just rhetoric. Our congressional members are concerned about the country's future and are sponsoring legislation that will put us on the path to long-term growth. The Commission's business leaders are some of the most innovative in the country, and they are leading their companies to become global competitors. All of us — including the Commission's mayors and labor leaders — are concerned about the work force of the next century and are acting now to overhaul our educational system.

We have not tried to be original for its own sake — our analysis builds on previous work and goes beyond it. We have put aside the stale ideological battles and developed specific, often controversial recommendations to strengthen our country. I want to thank the commissioners for their dedication, their selflessness, and their outstanding work on this project still in progress.

Ever since the end of World War II, the United States has sought to be prosperous at home and strong overseas. The world has changed. America's needs have changed. Today we must also be strong at home and prosperous overseas. The Commission offers this blueprint to help our country achieve those goals.

David M. Abshire

David M. Abshire
President, CSIS

WHY NOW?

★

The American people are not alone in their frustration with what goes on in Washington. Many of us who work here feel the same way. Two of us — one a Democrat, the other a Republican — are alarmed by our government's unwillingness or inability to address the challenges of the future. A recent editorial in the *Washington Post* characterized very well the current behavior in the capital with the headline "The Future be Damned."

Both of us are politicians who well understand the pressures of political life, but the time has come to say, "enough is enough." Elected officials, Democrat and Republican, must look less at short-term gains and more at the pressing, long-term problems of our country. Business must also abandon its shortsighted preoccupations. The news media must ask the right questions and demand substantive answers from those seeking higher office.

Americans themselves must realize that the problems facing the nation cannot be solved without sacrifices in one form or another in the years ahead. In fact, many Americans are sacrificing already. Some people have not seen their wages go up in close to two decades. Others are out of work. The question is whether we choose the sacrifices or whether the sacrifices choose us.

Concerned by the lack of urgency in dealing with our country's long-term problems, we readily accepted Ambassador David Abshire's invitation to chair the Commission for Strengthening America sponsored by CSIS.

The goal of our bipartisan Commission is to develop an action plan to strengthen the country. To do so, we drew upon the insights of an unusually talented and diverse group of Americans. The Commission brings together 17 chief executives of American companies, congressional colleagues from both sides of the aisle, mayors, labor leaders with a wealth of expertise on issues ranging from fiscal policy to education to science and technology. We are grateful to the Commission for their time, effort, and candor.

We especially want to thank Dr. Debra Miller of CSIS, the director of the Strengthening of America project, who has done an outstanding job in guiding the commission and who has demonstrated the patience of Job in organizing this report and supervising its completion.

We believe that, in many areas, fundamental change in our nation is required, is urgent, and is possible. Change will demand unity and strong leadership. The president alone cannot solve all of the problems. Neither can the Congress, nor one political party. There is much that American businesses and unions must do to make our economy stronger. There is much that local communities, schools, and parents must do. There is a role for every American, either in spirit or deed, and we hope that the Commission's bipartisan findings will give thoughtful people a place to start.

Along with our colleagues on the Commission, we offer an action plan for growth in this first report that addresses three critical areas: fiscal and tax policy; public and private investments in human resources, including education and training, science and technology, management, and infrastructure; and breaking the gridlock in Washington so that the president and the Congress can better make sound, long-term economic policy.

We believe that the recommendations we present will help put the country on the path to long-term health and prosperity. However, we want to say at the outset that this report is limited in scope. Other issues that are also critical to strengthening the country — such as health care reform, environmental and energy policy, regulatory reform, and international trade policy — are not covered in this report. Subsequent Commission reports will address these issues.

We are releasing our first report now, in the heat of the political season, because we hope it will influence the political debate in the weeks ahead.

- ★ We hope our report will help shift the focus of the elections from personalities and a horse race mentality to the long-term issues that matter.

- ★ We hope it will assist the media in asking the tough, specific questions that must be asked.

- ★ We hope it will encourage the voters to reject the quick-fix, feel-good rhetoric and solutions and increase understanding of the long-term trade-offs we must make.

- ★ We hope it will prompt the candidates to look beyond the polls and the political consultants and to think instead about the face of America for generations to come.

This is the spirit in which our Commission was convened and our first report was written.

Sam Nunn	Pete Domenici
Sam Nunn	Pete Domenici
U.S. Senate	U.S. Senate

EXECUTIVE SUMMARY

A new chapter is opening in American history. We won the Cold War in large part because this nation maintained a strong, bipartisan strategy over four decades to preserve our external security. Following the same logic and principles, the bipartisan Strengthening of America Commission was formed 18 month ago under the aegis of the Center for Strategic and International Studies to look strategically at our country's economic future.

A group of more than 50 leading citizens from public and private life — chief executives, labor leaders, members of Congress, mayors, and specialists, with a wealth of expertise ranging from fiscal policy to education, science and technology — has now drawn up a plan for domestic renewal that is both realistic and politically viable.

Among the Commission's key recommendations are:

- **Balance the budget by 2002 with a detailed action plan to reduce federal deficits by $2 trillion over ten years.** At the top of the agenda is getting our fiscal house in order. The Commission's comprehensive blueprint for fiscal reform will allow us to bring the budget into balance as quickly as we wisely can, while also permitting necessary, new investments in our human and physical resources. The plan will rely primarily upon spending reductions, reducing currently expected spending by 8% — saving $1.5 trillion — over the next decade. Placing a ceiling or cap on non-Social Security mandatory spending must be a critical part of this effort. The plan also includes increases in taxes that are 3% higher than expected revenues, producing $376 billion for deficit reduction.

  Spending reductions would be legally locked in before the raising of any new revenues. Revenue increases would be limited to a ratio of no more than $1 for every $2.75 of spending reductions. Another $150 billion would be saved through reduced interest rates brought about by large deficit reductions. This discipline over ten years would balance the budget without using the Social Security surplus and create the basis for long-term growth and higher real income for the American people.

★ **Abolish the current income tax system in favor of a new system that would stimulate greater savings, investment, and jobs.** Our savings rate, which is a critical component of investment, productivity, and growth, is at an all-time low. It has dropped precipitously below that of our major competitors. The Commission calls for a phasing out of the current income tax system, which is biased against savings, and replacing it with a consumption-based income tax system that will gear the economy for growth and be both progressive and fair in its impact.

★ **Create a $160 billion Endowment for the Future through increased federal investment in education, children, R & D, and technology.** In our zeal to reduce deficits, we must not ignore the need to improve our human resources and our capacity to innovate. To pay for this investment over ten years, the Commission recommends terminating or scaling back lower priority programs. On education and training, the Commission's proposals include a new certificate of mastery, based on national educational standards; expanded programs of technical apprenticeship and training for the 50% of American youth who do not attend college; and a comprehensive effort to promote school readiness in young children.

★ **To strengthen the industrial base,** the Commission recommends devoting more R & D to manufacturing and dual use (commercial/defense) technology, and redeploying resources of the national laboratories to solve major problems in process as well as environmentally conscious manufacturing.

The Commission is releasing this first report at the height of the political season, in hopes that it will help shift the focus to the important, long-term issues which confront the nation. Other recommedations will follow over the coming year.

* * *

Why We Must Change

The facts are simple. We have the largest economy in the world, but we have vulnerabilities that run far deeper than the latest recession:

- The growth rate of American productivity has slowed during the past 20 years, while the productivity growth rate of other major countries has accelerated. As a consequence, though our productivity and standard of living are the highest in the world, average American real income has stagnated since the 1970s.
- The U.S. net national savings rate, which is a critical determinant of investment and growth, is at an all time low: it plummeted from an average of 9.8% of GDP in the 1960s to an average of 3.6% in the 1980s. In contrast, Japan and European Community countries save at a rate of over 10% of their GDPs.
- Federal budget deficits are sapping the economic strength of our country. When the Treasury spends money it doesn't have, it must borrow money from U.S. citizens, corporations and businesses, and foreign investors. These borrowings absorb private savings that otherwise would be available for private investment — the primary growth engine of our economy.
- Our current tax system is hostile toward saving and tilted toward immediate consumption. Its structure encourages a focus on cash flow and short-term profitability, its complexity imposes heavy costs, and many of its regulations create a handicap for U.S. firms in the global arena.
- America's elementary and secondary education system, once the envy of the world, is performing well below the best international levels. Moreover, 50% of America's young people do not go on to college and receive little help moving from school to the work place.

- U.S. companies spend twice as many resources on the development of new product ideas as they do on the process technologies to manufacture the products themselves. As good as American companies have been at invention, many are not nearly as fast or as effective as their competitors in turning inventions into high-quality products, and then getting those products into the hands of consumers.
- Our nation's federal institutions were once regarded as a vital source of civic strength. Today, a disenchanted electorate views Washington with increasing cynicism and mistrust. The growing gap between our public servants and the public itself signals a potential crisis of confidence that cannot be ignored.

★

Getting Our Fiscal House In Order

At the top of the Commission's agenda is the task of getting our fiscal house in order by getting control over the deficit and restructuring the tax system to tax consumption, not income.

Both the deficit and the tax code work against our long-term economic vitality. Both inhibit savings that are needed for investment, which would, in turn, stimulate a rise in American productivity and higher real income for the American people.

The Commission, in assessing what it will take to put our fiscal house in order, draws three basic conclusions:

First, there are no quick fixes. The challenge facing America is structural, and the Commission recommends a realistic target date of 2002 — a ten-year plan — to meet it.

Second, deficit reduction alone is not enough to get us from where we are to where we want to go. We need mutually reinforcing deficit reduction and tax restructuring strategies to generate growth through increased savings and investment.

Third, while the private sector is the engine for growth, new federal expenditures on children, education, infrastructure, technology, and R & D can contribute to our over-all economic performance. Any plan of action should meet these legitimate needs, either by setting new spending priorities or providing additional funding on a pay-as-you-go basis.

The Commission proposes a specific Blueprint for Action that combines budget deficit reduction with the replacement of the current tax code by a progressive consumption-based tax. The predominant view of the Commission is that this approach be guided by ten principles:

1. Balance the budget by the year 2002, without using the Social Security surplus;

2. Promote long-term economic growth without undue short-term economic disruption;

3. Base projections for deficit reduction on credible, realistic economic assumptions;

4. Follow a step-by-step agenda, legally locking in spending controls before raising revenues;

5. Limit revenue increases to a ratio of no more than $1 for every $2.75 of spending reductions;

6. Bring mandatory spending under control by putting a cap on the growth of spending on non-Social Security entitlement programs;

7. Enact comprehensive health care reform that controls costs and insures the uninsured;

8. Restructure the tax code to promote growth by encouraging savings and allocating resources more efficiently, while preserving the over-all progressivity of the code;

9. Make room for increased investment in education, children, R & D, and technology by reducing or terminating lower priority programs;

10. Fully implement the "good-government" measures — such as sunsetting programs, using the "total quality" approach to management; collecting revenues from tax cheats, and reducing waste — to make government more efficient.

★

Budget Deficit Reduction Strategy

The Commission's 10-year blueprint calls for balanced deficit reduction totalling $2 trillion over the next decade. Spending would be reduced 8% below projected levels — saving nearly $1.5 trillion over ten years. Projected revenue increases would be 3% over the decade, which would add nearly $376 billion. Another $150 billion would be saved through reduced interest rates. The total sum from these spending reductions, added revenues, and lowered interest rates would balance the budget.

The Commission's blueprint includes increased spending of $160 billion on children, education, R & D, and technology. It also calls for another $100 billion for highways, airports, and other physical public infrastructure, to be funded by fees or revenues outside the deficit reduction package.

The Commission bases its strategy for deficit budget reduction on realistic assumptions about economic growth. To assume significantly higher growth would be self-defeating because such optimistic assumptions would make our fiscal plan less credible. America's current fiscal situation suggests that discipline is needed and that growth must be earned, not assumed. But should our action plan result in the higher growth that is potentially within reach, the dividends to the country would be all the greater and would permit lower tax rates, increased public sector investment, or the retirement of part of the national debt.

The predominant view of the Commission is to recommend the following blueprint for restructuring fiscal policy:

(1) Allowing two years for enactment and a gradual phase-in, cap spending on non-Social Security mandatory programs beginning

in 1995 — saving $660 billion over 10 years, or 10% of such projected spending over the ten-year period.

(2) Abolish the present tax code and enact progressive consumption-based income taxation within two years. This decision would include a commitment to implement a full consumption-based income tax before the year 2002 and to specify the tax restructuring which would provide for transition. This restructuring should be permitted to raise nearly $376 billion by the year 2002 but no more than $1.00 in taxes for $2.75 in spending reductions. This represents a 3% increase in projected revenues and an 8% cut in projected spending over the course of the plan.

(3) Reduce defense spending in an orderly fashion from 20% to 13% of the federal budget, with the goal of saving $290 billion over 10 years, an additional 10% reduction in projected spending.

(4) Allow international spending to increase at half the rate of inflation, growing from $20 billion in 1993 to $24 billion in 2002, while placing a greater emphasis on supporting newly emerging democracies and market economies — saving $21 billion by the year 2002, a 9% reduction in projected spending.

(5) Permit domestic discretionary spending to increase from its current level of $234 billion to $255 billion in the year 2002. The Commission believes that domestic discretionary spending should be reprioritized so that it emphasizes investment-oriented programs that promote economic growth in the following manner:

- ★ In particular, the Commission recommends $160 billion of *increased spending* over current projected levels for the ten-year period on education, children, R&D, and technology.
- ★ To help pay for these high priority investments, the Commission recommends terminating, scaling back, or streamlining lower priority programs. The Commission recommends a number of programs that should be reviewed for possible termination.

All told, this reprioritization of domestic discretionary spending will produce net savings of $243 billion over a ten-year period, a nearly 9% reduction in projected spending.

(6) From 1993-2002, increase spending on physical infrastructure — roads, bridges, airports, and tunnels — by $100 billion over current projected spending to be paid for, by increased energy taxes or user fees (no net effect on budget over the ten years).

(7) Interest payments would be reduced — saving $237 billion over the ten-year period, an 8% reduction. Lower interest rates brought about by large deficit reductions would increase these savings to $387 billion, for a total reduction of 13% in projected interest costs.

The Commission fully understands that the proposed spending reduction and tax reform will be extremely difficult. But it should also be stressed that *unless all of the key elements of the fiscal plan are implemented as a package, the country risks the real possibility of undermining America's international position without achieving its goal of a strengthened America at home. If we attempt to balance the budget by slashing national security and international programs, without restraining and reforming domestic discretionary and mandatory program spending, we will weaken ourselves both abroad and at home.*

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Tax Restructuring Strategy:
The Consumption-Based Income Tax

The Commission recommends abolishing the current tax system and replacing it with a progressive consumption-based income tax system that would exempt savings and investment from taxation. This proposal has gained increasingly wide support from leading economists and tax experts of varying political persuasions.

By removing the bias in favor of consumption in the current income tax code, neither consumption nor saving would be subsidized. The Commission believes that significant new saving and other benefits will result from this change.

The consumption-based tax would be levied in very much the same way as the personal income tax. A taxpayer would take annual income, add gifts and bequests as well as net borrowings, and subtract all savings — basically net investments and the net change in his or her bank balance. The remainder would equal consumption, and the resulting amount minus exemptions would be taxed.

Under a pure consumption-based income tax, businesses would not be subject to taxation. To reduce the burden on individual taxpayers, the Commission recommends a tax on business cash flow as a key element of the new tax structure.

The Commission recognizes that, under the best of circumstances, it will take time to design and implement a consumption-based tax system. Toward that end, the Commission believes that the principles that should guide the transition from the present tax code are progressivity, fiscal responsibility, transparency, and internal consistency.

Progressivity. Any tax on consumption must preserve equity, so that our citizens, no matter what their income level, share the tax burden fairly. This can be accomplished through a progressive structure.

Fiscal responsibility. Over the transition, revenues must be raised consistent with the goal of $376 billion of additional revenue for deficit reduction. These revenues should be raised from measures consistent with the consumption-based tax recommended herein.

Additional tax measures now under discussion such as investment tax credits, capital gains differentials, R & D tax credits, if implemented, should not increase the deficit during the transition. If these growth incentives are put into play during the phase-in of the consumption-based tax, they must be paid for on a progressive basis by broadening the tax base, rate increases, or reduction in subsidies to high-income taxpayers.

Transparency. Progressive changes and adjustments in the tax code during the transition must be clearly and rightly understood by all taxpayers, so that there is no sense that tax reform is another set of "tax gimmicks."

Internal consistency. During the shift to a consumption-based tax, changes in the code must be all of a piece with the new consumption-based tax structure, deficit reduction, and economic growth.

The Commission strongly urges that a concerted effort be made to educate the public about deficit reduction and tax reform during the current presidential campaign and beyond. Voters cannot hold candidates accountable unless the media does as well.

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An Investment Program To Promote Economic Growth

EDUCATION

The key component of a public investment strategy is investment in human resources. Strong schools, strong work force training programs, and strong families are the components of a strong educational system. We cannot be a first-rate country with a second-rate school system. We cannot compete successfully in a global economy with a low-skilled, low-wage work force. Without supportive, involved families, we will play constant catch-up with children ill-prepared to learn. Government, the education community, and business must be partners in a long-term effort to revitalize the American educational system.

The Commission recommends three principal initiatives to support a human resources investment strategy in the 1990s: a new system of national standards at the secondary school level; expanded programs of training and apprenticeships for students who directly enter the work force after secondary school, and expanded work force training programs for those already on the job; and a comprehensive effort to promote school-readiness in young children and strengthen their families.

A New System of National Standards

Compared to our competitors and to our own national needs, America's expectations for what the vast majority of our students should know and be able to do are minimal. To achieve both excellence and equity, our nation should develop educational content and student performance standards in core subjects, such as math, English, science, and history. Meeting those standards by the time they graduate from high school would earn students a certificate of initial mastery that signified preparation for democratic citizenship and readiness for high-productivity employment.

High quality standards should be supported by high quality student assessments. Student assessments should be linked to school curricula, should measure student achievement rather than aptitude, and require that students demonstrate not only the recall of facts but also their application.

To support the shift to higher expectations for student achievement at the secondary level, colleges, professional schools, and technical programs should raise their entry-level standards over a ten-year period. The nation — through student assistance and national service programs at the federal level, through scholarship programs of colleges and universities, and through private scholarship programs — should ensure that financial need should no longer be an obstacle to higher education for students who have performed well in secondary school.

Federal, state, and local governments should ensure that schools have the requisite resources to prepare their students to meet new and more rigorous standards. The Commission recommends increasing federal investment in the Chapter 1 program, which helps educationally disadvantaged children. The assistance should extend over the next 10 years, contingent upon the reform program spelled out in this report, and earmarking some of these funds to support the nation's R&D as well as meeting the needs of disadvantaged children.

Teachers must be capable of helping students meet these demanding national standards. To improve the quality of America's teachers, the Commission recommends, among other things, that:

★ Financial incentives be provided to attract new teachers into subject areas where teachers are in short supply; to attract the best and the brightest secondary and college students to pursue teaching careers; and to attract separated military and defense industry personnel to the teaching profession.

★ National standards be developed for state alternative teacher certification programs to allow qualified individuals who do not have an education degree to enter the teaching profession.

★ The education community provide financial incentives for teachers to enhance their own skills and knowledge in order to enhance their students' abilities to meet higher standards.

Strengthen the Work Force

Fifty percent of our young people do not go to college, but the United States, unlike its competitors, has no system to assist the transition from school to the work place. Nor do we have a system to educate and train front-line workers.

Structured on-the-job learning is the missing link in the partnership between schools and employers. Government, business, and labor should work together to establish apprenticeships that combine certifiable skill training, academic instruction, and work experience. Professionalized technical education in the form of "tech prep" programs, apprenticeships programs, and occupational training at both community colleges and technical schools should be expanded. A system of technical and professional certificates, recognized by employers and post-secondary institutions, should be developed to measure skill competencies gained through this education. This would allow workers to transfer from job to job or move from state to state as they wished.

American companies should also be encouraged to invest in their own workers. A target of 2% of payroll for training is reasonable. Congress should develop incentives and technical programs to increase training and upgrading of the work force, not just for top management, but also for front-line workers.

Promote school readiness and strengthen families

The Commission strongly endorses the expansion of programs that promote school-readiness in young children and support families. These programs include:

★ "WIC" (the special supplemental food program for women, infants, and children that provides prenatal and nutrition programs);

★ Childhood immunization programs;

★ Head Start, which should be made available to all three- and four-year old children, with non-disadvantaged children participating on a completely reimbursable basis, and full-day options provided; and

★ "Inter-generational programs" that provide education, employment, and parenting skills programs for mothers of Head Start children.

While these programs and others can do much to promote school-readiness in children, by far the most influential teachers are parents. Parents' attitudes toward education, their expectations for their children, the values they impart, and the environment they provide for learning all have an enormous impact on educational success. In addition, parents should monitor the amount and content of their children's TV viewing. The Commission also believes that the TV industry and those who advertise on TV must take responsibility for their enormous impact on children. Finally, though they are no substitute for parents, schools should adopt strong programs on values and ethical behavior.

Families can be supported in their efforts by their employers. Parental leave, flexible work scheduling, working at home, and career sequencing all enable working parents to spend time with their children and meet family obligations. The Commission is united in advocating that working parents be given greater opportunity to spend more time with their children.

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The American Industrial Base

The primary responsibility for producing competitive goods and services rests with the private sector. While American firms excel in some business sectors (e.g., pharmaceuticals, chemicals, aerospace and information services) American firms in other sectors (e.g., motor vehicles, telecommunications equipment, and computers) are being challenged by Asian and European companies.

In these industries and others, companies must develop new attitudes and strategies and learn new techniques to remain or become globally competitive.

The Commission points in particular to the path-breaking work produced by the MIT Commission on Industrial Productivity, *Made in America*, which documents how the 30 "best practice" American companies are meeting the challenge. Total quality management, just-in-time manufacturing, constant refinements in process technologies, and continuous training of front-line workers are among the management strategies that these companies use to become global competitors. The Commission strongly endorses these efforts.

At the same time, government can and should provide an economic environment that helps strengthen the American industrial base. As noted above, the federal government must put its fiscal house in order to increase the availability and decrease the cost of capital for productive business investment. In addition, the Commission recommends that government take these steps to leverage the efforts of private industry:

★ **R&E tax credit.** To encourage sustained private sector commitment to R&D, the Commission recommends extending the current 20% research and experimentation tax credit through the transition to a consumption-based tax. Its provisions should be amended to include expenditures on process technologies and cooperative research done at the national laboratories.

★ **Increased resources to manufacturing technology.** Manufacturing technology should be added as the "fifth horseman" to defense, health, energy, and space R&D. Less than 2% of the federal government's R&D budget was devoted to manufacturing technology in 1991. The Commission recommends that each federal agency support the development of manufacturing process technology as a concurrent and important aspect of ongoing R&D programs.

★ **National laboratories.** The national laboratories, an invaluable asset in meeting the military challenges of the past, must now help us meet the economic challenges of the future. The White House science and technology adviser, the national security adviser, appropriate members of the cabinet, and representatives of the private sector should establish a senior level working group to review and revise the missions of the labs to permit their best use. The labs can contribute immediately to large-scale projects such as environmental restoration, waste minimization. environmentally conscious manufacturing, energy efficiency and supply, advanced manufacturing, high-performance computing, and health care.

★ **Increased resources for dual use technologies.** The Defense Advanced Research Projects Agency (DARPA) should be transformed into the National Advanced Research Projects Agency (NARPA) in order to help integrate defense and commercial technologies into a strong unified national technology base. NARPA would continue to support technologies of potential military importance as well as focus more heavily on dual-use technology. DOD would benefit by getting faster and cheaper access to commercial technology, and commercial firms would benefit by the availability of additional federal R&D dollars.

★ **Increased resources for infrastructure.** Increased federal and state resources should be devoted to highways, mass transit and aviation, including innovative technologies such as high-speed rail and intelligent vehicle systems. The Commission recommends that the federal government increase total spending on such programs by $100 billion over a ten-year period. Funding for these new physical investments would come from infrastructure taxes, energy taxes, and fees.

In addition, the Commission recommends the support of policies to encourage the development of public communications networks that will meet the advanced telecommunications needs of all Americans, including deployment of fiber optic systems or other efficient broadband technologies.

★

Making Government Work

To help break gridlock in government, the Commission recommends structural reforms within the Executive and Legislative branches.

TO THE PRESIDENT: To bring focus and coordination to economic issues at the highest level of government, the Commission recommends creating a National Economic Council (NEC), headed by a National Economic Advisor, on a level with the National Security Council and the National Security Advisor.

TO THE CONGRESS: To end the quagmire of budgetary legislation, the Commission recommends creating a Joint Budget Committee, appointed by the joint leadership of both houses, to supplant the current budget committees; lengthening the budget cycle from one to two years; decreasing overlap among some 300 committees and subcommittees, and ending duplication inherent in the budget resolution/authorization/appropriation process. This streamlining would reverse the excessive growth of Congressional staff that has occurred over the past two decades.

★

If we stay our present course, we and our children and grandchildren will pay an increasing price. If we begin to make the tough decisions now, the rewards and benefits will be felt for generations to come.

We believe that, in many areas, fundamental change in our nation is required, urgent, and possible. Change will demand unity and strong leadership. The President alone cannot solve all of the problems. Neither can the Congress nor one political party. There is much that American business and unions must do to make our economy stronger. There is much that local communities, schools, and parents must do. There is a role for every American, either in spirit or in deed, and we hope that the Commission's bipartisan findings will give thoughtful people a place to start.

★

Future Agenda: The Strengthening Of America Commission

ENERGY AND THE ENVIRONMENT

HEALTH CARE

INNER CITIES

REGULATION

TRADE

LIST OF COMMISSION MEMBERS AND THEIR POSITIONS

★

Senators Sam Nunn (D-GA) and
Pete Domenici (R-NM)
Cochairmen

Debra L. Miller, Senior Fellow, CSIS
Commission Director

Jerry E. Abramson, Mayor, Louisville, KY*

Dwayne O. Andreas, Chairman of the Board and Chief Executive, Archer Daniels Midland Company

Anne Armstrong, Chairman of the Board of Trustees, CSIS*

Edwin L. Artzt, Chairman of the Board and CEO, The Procter and Gamble Company

Richard C. Atkinson, Chancellor, University of California at San Diego

William E. Brock, President, The Brock Group*

Leo Cherne, Chairman Emeritus, International Rescue Committee*

William F. Connell, Chairman and CEO, Connell Limited Partnership

Jim Cooper, U.S. House of Representatives (D-TN)

Thomas H. Cruikshank, Chairman of the Board and CEO, Halliburton Company

Michael L. Dertouzos, Professor and Director, MIT Laboratory for Computer Science

Richard J. Elkus, Jr., Chairman, Prometrix Corporation*

Joseph A. Fernandez, Chancellor, New York City Public Schools*

Stephen Friedman, Cochairman and Senior Partner, Goldman Sachs & Company

Robert W. Galvin, Chairman of the Executive Committee, Motorola, Inc.

Jack C. Gardner, President, The Gardner Group, Ltd.*

Richard N. Gardner, Professor, Columbia University Law School; Of Counsel, Coudert Brothers

David R. Gergen, Editor-at-Large, U.S. News and World Report

Joseph T. Gorman, President and CEO, TRW Inc.

William H. Gray III, President and CEO, United Negro College Fund

Richard C. Green, Jr., Chairman and President, UtiliCorp United

Maurice R. Greenberg, Chairman, American International Group, Inc.

Kent H. Hughes, President, Council on Competitiveness

John P. Imlay, President and CEO, Dun & Bradstreet Software

Manuel H. Johnson. Koch Professor, International Economics, George Mason University*

Fred Krupp, Executive Director, Environmental Defense Fund*

Jim Leach, U.S. House of Representatives (R-IA)

Joshua Lederberg, Professor and President Emeritus, The Rockefeller University

Jerry Lewis, U.S. House of Representatives (R-CA)

Russell B. Long, Partner, Long Law Firm; former U.S. Senator (D-LA) 1948-1986

Diana MacArthur, Chair and Chief Executive Officer, Dynamac Corporation

Maria Monet, Director, Ogden Corporation Board of Directors

Sue Myrick, President and CEO, The Myrick Agency; former Mayor, Charlotte, NC 1987-1991

Al Narath, President, Sandia National Laboratories

Paul H. O'Neill, Chairman and CEO, Aluminum Company of America

Richard E. Peck, President, University of New Mexico

Rudolph G. Penner, Director of Economic Studies, KPMG Peat Marwick; former director, Congressional Budget Office

Heinz C. Prechter, Chairman and Chief Executive, ASC Incorporated

Frank Press, President, National Academy of Sciences

Thomas J. Pritzker, President, The Hyatt Corporation

Susan F. Rasky, Visiting Professor, University of California at Berkeley*

Norman B. Rice, Mayor, Seattle, WA

Alice M. Rivlin, Senior Fellow, The Brookings Institution; former director, Congressional Budget Office

John D. Rockefeller IV, U.S. Senator (D-WV)*

Barry K. Rogstad, President, American Business Conference

Warren Rudman, U.S. Senator (R-NH)

Howard D. Samuel, President, Industrial Union Department, AFL-CIO*

Isabel V. Sawhill, Senior Fellow, Urban Institute*

John C. Sawhill, President and CEO, The Nature Conservancy

James Schlesinger, Counselor, CSIS

Albert Shanker, President, American Federation of Teachers*

William E. Simon, Chairman, William E. Simon and Sons, Inc.*

Alan Simpson, U.S. Senator (R-WY)*

Laurason D. Thomas, Executive Vice Chairman, Amoco Corporation*

Barrie A. Wigmore, Private Investor and Author

Andrew Young, Chairman, Law Companies International Group; former Mayor, Atlanta, GA 1982-1990

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* Commissioners who have separate statements in the Appendix.

WHY AMERICA MUST CHANGE COURSE

"If you don't change your direction, you'll wind up where you're headed."

— Commission member Dwayne O. Andreas

CEO, Archer Daniels Midland

The last four years have been an extraordinary time to be an American. We have seen rival governments and economic systems topple and unravel in virtually all of Eastern Europe and parts of Asia. Without its foes firing a shot, the Soviet Union, with the strongest army in the world, collapsed. No amount of military might could substitute for a government that did not work, an economy that could not produce, and a social policy that repressed the identities and aspirations of different nationalities and individual citizens. From these events, America has emerged as the sole superpower.

Our unchallenged preeminence in the world, however, has not left us altogether settled on our future course, nor free of internal problems. There is clear and increasing evidence that our own political and economic systems, though still resilient, must be strengthened. Our ability to continue to lead globally will be determined by our ability to put our own house in order.

We must change our course here at home in the 1990s. The facts are simple. We have the largest economy in the world, but we have vulnerabilities that run far deeper than the last recession. These weaknesses will continue to erode our economic strength and further burden future generations. Addressing these vulnerabilities will require reforms that will be painful at first.

If the United States is to strengthen its human resource base, educational standards must be tougher and children must study harder. If the country is to increase its level of saving, our political leaders must make some tough choices about how to balance the federal budget. If more U.S. businesses are to become globally competitive, they must develop new management practices and new production methods.

If we make these reforms, we can turn the country around, regain momentum, and provide for long-term growth and prosperity. We will not only be more successful at home but we will continue to provide constructive leadership in the world. The choice is ours.

STAGNANT PRODUCTIVITY GROWTH AND OUR STANDARD OF LIVING

The economist Paul Krugman notes wryly that "productivity isn't everything, but in the long-run, it is almost everything." Our standard of living, the competitiveness of our goods and services, and even our national power are all affected by how productive we are.

America is still the most productive country in the world. Using output per worker as the yardstick, the United States is more productive than either Germany or Japan. That means that every year, the average American worker produces more than the average German or Japanese worker.

Despite that success, most economists believe that productivity is the number one economic problem facing the United States. First, American productivity growth has slowed down considerably during the past 20 years, while the productivity growth of other major countries has accelerated. Second, for productivity to have real payoffs, companies must be strong in a few other key areas: excellent product quality; responsiveness to consumer preferences; and being first to market. Too many U.S. companies have been weak in these areas, and that weakness is playing a large role in the actual economic performance of our nation.

The slowdown in productivity growth has had major consequences for our standard of living. During the 1950s and 1960s, American productivity growth rates in the business, non-farm sector averaged 2.5% per year. As a consequence, real wages and living standards doubled every 28 years, or once a generation. Thus, in the 1950s and 1960s, most Americans could look forward to an ever-growing income stream for themselves and be optimistic about the earnings prospects of their children.

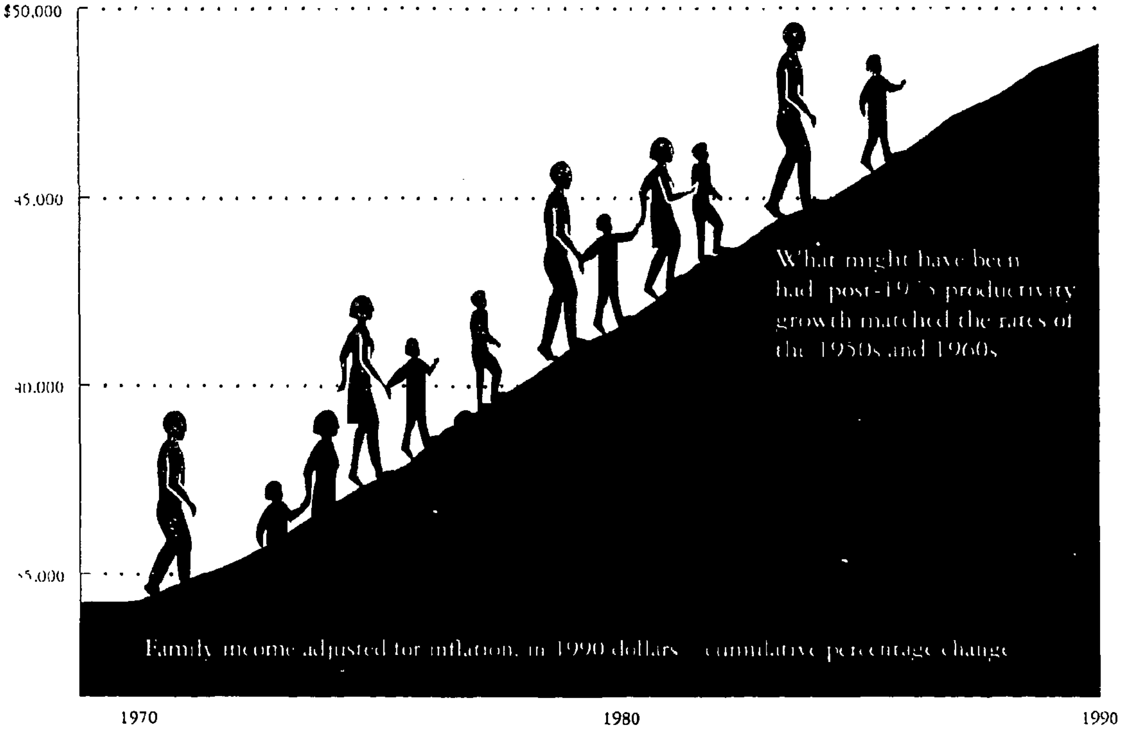
In 1973, however, productivity growth rates dropped abruptly; since 1979 they have averaged about 1% a year. As a consequence, the average American real income stagnated during the 1970s and 1980s. In fact, many families found that the only way to make ends meet was to have two wage earners rather than one. The numbers tell the painful story: in 1970, the typical family income (in 1990 dollars) was about $33,000. By 1990, this figure had grown by only $2,000. If productivity growth in the 1970s and 1980s had kept pace with its growth in the 1950s and 1960s, the typical 1990 family income would have been more than $47,000 (see Figure 1).

FIGURE 1

Most American families' incomes have stagnated since the early 1970s.

Families in the 1950s and 1960s could look forward to an ever-growing income stream because American productivity growth rates were healthy. In 1973, however, the productivity growth rate dropped significantly and never rebounded. Had post-1973 productivity growth matched the much higher rates of the 1950s and 1960s, family income in the 1970s and 1980s would not have stagnated — it would have grown. In fact, we could have expected that the typical 1990 family income of approximately $35,000 would have instead been over $47,000, an increase of 34%.

Source Isabel Sawhill and Mark Condon. "Bidding War–or Growth" *The Washington Post*. February 27, 1992. p A19



Source Census Bureau

MANUFACTURING PRODUCTIVITY AND SERVICE SECTOR PRODUCTIVITY

There is some recent good news in the productivity statistics, but it comes only from the manufacturing side of our economy. During the past decade, U.S. manufacturing companies have rebounded from 1970s lows to a more healthy 3% productivity growth rate per year. Nevertheless, productivity growth in the manufacturing sectors of Japan, Germany, Sweden, France, Great Britain, and Italy is still higher than it is in the United States.

The productivity growth of our service sector, which employs more than three-quarters of our work force, has not kept pace with manufacturing. The service sector is extremely diverse and includes business, financial, and legal services; amusements and recreation; telecommunications; insurance; real estate; government; medical care; education; the police force; public interest advocacy groups; religious establishments; and retail trade.

The sheer diversity of the service sector makes it difficult to generalize about the causes of its slow productivity growth. One explanation is that parts of the sector are characterized by little or no competition. For example, many government agencies and many non-profit organizations are not forced to become more efficient every year to remain viable — other institutions are not competing with them to provide similar services.

A second is that the service sector has been less able than the manufacturing sector to reap gains from new technology. For example, despite hefty investments in computers in the 1980s — at the rate of $9,000 per worker — the service sector showed very little productivity gains — less than two-tenths of a percentage point per year. Whether this is an intrinsic weakness of the sector or one that could be remedied by better management practices and greater investments in work force training is an open question.

There is, however, a growing body of opinion that productivity in the service sector is stronger than the statistics say it is. The data on service sector productivity just aren't very good. Statisticians and economists have yet to come up with good measures for the productivity of a government bureaucrat, a college professor, a telephone operator, a lawyer, or a doctor. A very common method of measuring productivity in the service sector is number of phone calls made per day. Clearly, this measure is inappropriate as a measure of productivity for many service subsectors.

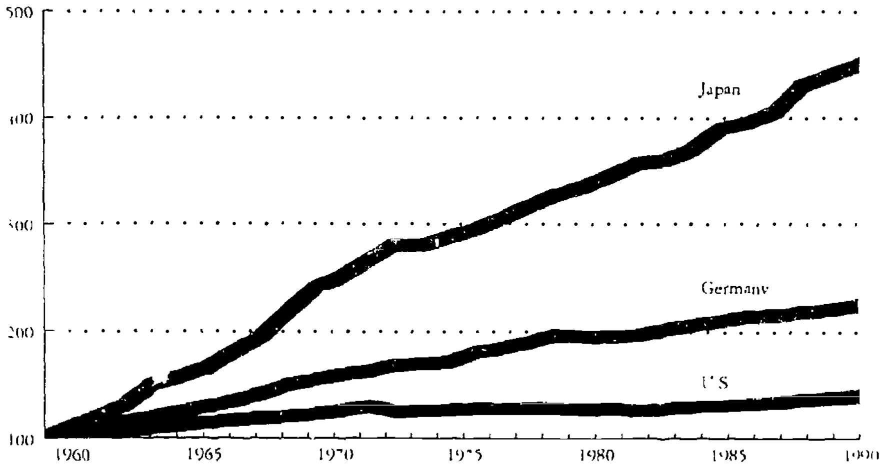
PRODUCTIVITY GAINS TRANSLATE INTO GREATER GLOBAL MARKET SHARE

Despite the difficulties in measurement, it can safely be stated that our major competitors' productivity growth rates are increasing at a faster rate than ours (see Figure 2). In fact, in certain economic sectors, Japan is simply more productive than the United States. Japanese companies that produce automobiles, steel, electric machinery, and electronic equipment are generally more productive than American companies that produce these goods. U.S. companies retain the lead in, among other sectors, agriculture, petroleum and coal refining, paper, printing and publishing, machinery (except electrical machinery), utilities, and processed food. Usually, but not always, companies that are more productive can translate their efficiency into a greater share of the global market.

This brings us to the second reason why economists worry about U.S. productivity. Some foreign companies that are less productive than their U.S. counterparts are sometimes more successful in the global

FIGURE 2

America's productivity growth rate is below that of our major competitors.



Index of GDP per Employed Person, 1960=100, U.S. 1990 Dollars

Source: U.S. Department of Labor, Bureau of Labor Statistics, Office of Productivity and Technology (January 1992) unpublished data marketplace. Why? Because even some of our most productive companies are weak in the areas of quality, responsiveness to consumer preference, and being first to market. These factors have an enormous effect on a product's acceptance in global markets and ultimately our workers' standards of living. For example, U.S. automakers chose not to be the first to this market with smaller cars in the 1970s. That decision, coupled with fewer defects and lower costs of Japanese cars, played a key role in increasing Japanese market share in the U.S. auto market, even though U.S. productivity — output per worker — was higher.

> "Productivity means nothing if all you can do is manufacture products others won't buy."
>
> *Richard J. Elkus, Jr., Chairman, Prometrix Corporation*

What will it take to make the U.S. companies more productive? A variety of factors influence productivity growth, but the consensus is that one factor outweighs most others: investment. Specifically, investment in plant and equipment, research and development (R&D), infrastructure, and human resources through education and work force training all determine productivity. And, increased investment in human resources demands improvements in management practices, such as planning for the long term, use of the "quality approach," and encouragement of teamwork.

It's too easy to say we need more investment in machines, bricks, and mortar. We need to invest in people — the true source of ideas and solutions. Combining this with the more traditional forms of investment will increase our standard of living, increase the global competitiveness of U.S. products and services, and solidify America's position as a world leader.

This report tackles this two-part investment approach, first by identifying what we need to do, and then by spelling out an action plan.

THE NEED TO ENCOURAGE SAVING

NATIONAL SAVING

National savings are the sum of all savings done by individuals, businesses, and governments (local, state, and federal) in the country. Daniel Yankelovich notes that most people think that "personal saving is bad for the economy because it takes money out of circulation....While experts call for greater savings to fuel investment, the public, with its focus on consumption, believes that greater savings will slow the economy down and cause America to fall further behind." Such persistent short-term thinking will not solve persistent long-run problems.

What are savings? They are funds that are taken out of current income for the purpose of financing the future. Said another way, savings are deferred spending — deferred so that greater consumption will be possible in the future.

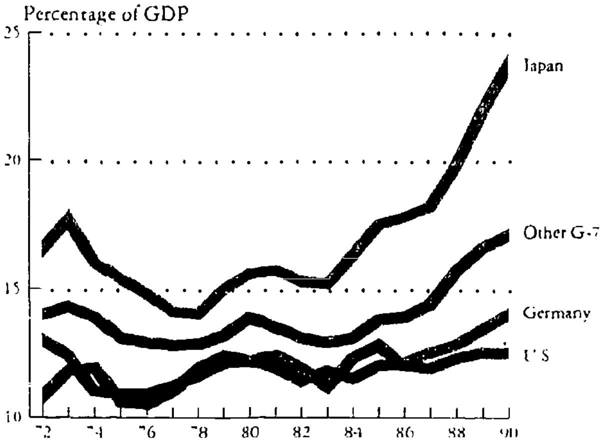
Foreign investment aside, national savings equal national investment. A low level of savings results in reduced economic growth, low productivity growth, and fewer jobs. In contrast, a high savings rate permits more investment in plant and

FIGURE 3

As a percentage of GDP, the U.S. invests less in some of the key factors that could increase its productivity — plant and equipment and R&D — than other G-7 countries

INVESTMENT

Private Industry Expenditure on Plant and Equipment



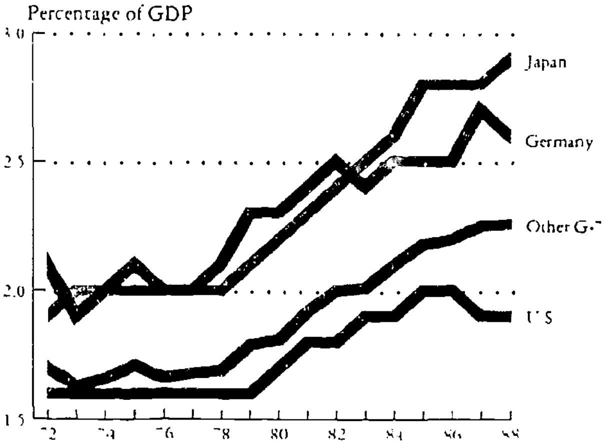
Source Council on Competitiveness and OECD National Accounts
Taken from Council on Competitiveness. *Competitiveness Index 1991*
(Washington, D.C. Council on Competitiveness. July 1991), p.8

FIGURE 4

Both Japan and Germany spend a greater percentage of their GDP on civilian R&D.

INVESTMENT

Non-Defense R&D Expenditure (public and private)



Source Council on Competitiveness and National Science Foundation (NSF)
Taken from Council on Competitiveness, *Competitiveness Index 1991*
(Washington, D.C. Council on Competitiveness, July 1991), p.9

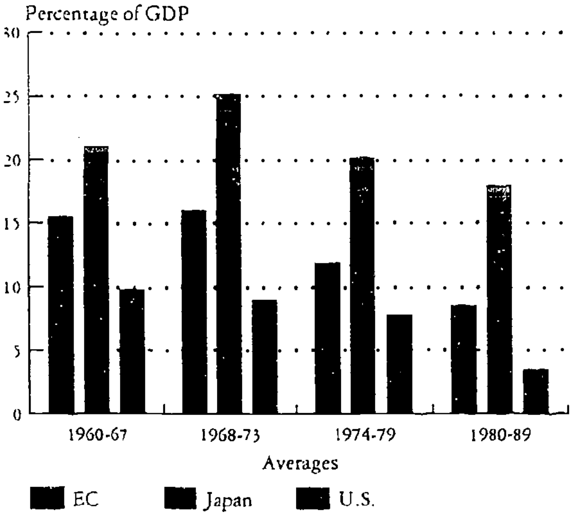
equipment, R&D, improvements in process technologies, education and training, and traditional and high-technology infrastructure — all of which are needed for accelerated productivity growth and a growing standard of living. However, the U.S. invests less as a percentage of its gross domestic product (GDP) in plants, equipment, and R&D than most other industrialized countries (see Figures 3 and 4).

The U.S. net national savings rate is at an all-time low: it plummeted from an average of 9.8% of GDP in the 1960s to an average of 3.6% in the 1980s. In contrast, Japan and the EC countries save at a rate of well over 10% of their GDPs (see Figure 5).

FIGURE 5

The U.S. saves less than its major trading partners.

NET NATIONAL SAVING AS A PERCENTAGE OF GDP



Source: Organization for Economic Cooperation and Development, *Economic Outlook, Historical Statistics, 1960-89*, p. 78

A fall in personal savings rates explains part of the decline in our national savings rates. American families saved close to 10% of their incomes 20 years ago; now they save at roughly half that rate.

The primary reason for the decline in the national savings rate, however, is not private behavior; two-thirds of the decline in the national savings rate is due to the growing federal budget deficit. A low personal savings rate puts us at a disadvantage. But huge continuing government budget deficits threaten to turn disadvantage into disaster.

When the national savings rate is low, businesses must compete with the government to borrow saved money, and they are less able to make investments in plant and equipment, R&D, and worker training. Or, they must borrow from better savers — foreigners. In the 1980s, domestic investment was heavily fueled by foreign capital; that is why capital investment as a percentage of GDP decreased less rapidly than our national savings rate.

But reliance on foreign capital will be more difficult in the 1990s than it was in the 1980s. German unification and the dissolution of the former Soviet empire in Eastern Europe have focused many potential investors on investment opportunities in that part of the world. Developing nations such as Mexico are also becoming a magnet for foreign investment. Japan's internal economic difficulties have already had a dampening effect on Japanese investors' willingness and ability to invest in the United States. The Japanese stock exchange has lost 60% of its value, compared to its peak in 1988; Japanese investors have lost money in dollar-denominated equity investments because of fluctuations in the exchange rate; and Japanese investors who bought at the top of the American real estate market have taken losses. For all of these reasons, there may be less foreign capital available for investment in the United States in the 1990s.

How do we encourage more saving? Quite simply, we make changes in both U.S. tax and fiscal policies. Our current tax laws make it more attractive for companies to go into debt than to expand investors' equity; they encourage households to borrow and spend money and punish them for saving; they penalize U.S. companies in international trade, compared to our foreign competitors. Finally, the huge federal budget deficit diverts the little private savings there are away from productive investment in the future, principally to pay for public consumption in the present. To encourage saving, government needs to set the model with spending and borrowing philosophies.

FISCAL RESPONSIBILITY

Federal budget deficits are sapping the strength of our country. When the Treasury spends money it doesn't have, it must borrow money from U.S. citizens, corporations and businesses, and foreign investors. These borrowings absorb private savings that otherwise would be available for private investment. Less money available for investment means less investment in modern equipment and factories, less productivity, and less economic growth. Everyone loses.

Deficits matter because they reduce net national savings. Deficits must be funded with borrowing, and this means the government must pay interest to those who have lent it money. Interest accounts for an ever growing percentage of total federal outlays. Net interest on the national debt — the accumulation of past deficits — will be more than $200 billion this year. That makes interest the third largest "program" in the budget. Only defense and Social Security are larger — our net interest payments are roughly equal to total domestic discretionary spending. We may debate whether to spend more on infrastructure or education, but that money is already earmarked for servicing the debt.

The deficit results in a distortion of spending priorities. Just as the private sector has less money to invest, so too does the government have less money to invest in public programs and projects designed for long-term economic growth. As a consequence, resources are limited for highways and public infrastructure programs, education, and training programs, all important for increased private and public sector productivity. To take another example, the Social Security system supposedly was placed on a "sound financial basis" through program reform and payroll tax increases in 1983. The 1983 amendments were intended to build up a reserve in the Social Security Trust Fund so that when the time comes for the baby boom generation to retire, the nation would have the Trust Fund to pay the benefits. But now we've cracked into that bank, too, and we're spending the reserves for non-Social Security functions. Sure, that reduces our need to borrow money now, but we're mortgaging our future. When we have to pay back the Social Security Trust Fund — about 20 years from now — large tax increases or benefit cuts will likely be required.

Deficits matter because the costs and perils associated with being the world's largest debtor nation (which the United States has been since the mid-1980s) include a permanent loss of United States investment capital, and the risk of a weakened economy lessening the attractiveness of foreign capital investment. And, being indebted to other countries, we are subject to increased constraints on the independent conduct of our economic and foreign policies, and we are left more vulnerable to decisions made abroad.

Deficits matter because they are the most prominent example of our inability to come to grips with important public issues. Deficits and debt are concrete evidence of the gridlock and stalemate that afflict our public institutions. Philosophically, they feed into a societal attitude of being a nation unable to live within its means.

Both American voters and our trading partners are frustrated with our political system's seeming inability to deal with these issues. Solving the deficit problem would contribute to savings and productivity and help restore confidence in our political system.

DIMINISHED RETURNS FROM INVESTMENTS IN HUMAN RESOURCES AND MANAGEMENT

EDUCATION

America's elementary and secondary education system, once the envy of the world, is performing well below the best international levels. Too few schools and parents insist that their students meet high standards, too few colleges set rigorous entry requirements, and too few employers demand evidence of educational achievement from high school graduates seeking jobs.

Low educational achievement is a particularly acute problem in our urban centers, where the crises of poverty and family and community disintegration compound the woes. But the problem is not only urban, it is national: from rural communities to our most advantaged districts, American schools are failing to produce a sufficient percentage of students with the high-level knowledge, skills, and motivation necessary for informed citizenship and for a strong, globally competitive economy.

A well-educated and highly skilled population is key to a high standard of living. U.S. productivity growth declined during the past two decades in part because the skills of American workers failed to keep up with increasingly complex technology. During the past decade, manufacturing wages declined for the first time since World War II. Increasingly, we're becoming a nation that competes in the international marketplace because we're cheap — not skilled.

In contrast, our major competitors have made the necessary investments in education and in work force training and have experienced an increase in real wages. In these countries the workplace is organized very differently than ours. Workers' skills are constantly being developed, used, and upgraded. A greater percentage of workers in these countries can compete on the basis of high skills rather than low wages.

Despite its crucial relationship to productivity and competitiveness, our educational system is often neglected. The public bemoans the state of American schools, but few are willing to accept sacrifices in order to do something about it. Bearing the costs of achieving quality education is unattractive to the three-quarters of all taxpayers who do not have children in school. Even parents of school children are often unwilling to vote to raise their own taxes to improve their schools.

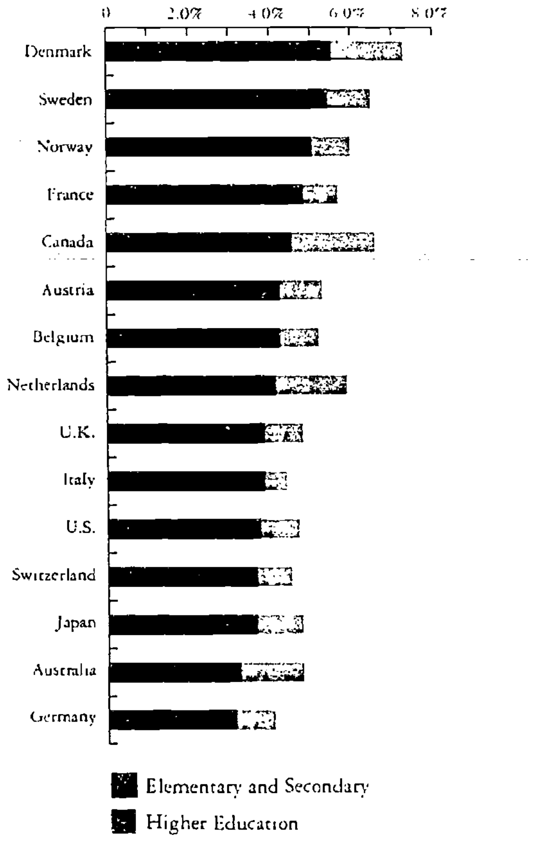
When school bond issues are defeated, when athletics win over academics, when television consumes 25% of the waking hours of students, and when many colleges and employers are indifferent to high school achievement, is it surprising that our educational system is performing so poorly?

As a nation, we have made substantial investments in education. The United States invests more in higher education than any other country. Among advanced industrialized countries, the United States ranks eleventh in public spending on elementary and secondary education as a percentage of GDP, and sixth in public spending on education per pupil (see Figures 6 and 7). In addition, our nation funds parochial and independent school systems and those funds are not included in these international comparisons.

But these substantial investments are not paying off the way they should. Not all school districts are adequately funded. In many districts where funding has increased, people feel rightly that more spending does not equal better results. Education dollars that reach public schools are not always wisely or efficiently allocated. Our schools choke on bureaucracy and administrative inefficiency. There is a pervasive lack of standards and discipline. Consider the evidence:

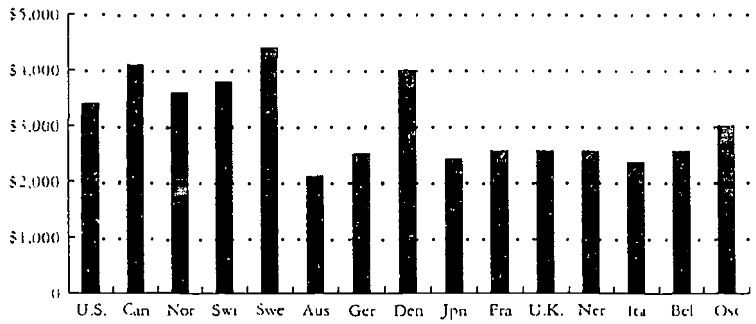
- U.S. students are simply not learning what they need to

FIGURE 6
PUBLIC SPENDING ON EDUCATION AS A PERCENT OF GROSS DOMESTIC PRODUCT
(Current Expenditures)



Source *International Comparison of Public Spending on Education* American Federation of Teachers, AFL-CIO (Washington, D.C. AFT, February 1991), p. 15

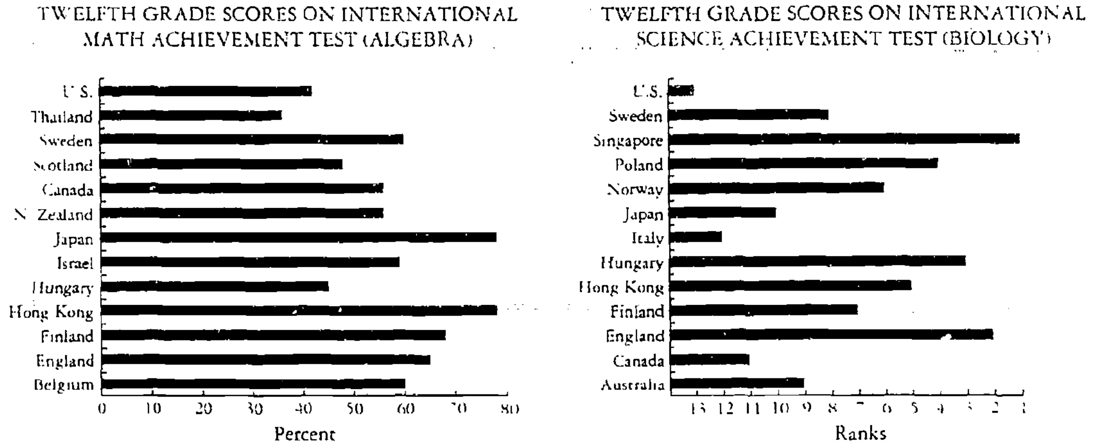
FIGURE 7
PUBLIC SPENDING ON EDUCATION PER PUPIL



Note All figures in U.S. dollars using Purchasing Power Parities for currency conversion
Source *International Comparison of Public Spending on Education* American Federation of Teachers, AFL-CIO (Washington, D.C. AFT, February 1991), p. 16

FIGURE 8

U.S. students rank nearly last in math and science in international comparisons.



Source: International Association for Evaluation of Educational Achievement. Reprinted from *Changing America: The New Face of Science and Engineering*, Task Force on Women, Minorities and the Handicapped in Science and Technology, 1988.
Taken from Council on Competitiveness. *Picking Up the Pace: The Commercial Challenge to American Innovation.* Washington, D.C.: Council on Competitiveness, September 1988, p. 22

know to compete and prosper in today's global economy. In comparison to students in other industrialized countries, our students, by many measures, rank at or near the bottom in math and science (see Figure 8).

- In the United States, teaching may as well be considered a second-rate profession in terms of educational preparation, licensing requirements, pay, status, or professional development. Few prospective elementary school teachers are required to have even a rudimentary background in science and math and in how to teach those subjects. Only half of our math and science teachers are certified in their subjects, and only half of our high schools have physics teachers.
- More than one out of five U.S. students leave school before receiving a high school diploma. Only one-third of those who leave early will obtain a high school diploma or its equivalent by their mid-thirties. In our inner cities, more than half of the students drop out before graduation.

"The reason our kids are not learning as much as kids are in other countries is that they are not working as hard — because nothing seems to be at stake. Nobody is denied entrance into 95% of our institutions of higher education because they do not know something."

Albert Shanker, President, American Federation of Teachers

Does Education Pay Off?

Dropping out is one of the costliest decisions a young person can make. According to the Census Bureau, in 1990, those without a high school diploma had a mean monthly paycheck of $452; high school graduates earned $921; vocational degree holders earned $1,088 per month. Those with an associate degree earned $1,458; those with a bachelor's degree earned $1,829. As the numbers suggest, the poverty rate among high school dropouts is significantly higher than for high school graduates, and that rate is increasing.

"We've got to give the young people a chance early on in life to develop what they want to be. Do they want to be academics, do they want to be technicians, do they want to be engineers? They should have the opportunity to pursue each of these worthwhile paths."

Heinz C. Prechter, Chairman and Chief Executive, ASC Incorporated

- Our educational system virtually abandons the 50% of our young people who can not or will not go to college. Our high schools do little to prepare students for work or to guide them in making choices. Compared to many European countries, the American apprenticeship system is narrow in content and minuscule in coverage — it serves less than 1% of the work force. There is no widespread, formal system of education and training for service or manufacturing trades and technical professions. Our non-college bound students are left to sink or swim on their own. Many sink.

- Many are given the same daunting choice when they report for work. Only 11% of all employees receive any formal training from their employers to prepare for their jobs, and fewer receive formal training to upgrade their skills once they are on the job. Although some employers do not believe they have a shortage of skilled workers, this is largely because they rely on production methods that do not require high skills. Our most successful companies have moved to high-productivity, "lean production" manufacturing processes that depend on high skills, innovation, and flexibility.

If our companies are to be competitive, more must adopt the high-skills approach. If our students are to prosper, they must obtain the skills needed by our most successful workplaces.

The High Skills Workplace

The mass-producer uses narrowly skilled professionals to design products made by unskilled or semiskilled workers tending expensive, single-purpose machines. The workers churn out standardized products in very high volume. Because the machinery costs so much and is so intolerant of disruption, the mass-producer adds many buffers — extra supplies, extra workers, and extra space — to assure smooth production. Because changing over to a new product costs even more, the mass-producer keeps standard designs in production for as long as possible. The result: The consumer gets lower costs, but at the expense of variety and by means of work methods that most employees find boring and disrupting.

The lean producer, by contrast...employ[s] teams of multiskilled workers at all levels of the organization and use[s] highly flexible, increasingly automated machines to produce volumes of products in enormous variety....Perhaps the most striking difference between mass production and lean production lies in their ultimate objectives. Mass-producers set a limited goal for themselves — "good enough," which translates into an acceptable number of defects, a maximum acceptable level of inventories, a narrow range of standardized products. To do better, they argue, would cost too much or exceed inherent human capabilities.

Lean producers, on the other hand, set their sights explicitly on perfection: continually declining costs, zero defects, zero inventories, and endless product variety. Of course, no lean producer has ever reached this promised land — and perhaps none ever will, but the endless quest for perfection continues to generate surprising twists.

For one, lean production changes how people work but not always in the way we think. Most people — including so-called blue-collar workers — will find their jobs more challenging as lean production spreads. And they will certainly become more productive. At the same time, they may find their work more stressful, because a key objective of lean production is to push responsibility far down the organizational ladder. Responsibility means freedom to control one's work — a big plus — but it also raises anxiety about making costly mistakes....Lean production calls for learning far more professional skills and applying these creatively in a team setting rather than in a rigid hierarchy.

Taken from James P. Womack, Daniel T Jones, and Daniel Roos. *The Machine That Changed the World* (New York: Rawson Associates, 1990), pp. 13-14.

MANUFACTURING AND MANAGEMENT

Although labor productivity growth rates in the U.S. manufacturing sector improved in the 1980s (see Figure 9), too many American companies still need to sharpen their competitive edge in manufacturing — in "making things." A strong manufacturing base is critical to our country's national defense, economic well-being, and a favorable balance of trade.

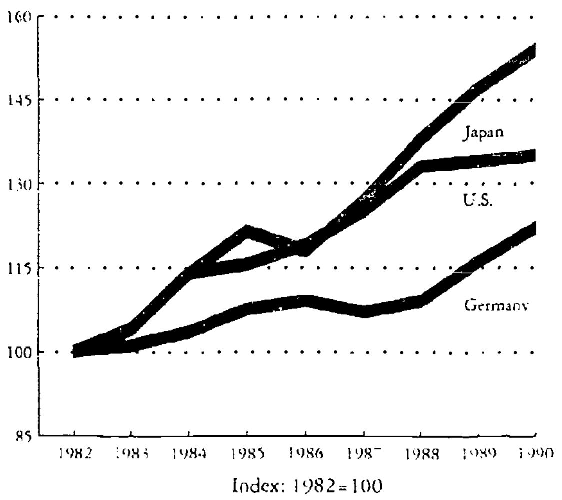
- Almost one-quarter of all Americans are employed in manufacturing. Traditionally, manufacturing has contributed many of the high-wage jobs in our economy.

- The increase in U.S. exports in the late 1980s can be directly attributed to increased exports of U.S. capital goods such as industrial machinery and computers as well as chemicals and aircraft. If we are to remain a strong exporter, our manufacturing base must remain strong.
- Although manufacturing is less than one-fourth of our GDP, more than 80% of all private research and development is done by manufacturing companies. These companies are thus agents of technological change and modernization.
- The health of the service sector is highly dependent on the health of the manufacturing sector, which is the major customer and supplier for service enterprises.

"Prowess in research does not lead automatically to commercial success. New ideas must be converted into products that customers want, when they want them, and before competitors can provide them, and the products must be made efficiently and well."

Michael L. Dertouzos, Professor and Director, MIT Laboratory for Computer Science

FIGURE 9
MANUFACTURING LABOR PRODUCTIVITY GROWTH RATES



Source: U.S. Department of Labor, Output per Hour, Hourly Compensation, and Unit Labor Costs in Manufacturing, Twelve Industrial Countries, 1960-1990, and Unit Labor Costs in Korea and Taiwan, 1970-1990 (Washington, D.C.: Bureau of Labor Statistics, Office of Productivity and Technology, February 5, 1992), p. [illegible]

For example, as good as American companies have been at invention, they are not nearly as fast or as effective as their competitors in turning inventions into high-quality products and then getting those products into the hands of consumers. We run to discovery, and then we walk to production: U.S. companies spend twice as many resources on the development of new product ideas as they do on the process technologies to manufacture the products themselves. Foreign companies, especially in Japan and Germany, have been more successful in commercializing some American inventions than U.S. companies have: the color television, the VCR, and the fax machine were all invented in America, but U.S. companies do not make these products any longer. As a result, we have lost markets and jobs.

Beyond time-to-market problems, many U.S. companies — in both service and manufacturing sectors — face two additional management issues.

First, American companies were relatively slow to embrace the "total quality approach." Fascinated by the teachings of W. Edwards Deming, the American statistician, Japanese companies began using this approach in the 1950s and perfected it in the 1970s by concentrating on achieving customer satisfaction and driving out defects, waste, and rework to gain a competitive advantage in quality.

American executives who brought the total quality approach to their companies are enthusiastic about its benefits. Commission member Edwin Artzt, CEO of Procter and Gamble, suggests that "the adoption of total quality systems throughout American business and industry should become a national priority." Commission member Robert Galvin, chairman of the Executive Committee of Motorola, argues that all companies should compete for the Commerce Department's Malcolm Baldrige quality award. Clearly, more American companies need to embrace a total quality approach.

Second, there is clear justification for concerns over U.S. corporate time horizons. American companies often have shorter time horizons than many of their foreign counterparts, especially in Japan and Germany. Certainly the lower cost of capital in Japan and Germany in the 1980s and the relationship between Japanese and German companies and their banks allowed them to plan long term. In addition, the Japanese and German advantage in commercializing technology helped; the National Academy of Engineering in a recent study noted that "companies with deep and genuine competence in commercial application of technology will have a distinct advantage in adopting longer time horizons...because they are able to reduce...risk."

Government tax policy also has an impact on corporate time horizons. Our tax code encourages debt and mergers and acquisitions, providing incentives for companies to focus on short-term paper profits. We need only look at the record number of mergers, acquisitions, and leveraged buy-outs in the 1980s to understand how sensitive companies were to these incentives. In a survey of Japanese and American companies, American executives ranked return on investment "8" in importance (where "10" was the most important) and market share "2"; Japanese executives ranked return on investment "4" and market share "5." Unfortunately, the victims of American preoccupation with short-term return on investment have too often been core business health, long-term market development, and long-term profitability.

Finally, the Commission notes with concern the problems of small and medium-sized businesses. Their vitality is of paramount importance to the nation. During the 1980s, most of the new jobs, especially in urban areas, have been created by small and medium-sized businesses. These firms account for almost one-half of U.S. exports, and they produce about one-third of the value added in all U.S. manufacturing.

"Companies in their entrepreneurial phases have the aggregate potential for the rapid exploitation and diffusion of innovation, for high growth in employment, and for the aggressive creation of new markets and new industries."

John P. Imlay, President and CEO, Dun & Bradstreet Software

Nevertheless, small and medium-sized businesses face real challenges. They have been hit hardest by U.S. fiscal policies and our savings and loan crisis: during the past five years and the recent credit crunch, small and medium-sized firms have been unable to borrow or otherwise attract enough capital to adequately modernize their plant and equipment or to fund research and development. Preoccupied with the day-to-day problems of meeting delivery schedules and payrolls, managers of small firms often have little time to devote to learning new management techniques or new production processes. Small firms in which each worker's effort counts are even more vulnerable to declining skill levels of the work force than are large firms. For all of these reasons, small and medium-sized manufacturing enterprises suffered a decline in productivity in the 1980s, while the productivity of larger companies was increasing.

SCIENCE AND TECHNOLOGY

As a nation, the United States is very strong in science and technology. We produce world-class high technology products in areas from computers and satellites to industrial controls. Our nation's research institutions — both public and private — are an invaluable resource, with facilities and scientists among the best in the world. American scientists have won two-and-one-half times more Nobel Prizes than scientists of any other country of the world.

These strengths feed on themselves. So do weaknesses.

New evidence shows that the United States is falling behind the European Community and Japan in the development and application

FIGURE 10

Comparison of where the United States, EC, and Japan stand in 12 emerging technologies.

	JAPAN		EUROPEAN COMMUNITY	
	R&D	Product Information	R&D	Product Information
Advanced Materials	= ↓	— ↓	+ ↔	= ↔
Advanced Semiconductor Devices	= ↔	— ↓	+ ↔	= ↔
Artificial Intelligence	+ ↔	+ ↔	+ ↑	+ ↔
Biotechnology	+ ↓	+ ↓	+ ↑	+ ↔
Digital Imaging Technology	= ↓	— ↓	↓	— ↓
Flexible Computer-Integrated Manufacturing	+ ↔	= ↔	+ ↓	— ↓
High-Density Data Storage	= ↔	— ↓	+ ↔	= ↔
High-Performance Computing	+ ↔	+ ↓	+ ↑	+ ↑
Medical Devices and Diagnostics	+ ↔	+ ↓	+ ↔	+ ↓
Optoelectronics	= ↔	— ↓	↔	+ ↔
Sensor Technology	+ ↓	= ↔	+ ↔	= ↔
Superconductors	↓	— ↓	↔	↔

Current Status:
+ = U.S. Ahead
= = U.S. Even
— = U.S. Behind

Trend:
↑ = U.S. Gaining
↔ = U.S. Holding
↓ = U.S. Losing

} as compared to Japan EC

Source: Compiled from the knowledge residing within the Department of Commerce, mostly from contributions within the National Institute of Standards and Technology and the International Trade Administration.

Taken from *Emerging Technologies: A Survey of Technical and Economic Opportunities* (Washington, D.C.: U.S. Department of Commerce, Technology Administration, Spring [illegible]), p. [illegible] of several important emerging technologies that are critical to national security and economic success in the future (see Figure 10). This is a looming failure for our country.

In 1991, the National Critical Technologies Panel identified 22 technologies as being critical to national security and economic well-being (see Figure 11). Some of the technologies are familiar — biotechnology, advanced manufacturing, microelectronics, and high performance computing and networking. In the words of the National Critical Technologies Panel, "...critical technologies in materials, manufacturing and information/communications are the 'building blocks' for virtually all sectors of the economy." Losing the lead in critical technologies can jeopardize not only our ability to produce competitive products in that sector but our ability to develop related technologies in other areas.

For example, because we have already forfeited large segments of our consumer electronics industry, our ability to get into the production of emerging new technologies, such as high-definition systems, flat screen displays, and other imaging products that have large market potentials may be compromised because we now lack a consumer electronics manufacturing infrastructure in the United States.

FIGURE 11

National Critical Technologies

MATERIALS
- Materials synthesis and processing
- Electronic and photonic materials
- Ceramics
- Composites
- High-performance metals and alloys

MANUFACTURING
- Flexible computer integrated manufacturing
- Intelligent processing equipment
- Micro- and nanofabrication
- Systems management technologies

INFORMATION AND COMMUNICATIONS
- Software
- Microelectronics
- High-performance computing and networking
- Sensors and signal processing
- Data storage and peripherals
- Computer simulation and modeling

BIOTECHNOLOGY AND LIFE SCIENCES
- Applied molecular biology
- Medical technology

AERONAUTICS AND SURFACE TRANSPORTATION
- Aeronautics
- Surface transportation technologies

ENERGY AND ENVIRONMENT
- Energy technologies
- Pollution minimization, remediation, and waste management

Source: *Report of the National Critical Technologies Panel* (Washington, D.C.: National Critical Technologies Panel, March 1991), p. 3

The federal government's contribution to our R&D base has been of enormous importance to our national security, productivity, and economic growth during the past 50 years. Commercial spin-offs have often resulted from military R&D, and government-sponsored basic science research has had significant commercial returns, estimated at about 30%. Condensed-matter physics work led to the transistor; research on the microwave spectrum of ammonia led to the laser; the study of molecular biology — supported entirely by government basic research funds — led to the whole field of biotechnology.

Nevertheless, other governments approach science and technology with a more commercial focus than we do. Some carefully target key technologies. Ultimately, these strategies have paid off in the international marketplace. Most of our R&D budget goes to defense applications or to support basic science while, since the early 1980s, our federal R&D budget for civilian technology has stagnated. Unfortunately, U.S. companies overall have not picked up the slack; since 1990, their expenditures on R&D have remained flat, whereas those of Japanese companies have grown at a rate of 10% per year. We will continue to lose market share in high-technology sectors unless we invest not only in critical technologies development but also in the machinery, plant, and equipment to meet the market requirements for sophisticated volume products.

"In a day when continuous improvement means continuous improvement in manufacturing processes as well as product technology, the Japanese do provide that tax incentive, and we don't."

Joseph T. Gorman, President and Chief Executive Officer, TRW Inc.

THE CRISIS IN FEDERAL INSTITUTIONS

There's something wrong in Washington. Our nation's federal institutions were once regarded as a vital source of strength. Today, a disenchanted electorate views Washington with increasing cynicism and mistrust. The growing gap between our public servants and the public itself signals a potential crisis of confidence that cannot be ignored.

The lack of confidence in our government institutions has at least three sources. First, the problems facing the country are extremely difficult to solve and require that politicians make hard choices.

"We are in a period in which the competence of our national institutions and the values of the American people are being critically challenged."

Leo Cherne, Chairman Emeritus, International Rescue Committee

Unfortunately, politicians avoid taking these choices and voters don't hold them accountable. Divided government has served to exacerbate the problem of stalemate. For example, regarding the budget deficit, Commission member and former Director of the Congressional Budget Office Rudy Penner writes:

> *The basic problem is quite simple. It is fun to live on borrowed money. Deficit reduction brings nothing but pain in the short run, either in the form of higher taxes or less generous programs. No process can make painful options completely painless. Although process reforms may help at the margin, no such reforms can guarantee a solution to the deficit problem. It will take some courageous politicians to do that.*

The second reason underlying the current malaise about government has to do with government's posture toward business and the economy. Despite rhetoric to the contrary, it is not clear that the federal government has accepted the notion that furthering the competitiveness of U.S. industries is one of its principal missions or that the coordination of economic policies and programs is desirable. Economic policy-making and program implementation is dispersed among many federal agencies and many congressional committees. It does not always get the attention from the president that it deserves, and no one agency has the lead on issues that could roughly be characterized as "competitiveness issues." For example, 12 different agencies distribute civilian R&D funds. Depending on the issue, up to 20 different federal agencies make policy on international trade, only loosely coordinated by the U.S. Trade Representative's office.

Critics of the current policy-making process argue that it does not reflect the economic priorities of the nation and has caused business to view government more as an adversary than an ally. Commission member Hank Greenberg, CEO of American International Group, argues:

> *It is clear that the problems the United States faces include burdensome regulation and. in many cases. mindless regulation ill-suited to a world-class market economy. a fiscal policy that has driven the country to the brink of financial weak-*

> *ness, a litigiousness matched nowhere else in the world, and an inconsistency in trade policy that confuses American companies while providing our foreign competitors with significant advantages in world markets.*

A symptom of our society's current problems in making sound economic policy is its excessive reliance on expensive and ruinous litigation to solve everything from labor relations to environmental liability — more than 18,400,000 lawsuits were filed in 1990 alone. We need to rethink the policy-making process itself and the kinds of legislation and regulations that are created if we are to reverse that trend. One of the most horrendous examples is the Federal Superfund program, designed to clean up America's toxic waste sites. Superfund has been a gold mine for lawyers and consultants, but cleanup has been completed at fewer than 5% of the nation's 1,200 most dangerous waste sites. Why? Because an enormous amount of time and money has been spent in arguing over who should pay for the cleanup. While there is a legitimate role for regulation in society, well intentioned but badly-conceived programs merely invite mass litigation, rather than accomplish their worthy goals.

Thus, in their relations with government, U.S. business faces formidable obstacles to productivity, profitability, and competitiveness. American companies have been hampered by the lack of a coordinated approach to economic policy-making and by late and inadequate consultations about proposed government policies and regulations. One of the tests for proposed regulations and legislation should be the impact they will have on the competitiveness of industry and on the vitality of the economy. But business is too seldom given a chance to ponder that test.

Finally, and for a variety of reasons, it has become increasingly difficult to attract good people to government. In the 1950s and 1960s, more people viewed government careers as meaningful public service. Public and private salaries for entry-level professionals were nearly the same. Since the late 1970s, however, every presidential candidate has run on a platform "against Washington." The notion of public service is scoffed at. Salaries reflect the changed attitude: although pay reform legislation passed in 1990 acted as a corrective in some cases, the gap between public and private sector entry-level salaries for certain professions is still vast. The gap between public salaries for cabinet and subcabinet officials and their private sector counterparts is a yawning chasm, making it more and more difficult to attract excellent people to government.

★ ★ ★ ★

Those of us on the Commission who focus on domestic issues believe that the trends outlined on the preceding pages do not bode well for the long-term economic growth and social cohesion of our country or for the standard of living of most of our citizens. Those of us on the Commission who are from the foreign policy community are also concerned: the global influence of the United States ultimately rests on the strength of the U.S. economy. Our current course will most certainly not contribute to our economic strength and may ultimately cause its slow and steady erosion during the next decade. No international strategy can compensate for weaknesses at home. We have seen this illustrated all too vividly in the Soviet Union.

The Commission is confident that America has the talent, resources, ingenuity, and staying power to turn the situation around. What we need is a broad-based understanding of the reality behind our problems, the civic determination and political will to address them, and a plan of action, built on a consensus among our citizens, to confront them, full on.

A GROWTH PLAN TO STRENGTHEN AMERICA

I. GETTING OUR FISCAL HOUSE IN ORDER

"To preserve our independence, we must not let our rulers load us with perpetual debt."
—Thomas Jefferson

"It is fairer to tax people on what they extract from the economy, as roughly measured by their consumption, than to tax them on what they produce for the economy, as roughly measured by their income."
—Thomas Hobbes, English philospher (1588-1679)

"Given the centrality in our revolutionary origins of the precept that there should be no taxation without representation, it seems especially fitting in principle that we seek somehow to tie our hands so that we cannot spend our children's legacy."
—Laurence Tribe, Professor, Harvard Law School

Putting the U.S. economic house in order is at the top of the Commission's agenda to strengthen America. It is our nation's long-term economic performance, more than near-term recovery, that has commanded the Commission's attention. Our shared goal is improving this performance on an enduring basis through higher growth, increased savings, and greater productivity.

The Commission believes that two structural challenges hold the key to our nation's long-term economic vitality: bringing the budget deficit under control and revising the fundamentals of the U.S. tax code. These challenges have to be addressed in tandem. Both cut to the heart of our capacity to set priorities and allocate resources. Both are central to growth.

The costs of failing to put our fiscal house in order will not be felt as a single jolt but rather will continue to chip away at the nation's economic base. For example, economists at the Federal Reserve of New York estimate that the drop in savings during the 1980s — largely caused by the budget deficit and by families attempting to maintain their standard of living with no real growth in wages — has already cost the U.S. economy about 15% of its capital stock. That stock comprises buildings, machinery, plants, and equipment, which help to increase productivity, incomes, and wealth.

By contrast, if we can reduce the budget deficit and restructure the tax code to encourage saving, the payoffs will be far-reaching.

- Economically, putting our fiscal house in order will increase our level of national saving. The current tax code has a systemic tilt toward consumption that diminishes our nation's pool of savings. Eliminating this anti-saving bias should encourage more productive private investment. Just as important, the Treasury now borrows at the rate of $695,000 every minute, or $1,000,000,000 every day, to finance the deficit. Without that colossal burden, more money would be available for job creation and private sector investment, and at a lower cost. The federal government would also be in a better position to undertake the necessary investments in research and development, technology, education, and infrastructure that will strengthen our free enterprise system and increase the nation's productivity, standard of living, and competitiveness.
- Politically, putting our fiscal house in order will enhance the credibility of our federal institutions. Growing deficits reflect a lack of political courage on the part of Congresses and presidents. The maintenance of the status quo on taxes reflects a corresponding lack of vision. No one wants to make the hard choices. If our leaders agree to a course of action and actually see it through, there would be renewed faith in the ability of Washington to govern the nation.

FIGURE 12

How Big is the Budget Deficit?

Federal outlays this year will total close to $1.5 trillion—$1,500,000,000,000. One trillion is ten thousand times one hundred million.

The federal budget deficit this year will approach $330 billion—$330,000,000,000. That is almost four times as large as the entire budget of the largest state in the union, California. The federal government goes $1,000,000,000 deeper into debt every single day of the year.

There are only two U.S. companies that have gross sales of $100 billion per year.

If you had a stack of thousand dollar bills in your hand that was four inches high, you would be a millionaire.. You would need a stack of thousand dollar bills 64 miles high to have one trillion dollars.

The following pages analyze the dual challenges of budget deficit reduction and tax restructuring and propose a comprehensive plan to put the U.S. economic house in order.

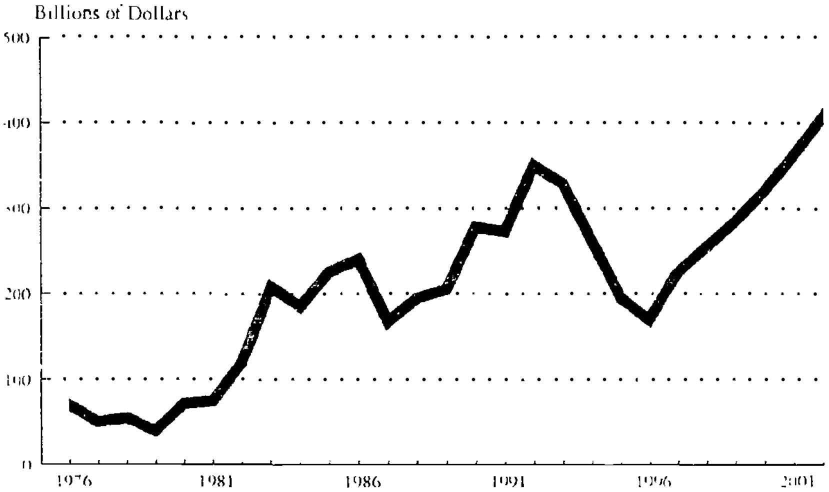
The Challenge: Deficit Reduction and Tax Reform

1. THE BUDGET DEFICIT OUTLOOK

The federal budget deficit matters. As staggering as the deficit numbers are now, they will get worse if we do nothing. Since the late 1970s, federal spending has grown rapidly — from $500 billion in 1979 to a projected $1.5 trillion this year. You would need a stack of thousand dollar bills 96 miles high to have $1.5 trillion (see Figure 12).

At the same time, the federal budget deficit has dramatically grown, and federal budget outlays, as part of GDP, have increased more than 15% since the late 1970s (see Figures 13 and 14). The deficit for 1979 was $38 billion. This year, the deficit is projected to be $330 billion. The Congressional Budget Office (CBO) predicts that the deficit will drop to about $200 billion annually as the recession ends and the bailout of the savings and loan industry is completed. But

FIGURE 13
FEDERAL BUDGET DEFICITS 1976-2002

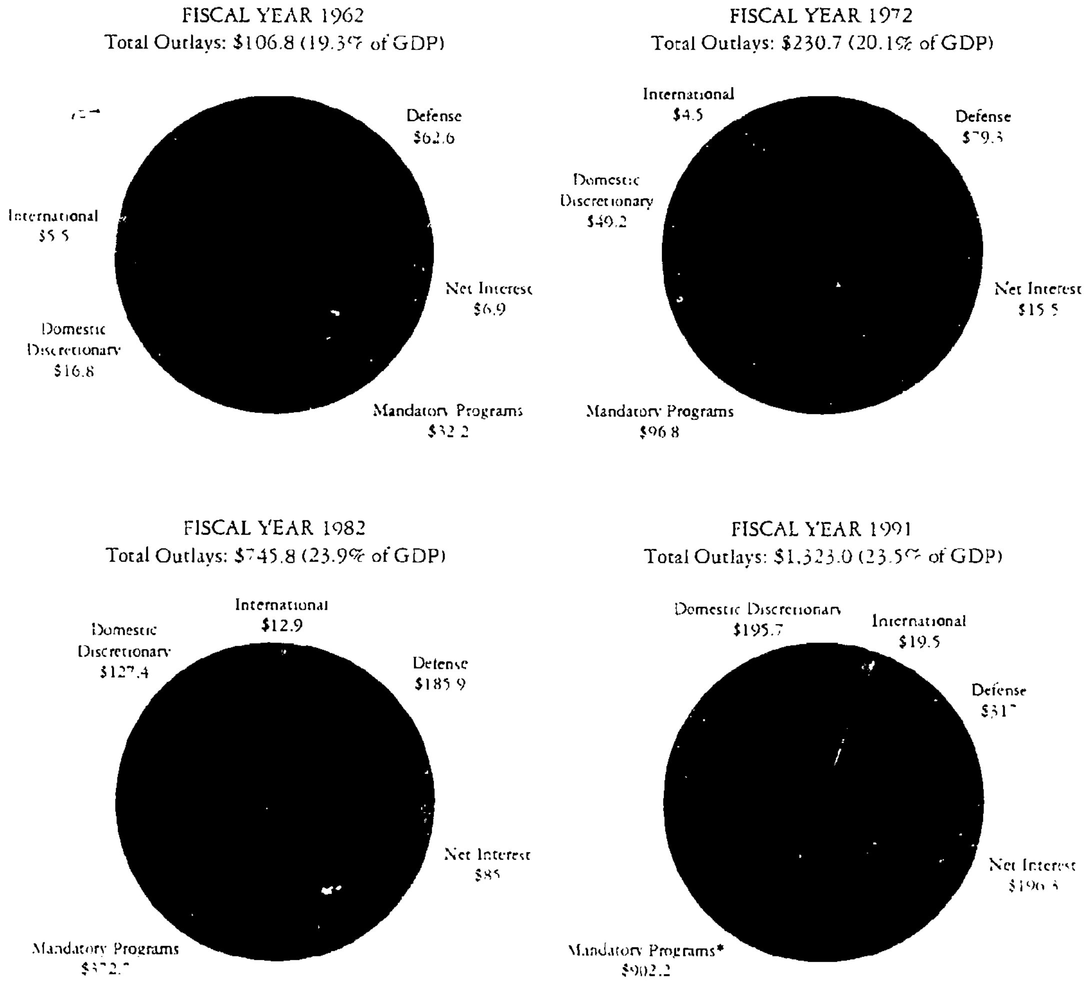


Source for years 19[illegible]-1990: Office of Management and Budget, *Budget of the United States Government, Fiscal Year [illegible]* (Washington, D.C.: Executive Office of the President, 19[illegible]), Part Seven-p. 18.
Source for years 1991-2002: Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years [illegible]* (Washington, D.C.: Congress of the United States, January 1992), pp. [illegible]

after that, budget deficits will begin climbing again, and by 2002 they will exceed $400 billion annually. Because slow growth, combined with rising health care costs and an aging population, will cause the deficit problem to get worse again in the latter part of the decade, a plan that purports to balance the budget in five years will not necessarily balance the budget for the long term.

Experts may differ as to specifics, but no one disputes the direction in which the deficit is heading. According to one recent Office of

FIGURE [illegible]
FEDERAL BUDGET OUTLAYS
(in billions of dollars)



*Includes $66.3 billion for deposit insurance

Source: Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years* [illegible] Washington, D.C.: Congress of the United States, January 1992, pp. 118-120
Note: Figures do not add up to total outlays due to offsetting receipts

Management and Budget projection, deficits could exceed $600 billion per year by the year 2000.

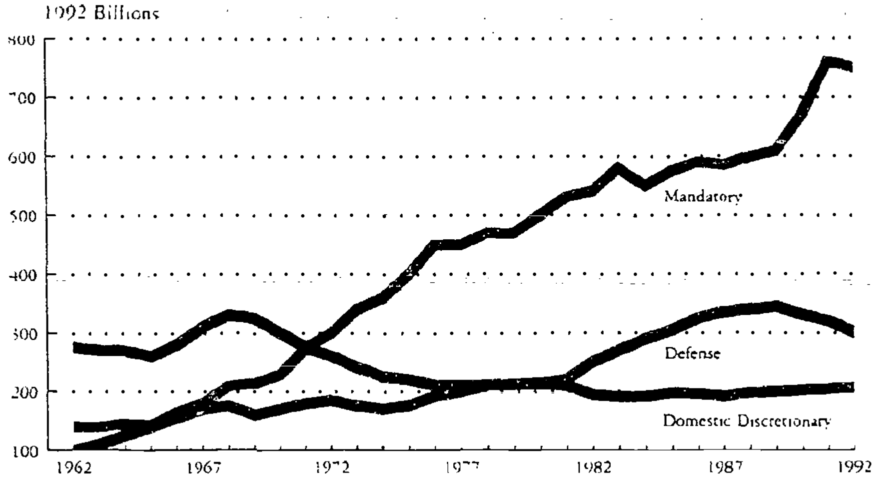
Unfortunately, even these predictions may be optimistic. They assume that an era of peace will continue and that the presence of large numbers of American troops will not be required in other parts of the world. They assume that real dollars spent on existing discretionary programs will not increase. In other words, on balance, there will be no additional federal dollars for infrastructure, education, or other such programs. They assume that no new crises — such as savings and loan bailouts, natural disasters, or another recession — will add to the deficit.

What programs account for most of the budget? (see Figure 14). Currently about 50% of the budget is devoted to mandatory programs such as Social Security, Medicare, Medicaid, farm supports, unemployment compensation, federal retirement programs, welfare payments, and food stamps. In the past, spending on mandatory programs has consistently exceeded projections.

These programs are classified as "mandatory" because no matter how high the price tag climbs, if people are by law eligible to receive the benefits, they do. The price tags of mandatory programs are determined by benefit levels and eligibility criteria written into permanent laws as well as by other factors such as provider costs — the fees that doctors and hospitals charge — and actual participation. Congress does not review spending on mandatory programs through its annual appropriations process. Sometimes mandatory programs are called "entitlements," because people who are eligible for them can file a claim against the U.S. Treasury if they don't receive the benefits they are due under the law. Changes in eligibility or benefit levels must be enacted into law to alter spending.

Defense programs are the second largest category of expenditures, making up about 20% of the federal budget, but they are declining. Interest payments on the national debt (the accumulation of past deficits) are the third largest item in the budget and are increasing

FIGURE 15
DOMESTIC DISCRETIONARY, DEFENSE OUTLAYS, AND MANDATORY SPENDING



Source Office of Management and Budget Budget of the United States Government Fiscal Year 1992 (Washington, D C Executive Office of the President, 1991), Part One p 12

rapidly. Interest payments now constitute 14% of all outlays[1] and within a few years will exceed defense programs. Domestic discretionary spending, which includes federal expenditures for education, transportation, infrastructure, R&D, drug abuse prevention and rehabilitation, other law enforcement measures, and housing, makes up 14% of the budget.

The composition of federal spending has shifted dramatically since the 1960s. Spending on defense has declined from over 50% of total spending in 1962 to 20% in 1992, while spending on mandatory programs has increased from 30% to 50% over the same time period (see Figure 15). In addition, a growing percentage of mandatory program beneficiaries are middle- and high-income individuals and families rather than lower-income individuals and families (see Figure 16).

Thus, the growth in the deficit is propelled mostly by interest on the national debt and spending on mandatory programs, particularly Medicare and Medicaid. In the 1970s, Medicare and Medicaid costs

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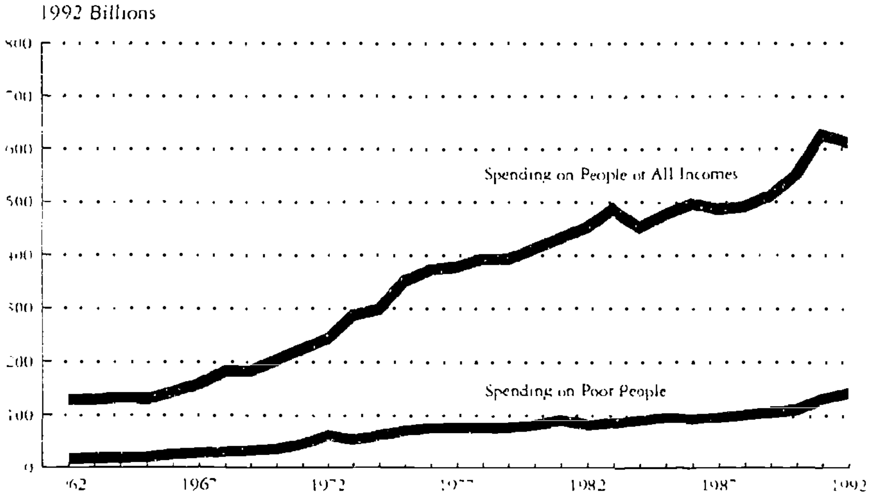
Some point to gross interest as the second largest item in the federal budget. But this is misleading—a substantial portion of interest payments go to the government itself and hence net interest is a much smaller amount. As an example, when the Social Security Trust Fund runs an annual cash-flow surplus, that surplus is "lent" to the Treasury for funding non-Social Security expenditures. The Treasury "pays" interest to the Social Security Trust Fund by issuing securities to its own trust funds, but no money ever leaves the government. These and other interagency interest fund transfers do not add to the current year deficit and do not increase current year credit demands on the private sector. When, however, the Social Security Trust Fund moves from surplus to deficit in approximately 25 years, these interagency interest payments will matter, as they will have to be repaid by either cutting *benefits* or increasing taxes.

grew an average of nearly 18% a year and in the 1980s slowed to between 11 and 12% average annual growth — a growth rate still two or three times the rate of inflation. And no one is predicting an end to this cost explosion. Over the next 10 years, Medicare spending is expected to increase from $128 billion in 1992 to $368 billion in 2002, an 11% average annual growth rate. Medicaid is expected to increase from $68 billion to $227 billion, a nearly 13% average annual rate of increase, unless the health care system is reformed.

Some may think these programs "pay for themselves" through premiums and payroll taxes, but some very large programs do not. For example, in the 1993-1997 period, the government will take in $590 billion to pay for Medicare from payroll taxes, but projected outgo will be $913 billion. In other words, for every dollar spent on the program, we fall about 40 cents deeper in debt. And Medicaid is funded entirely from general revenues. *A growing aging population and fewer workers relative to retirees in the twenty-first century will only exacerbate the trend toward unfinanced mandatory spending.*

In contrast, other mandatory programs are expected to grow more slowly, or not at all, and not increase their burden in the future. For

FIGURE 16
MANDATORY SPENDING BY INCOME
(Outlays)



Source: Office of Management and Budget, Budget of the United States Government, Fiscal Year 1992 (Washington, D.C.: Executive Office of the President, 1991), Part One, p. [illegible] example, unemployment insurance, currently at $35 billion, is expected to decline to $26 billion in 1997. The food stamp program is projected to increase only slightly, from $23 billion to $25 billion over five years.

FIGURE 17
SOCIAL SECURITY TRUST FUNDS
($ billions)[1]

Cal-Year	Non-Interest Income[2]	Interest[3]	Total Income	Outgo[4]	Surplus/Deficit[5]	Accumulated Balance[6]
1992	313.4	25.0	338.4	291.4	47.0	327.8
1993	335.3	27.7	363.0	307.2	55.8	383.6
1994	356.5	30.5	387.3	324.4	62.9	446.5
1995	377.6	34.4	412.0	342.5	69.4	515.9
1996	402.1	38.5	440.8	383.0	77.8	593.7
1997	426.8	43.5	470.3	384.4	85.9	679.6
1998	453.6	49.0	502.6	407.1	95.5	778.1
1999	482.2	55.0	537.2	431.4	105.5	880.9
2000	512.5	61.7	574.4	457.3	117.1	995.0
2001	544.8	69.1	614.0	454.9	129.1	1127.1
2005	689.0	105.1	794.1	610.1	184.0	1776.4
2010	917.3	172.0	1089.3	836.1	253.2	2915.6
2015	1206.2	254.0	1460.2	1194.1	265.1	4256.1
2020	1568.0	323.5	1691.5	1724.6	167.0	5341.0
2025	2027.5	341.6	2369.1	2434.4	-65.3	5534.6
2030	2622.7	266.3	2889.0	3320.4	-431.4	4156.9
2035	3401.1	57.4	3458.5	4354.8	-926.3	564.9

After the year 2015, payroll tax revenues of the work force will no longer cover Social Security benefits to eligible retirees.

Source: Senate Budget Committee, Minority Staff

[1] Projections are from the 1992 Trustees' Report using intermediate (alt. 2) economic and demographic assumptions, including assumed inflation of 4.0%, and real economic growth of between 2 and 3 percent initially and 1.8 percent ultimately

[2] Non-interest income is primarily payroll taxes and income taxes collected on Social Security benefits

[3] The trust funds earn interest on the Treasury securities purchased with the accumulated trust fund balances.

[4] Outgo is primarily Social Security benefits and administrative expenses

[5] Total income minus total outgo in the year

[6] The trust funds are projected to be depleted in 2036.

Only Social Security is projected to grow at a rate remotely approaching Medicare and Medicaid. At present, Social Security payroll taxes paid by current workers more than cover current Social Security expenses. In fact, the surplus in the Social Security Trust Fund, an estimated $47 billion in calendar year 1992, is loaned by the Trust Fund to reduce the federal government's borrowing in the bond markets. To date, a total of $327 billion has been loaned by the Social Security Trust Fund. However, payment of Social Security benefits will become a *big* problem beginning about 2015, when the baby boom generation retires (see Figure 17). Payroll tax revenues of the work force will no longer cover Social Security benefits to eligible retirees. The general fund will have to start repaying the Social Security Trust Fund. That will force the government either to cut benefits or significantly raise taxes to keep benefits at the same levels — or to raise the deficit even further. This is why the Commission places so much emphasis on beginning to really save the Social Security surplus in the year 2002, rather than continuing to borrow it from the younger generation.

2. BEHIND THE BUDGET CHALLENGE: HEALTH CARE COSTS

A principal reason current mandatory programs continue to swell the budget deficit, and will push it even higher in the future, is skyrocketing health care costs. Currently, about 14% of our GDP is spent on health care. Some analysts predict that this figure could double in the first decade of the next century. In contrast, in 1982,

FIGURE 18

TOTAL HEALTH EXPENDITURES

As a Percent of Gross Domestic Product (GDP)

	U.S.	Canada	France	Germany	Japan	U.K.
1970	7.4%	7.1%	5.8%	5.9%	4.4%	4.5%
1980	9.3%	7.4%	7.6%	8.5%	6.4%	5.8%
1989	11.8%	8.7%	8.7%	8.2%	6.7%	5.8%

Estimates indicate U.S. spending at 14% of GDP in 1992.

Source: *1992 Green Book*, Committee on Ways and Means, U.S. House of Representatives, WMCP 102-44, p. [illegible] the most recent year for which international data are available, other industrialized countries devoted less than 9% of their GDPs to health care (see Figure 18). They also have much more confidence in their ability to control cost growth in the future.

As health care costs rise, so too do the government's Medicare and Medicaid obligations, because the federal government is the biggest buyer of health care. The elderly, regardless of income, and the poor receive health care services, and the taxpayer picks up a substantial part of the tab. In 1970, the nation's overall health bill was $74 billion; it is now nearly nine times that amount — an estimated $666 billion in 1990. The federal government paid 24% of the bill in 1970; today it pays almost 30%. Direct federal health spending is more than 15% of the budget. In addition to that, the federal government forgoes over $40 billion in revenues a year because it does not count the value of medical benefits provided by employers as income. Further, the federal/state Medicaid program is straining state budgets with the states today paying 43% of the program's costs. Nevertheless, the Office of Management and Budget notes that:

> *This enormous and rising claim on resources comes at the expense of what might otherwise be the expansion of services for those who do not have fair or adequate access to the health system. And, notwithstanding the huge expenditures, indicators such as infant mortality and preventable death and disease remain unnecessarily high.*

Reform of our health care system must begin now. Attempts to control the growth of health care expenditures in the 1980s suggest that system-wide reform is required, not just reform of segments. As system costs increase, so does federal health spending. At the same time, federal health programs — the largest health insurance programs in the country — *contribute* to system-wide cost escalation. They do so because their design and incentives are counter to cost control. Federal health programs are part of the health care cost problem, and their reform must be part of the solution.

Any comprehensive health care reform must emphasize elimination of inefficiencies and perverse incentives in the current system, and coverage must be provided to the 35 million Americans who currently do not have insurance. But that coverage must be paid for. The resources to do this must come, in part, from limiting the growth in expenditures for current federal health care programs.

Health care reform is needed for another reason — soaring medical insurance premiums are reducing the nation's competitiveness. Costs for the uninsured are reflected in health care charges to those with insurance. This leads to rising premiums for both employers and employees and can sharply affect the cost of doing business. For example, the sticker price for a typical American car includes about $750 for the automaker's share of its workers' health care costs; the typical sticker price for a Japanese car contains less than $200 for health care costs to Japanese automakers. The difference in costs is nearly equal to the manufacturer's profit margin on the sale of a car. While the high cost of health care is not the only competitiveness problem for American carmakers, the disparity is still important.

There are many options that would slow the growth of Medicare and Medicaid costs in the near term and help keep federal expenditures within the constraints proposed later in this report. For example, the following options would all reduce the costs of Medicare: raising and indexing the deductible for physician services; requiring co-payments for home health care and clinical lab services; reducing the disproportionate share of indirect medical education payments to hospitals; requiring Medicare patients to participate in managed care organizations; means-testing Medicare; slowing rate increases for the prospective payment system to hospitals and reimbursements for physicians; and applying Medicare hospital payment limits to all retired federal employee health payments. While the Commission has not yet taken a position on any of these options, the nation must consider each of them carefully as it makes the hard choices necessary to control the costs of federal health care programs.

In the long run, controlling the growth of the nation's health care costs and the growth of Medicare and Medicaid will require much more than the incremental options laid out above. What is needed is systemwide health care reform that slows the long-term growth of health care costs, discourages cost shifting, and provides health care to those who are currently uninsured.

Policymakers and the nation are currently considering a number of health reform options including "Managed Competition," "Play or Pay," "National Health Insurance," and "Market-based Competition." President Bush has proposed a health care plan, and former Presidents Ford and Carter have jointly proposed a plan. The House of Representatives Conservative Democratic Forum has recently introduced a comprehensive health care reform plan.

While each plan has its strengths, all plans involve making hard choices and call for substantial overhaul of aspects of the health care system. There is no simple approach that is likely to reduce long-run costs. An interrelated set of changes involving several aspects of the health care system is necessary. Moreover, cost control should not be the only goal of comprehensive health care reform; cost control should be linked to quality improvements in health care as well as insuring those who are currently uninsured.

It is the Commission's view that our society is spending an adequate amount of money on health care to provide basic care for everyone. Therefore, it recommends that any comprehensive health care reform be based on the following principles:

First, the orientation of reimbursement policies should be changed to favor prevention and primary care, home services rather than institutional care, and outpatient rather than inpatient care. Over the long haul this reorientation could result in significant savings.

For example, it is clear that our nation could greatly improve preventative care. The United States ranks 25th in immunization rates of preschool children. The rate of immunization of nonwhite American preschool children is one of the lowest in the world. Seventy-four other countries have higher rates. Although preventative care requires up-front investment, long-run national health care costs will decrease as a result. Any comprehensive reform of the health care system should provide incentives for preventative care.

Second, comprehensive reform should shift the balance of expectations of both patients and physicians away from high-technology acute care toward disease prevention and individual responsibility. Hundreds of new technologies, many of them extremely costly, enter the health care system each year. New equipment, procedures, and systems often spread rapidly and widely before they have been subjected to well-designed research on their relative effectiveness. Better assessment of the effectiveness of new technologies and procedures should take place in parallel with their rapid dissemination.

Third, comprehensive health care reform should provide incentives for healthy lifestyles. *Almost half the mortality in our country is related to health-damaging behavior.* Smoking, poor nutrition, drug and alcohol abuse, and unsafe sex all contribute to disease and death. Extensive public education campaigns — in school, at work, at community centers, and on radio and television — would contribute enormously to healthy lifestyles. The United States has made real progress, more than most other countries, on smoking behavior largely because of extensive public education campaigns. Such public education, coupled with incentives in insurance plans for healthy lifestyles, could both reduce health care costs and improve and lengthen American lives.

Fourth, comprehensive health care reform will not be complete without a social consensus on care for the terminally ill. Approximately 30% of total Medicare dollars are spent on patients in the last year of their lives.

Fifth, administrative costs must be reduced. According to health care industry estimates, 22 cents of every health care dollar are spent on administrative costs.

Health maintenance organizations (HMOs), simplification of bureaucracy, the introduction of more competition into the health care system, and tort reform have all been promoted as important cost-reducing measures. While each may be important, none is a panacea for growing health care costs. In choosing a health care reform package, the nation should look hard and long at the experience of other countries, including *all* Organization for Economic Cooperation and Development (OECD) countries.

The Commission will conduct a comprehensive study of health care reform in its next phase. In the meantime, the nation needs to understand that both its clamor for health care and exploding associated costs must be controlled. Facing fiscal reality means that needed reform of health care must expand coverage for 35 million citizens presently not insured while at the same time reducing the overall rate of growth of health care costs. The Commission believes the federal government should not simply pass along added costs to private industry or state and local governments. What is required is an unprecedented determination to implement cost control prior to, or in parallel with, expanding coverage for the uninsured.

Though a daunting task, broadening the coverage under these strictures is achievable. A significant percent of medical costs for the uninsured is presently borne by emergency rooms, free clinics, and other unreimbursed health care, or reflected in higher premiums paid by the insured. There are also other costly inefficiencies in the present health care system, which must be ended by health care reform.

3. LEARNING FROM THE PAST: WHY GRAMM-RUDMAN-HOLLINGS DID NOT BALANCE THE BUDGET

Various procedural remedies to correct the deficit problem have been tried. The Gramm-Rudman-Hollings Act of 1985 was one of the most ambitious efforts at balancing the budget. In this act, Congress and the president wrote specific deficit limits into law. The law called for "sequestration," a mechanism to impose automatic across-the-board spending cuts if the deficit limits were exceeded. The purpose of the sequestration threat was to force leaders to make the hard choices necessary to balance the budget. If they did not, sequestration was supposed to balance the budget anyway.

The deficit limits in the original law proved too ambitious and therefore, were unachievable. As a result Gramm-Rudman-Hollings was amended in 1987 to stretch out the deadline for reaching a balanced budget. Even so, sequestration did not operate as the framers of the law envisioned. For example, allowing the automatic cuts to occur would have decimated defense and domestic discretionary spending in 1990 when the targets were once again missed.

Gramm-Rudman-Hollings was flawed from the start: nearly three-quarters of all federal spending remains exempt from sequestration. Major mandatory programs are either exempt from the threat of across-the-board cuts or, as in the case of the Medicare program, shielded from their full force. As noted above, these are some of the largest, fastest growing programs in the budget. Even in 1990, when Congress and the president agreed to modify Gramm-Rudman-Hollings for a third time, raise revenues, cap spending for defense and domestic programs, and establish pay-as-you-go procedures for new mandatory spending, those changes still could not make up for the built-in and automatic growth of mandatory programs. If mandatory spending is not controlled, the budget can never be balanced.

4. THERE ARE NO SIMPLE SOLUTIONS TO THE DEFICIT PROBLEM

A number of simple solutions have been offered to help bring the budget into balance. There are other good reasons to consider some of these, *but none is a serious or workable proposal to balance the budget.* None of the "solutions" considered produces sufficient savings over a 10-year period to generate the $1.5 trillion (using the Social Security Trust Fund surplus) or the nearly $2 trillion (without using the Social Security Trust Fund surplus) needed to balance the budget by 2002 (see Figure 19).

FIGURE 19

How much deficit reduction is needed to balance the budget?

The Commission's fiscal plan balances the budget, without using the Social Security surplus, in the year 2002. How much deficit reduction is required to do that?

Deficit reduction efforts are measured against a so-called "baseline." The "baseline" is a projection of the deficit that would result if all current tax laws and spending programs remain unchanged (except that tax brackets and spending programs are adjusted to keep pace with inflation), given a set of economic assumptions and estimated population growth. The following table shows the projected deficits, both including and excluding the Social Security surplus, using the Congressional Budget Office's baseline.

CBO BASELINE BUDGET DEFICITS
(Billions of Dollars)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Including Social Security	$336	$267	$203	$189	$237	$265	$296	$333	$375	$423
Excluding Social Security	$400	$343	$290	$287	$346	$388	$432	$483	$589	$603

Total projected deficits over the next five years are $1.2 trillion including the Social Security surplus, and $1.7 trillion excluding Social Security. Total projected deficits over the next 10 years are $2.9 trillion including Social Security, and $4.1 trillion when the Social Security surplus is excluded.

Almost all plans to reduce the deficit build up savings gradually. A plan that balances the budget in 5 or 10 years should be expected to eliminate about half of the deficits projected during the relevant time period. Thus any plan to balance the budget in five years should save at least $600 billion (or $800 billion if the Social Security surplus is excluded); a plan to balance the budget over 10 years should save $1.5 trillion (or $2 trillion if balancing the budget without using the Social Security surplus, as the Commission recommends).

SILVER BULLETS Figure 20 evaluates five deficit reduction proposals on the basis of the ability of each to generate the $630 billion — that's $630,000,000,000 — needed to balance the budget over a five-year period by 1997: a balanced budget constitutional amendment, a line-item veto, a freeze on federal spending, elimination of various government agencies, and tax amnesty. Each was found by the Commission to be a partial answer at best, and *billions*, not merely *millions*, of dollars short.

FIGURE 20

No Silver Bullet With The Deficit's Name On It

■ A constitutional amendment requiring a balanced budget — Congress may eventually pass an amendment to the Constitution that will require a balanced budget. Some suggest that the states would then ratify the amendment within two years.

Even a constitutional amendment would not cut $1.00 of spending or raise $1.00 in revenue. The amendment itself would not be self-executing. Congress and the administration would still have to make hard choices on how to achieve balance and agree to a program of spending cuts and/or tax increases.

If the constitutional amendment requires a balanced budget by 1997, Congress and the Administration would have to agree to at least $630 billion in spending restraints and/or revenue increases over the next five years. Thus, a constitutional amendment is not in and of itself a solution; it is an exhortation, but not a guarantee, that a plan requiring hard choices be agreed to and implemented.

■ Line-item veto — Most experts agree that a president is not likely to trim much more than 2% of discretionary program funding each year. Congress eliminates about the same amount of spending through its annual appropriations process.

It should also be noted that although 43 of the 50 governors have both line-item veto powers and balanced budget requirements, they are not allowed to cut federally mandated levels of payments on programs they oversee — the state-wide equivalent of federal entitlements. Similarly, about half of the federal budget consists of mandatory programs that would not generally be subject to line-item veto.

Line-item veto is an important issue in the separation of powers debate, but it is not a strategy to balance the budget.

■ Freeze federal spending — A freeze in federal spending would balance the budget in five years. However, nobody is proposing a freeze, and for good reason.

First, interest payments on the national debt cannot be frozen. Interest is now the third largest item in the budget, projected to increase $77 billion over the next five years. To freeze total federal outlays *and* pay the projected increase in interest, other programs would have to be cut by an equivalent amount, or taxes would have to raised to pay the interest. Politically and practically, neither is likely.

Second, freezes cannot help us avoid making hard choices. For instance, Social Security costs will increase by $90 billion for a combination of reasons: current beneficiaries get cost of living adjustments (COLAs) every year; there are more people eligible to collect benefits every year; and new recipients receive higher average benefits based on higher earnings histories. To freeze total federal outlays, then, either Social Security benefits would have to be cut or the $90 billion in new costs would have to be taken from other programs.

■ Eliminate several federal government agencies — Consolidating or eliminating entire government departments is estimated to save approximately $10 to $20 billion in administrative overhead over a five-year period. That is significant, but far shy of the amount needed to balance the budget.

■ Tax amnesty— A program under which tax delinquents go unpenalized if they pay overdue taxes within a prescribed period has helped some states raise revenue. Proponents of this program at the federal level estimate that tax amnesty could raise a considerable amount of delinquent taxes, perhaps as much as $38 billion over a five-year period. However, there is considerable controversy over the amount of potential savings. Most believe that the figure is inflated.

"GOOD GOVERNMENT" MEASURES Implementation of a series of "good government" measures, listed in Figure 21 also has been cited as a way to tackle the budget deficit: eliminating waste, fraud, and abuse; biennial budgeting; improving tax collections; "sunset" reviews of existing programs to make sure they are still needed and working as envisioned; and making government more efficient. These items are good budgeting concepts that should go hand in hand with our elected officials' power to spend taxpayers' funds, but they do not result in the mega-dollar savings that are needed to put our fiscal house in order. The Commission believes that these good government initiatives should be undertaken with vigilance and that the savings from rhese reforms should be used to "pay-as-you-go" for new high priority programs. To pretend, however, that any combination of these can eliminate the deficit is an illusion, easily disproved by simple arithmetic.

FIGURE 2:

"Good Government"
Measures that will not Balance the Budget

■ Make government more efficient — Efficient and less costly government should be a national priority. The Commission believes that government's "Total Quality Management (TQM)" programs are a step in the right direction. However, while these programs result in faster and more efficient delivery of services, they usually do not result in significantly lower program spending; people usually resist reducing spending for popular programs.

Nevertheless, some money can be saved through efficiency. For example, after implementing TQM programs, the Naval Aviation Depot of Cherry Point, North Carolina, saved $12 million over a two-year period; the Ogden Service Center of the IRS saved $11.4 million over a three-year period. TQM programs might ultimately save the federal government hundreds of millions of dollars — but not hundreds of billions of dollars.

■ Biennial Budgeting — One way to make government more efficient is to move to biennial, rather than annual, budgeting. Under the current system, Congress spends almost all its time considering next year's budget, with no time for oversight. Although nobody knows how much could be saved under biennial budgeting, clearly it could help us get more out of the dollars we spend by creating more stable, predictable budgets while increasing Congress' ability to base program budgets on actual performance.

■ Reduce government waste, fraud, and abuse — While absolutely essential to the political system and to our hopes of making Washington work better, this solution is also difficult to quantify — and to implement. City dwellers tend to think farm price supports are wasteful; farmers think mass transit shouldn't be subsidized.

Closing military bases is the most significant recent attempt to save money by eliminating "waste," i.e. eliminating programs that are no longer needed. However, the recent combined base closure lists will save less than $10 billion over 10 years.

■ Increased tax compliance — Government should go after the tax cheats. Internal Revenue Service efforts should be enhanced to ensure that people pay their fair share of taxes promptly and in full. Tax cheats shift the burdens of taxation to honest taxpayers. Every effort should be made to collect tax revenues already owed, whatever their source. Nevertheless, even the most strict tax compliance prngram will not bring the budget into balance.

■ Sunset programs — Sunset legislation would make all existing federal programs, including entitlements, subject to a mandatory review on a rotating basis, with 10 - 20% of programs and expenditures subject to Congressional scrutiny each year. This might help redress the strong bias that now exists toward extending in perpetuity existing programs. Although sunsetting might facilitate the elimination of outdated programs and the elimination or reduction of low-priority programs, the net result would probably not make much difference in total spending levels.

HIGH GROWTH ESTIMATES Some argue that it is possible to balance the budget without making any hard choices. They project higher economic growth than our economy has experienced during the past two decades. Higher growth assumptions project increased tax revenues (because more people are working and profits are higher), reduced spending on unemployment and some other programs, and reduced interest costs — all painlessly. These assumptions can posit an enormous difference. For example, a one-percentage-point jump in economic growth for each of the next 10 years would reduce projected deficits by $1.3 trillion over 10 years.

But assuming higher economic growth *without taking the steps necessary to produce it* only works on paper, not in the real world.

"EASY" CHOICES Liberals may think that it is easy to cut defense and tax the rich; conservatives may think it is easy to cut welfare; many think it easy to cut foreign aid. The problem is that to balance the budget through these "easy" choices, almost all of them would have to be made. And people tend to support one set of options or the other, not "all of the above."

If all welfare cash payments were wiped out — including those to the elderly poor, the blind and disabled, veterans, and families with dependent children — $206 billion would be saved over a five year period. If the food stamps program were eliminated, $116 billion would be saved over five years. Such insensitive and heartless measures would abandon the needy and helpless. Taking away the "safety net" that our society has an obligation to provide would still not balance the budget. Moreover, what we would "save" in eliminating the safety net would cost mightily in other areas — increased homelessness, malnutrition, poor health, and alienation. Alienation breeds anger and crime, which would mean more prisons, more law enforcement, and greater state and local government financial burdens.

What if all foreign aid were eliminated? Eliminating foreign aid would save $105 billion over a five-year period, about one-sixth the total needed to get to a balanced budget.

Even reducing the defense budget dramatically will not solve the deficit problem. Under the 1990 Budget Summit agreement between the president and the Congress, the defense budget was to be reduced by 20% from 1990 to 1995, reflecting the collapse of the Warsaw Pact in 1989. Then, after the dissolution of the Soviet Union, President Bush proposed an additional $50 billion in reductions, which would increase the real defense reduction to 25% by 1997, but the large deficits projected (in figure 19) already assume these defense cuts. By the end of the decade, the defense budget will be 30% to 40%, possibly even 50% smaller than it was in 1990. But these reductions are based on the continuation of present trends, which indicate a greatly reduced military threat to the United States. At some point in this decade we will reach the minimum defense establishment necessary to promote American interests and peace in the world. Continued defense reductions may be possible for the rest of the decade, but defense savings are unlikely to be a key part of a deficit reduction strategy after the year 2000. For the most part, the "peace dividend" has either already been spent or has been incorporated into deficit projections for the years ahead.

What about taxing the rich? If a 20% surtax were levied on incomes over $1,000,000, only $16 billion would be raised over five years. Even raising the top federal tax rate from 31% to 33% would only generate $32 billion more in revenues over five years. This combination leaves us about $580 billion short of deficit reduction goals.

In a nutshell, "easy" choices are in the eye of the beholder. Such choices invariably come up far short, or produce packages that are grossly unfair or misguided.

5. TWO CONTRASTING DEFICIT REDUCTION OPTIONS

The Commission considered two contrasting options that illustrate the difficulty of eliminating the deficit by 1997, the time frame proposed in the most widely supported version of the constitutional amendment to balance the budget. To eliminate the deficit by 1997 requires reductions of $630 billion over the five-year period 1993 through 1997. The two options use the CBO assumptions of 2.5% average real GDP growth annually through 1997, with an average unemployment rate of 6% and an average long term interest rate of 7.1%.

OPTION 1 REDUCE SPENDING ONLY

To balance the budget by 1997 through $630 billion in spending cuts alone, *all* of the following targets would have to be met:

Significantly reduce defense spending — below the cuts in the Budget Summit and the $50 billion in additional cuts proposed by the President this year — by an additional $100 billion over the next five years; *and*

Eliminate COLAs — except for the poor — in Social Security, railroad retirement, and all other federal pension programs — saving $150 billion over five years; *and*

Put a ceiling on non-Social Security mandatory spending programs, primarily Medicare and Medicaid, as well as farm price supports, guaranteed student loans, food stamps, and other benefit programs, allowing only for increases in participation and general inflation — saving $190 billion over the next five years; *and*

Allow no inflation adjustment for domestic discretionary spending over the next five years — saving $108 billion over five years;

If all the above were accomplished, reduced interest payments on the national debt would save an additional $70 billion.

Other spending reduction options can be devised, but no such option can avoid significant spending reductions in defense and domestic programs, Social Security, and mandatory benefits if it is to raise $630 billion in five years. No combination of "spending only reductions" will have broad appeal. All will produce economic dislocations and disrupt economic growth.

It is the Commission's judgment that it is politically very unlikely that spending can — or should — be cut far enough and fast enough — by $630 billion over five years, including the budget year currently under consideration in the Congress — to balance the budget by 1997.

Option 2 Increase Taxes Only

Most Americans would shudder, rebel, or revolt at the thought of a 20% tax surcharge on their income tax bill, but that is what it would take each year for the next five years to balance the budget by 1997 if nothing else were done.

Alternatively, all of the following taxes would have to be levied to raise $630 billion over the next five years:

> A 5% value added tax (VAT) first effective in 1994 (food, housing, and medical care exempted to offset regressivity) — raising $267 billion; *and*
>
> A 50-cents-per-gallon motor fuels tax increase — raising $230 billion; *and*
>
> Taxes on air pollutants — raising $75 billion; *and*
>
> An increase of the alternative minimum federal income tax to 28% — raising $27 billion; *and*
>
> If all the above were accomplished, interest payments would save an additional $70 billion.

Although these hefty revenue increases would theoretically balance the budget by 1997, the "victory" would be short lived. Tax increases of such magnitude would shake economic growth in the short run. Moreover, the deficit problem would come back to haunt the nation by the end of the decade: spending on mandatory programs is growing at three or four times the rate the economy is growing, while revenues tend to grow only at the same rate as the economy grows. If we were to rely only on taxes to keep the budget in balance, additional tax increases — beyond those listed here — would have to be imposed to keep up with the growth of mandatory programs in the years beyond 1997. This option is politically impossible and economically unsustainable.

In sum, there are no simple or painless solutions to eliminating the federal government's budget deficit. A five-year time horizon looks unrealistically short. We believe it is time for our leaders to talk frankly to the American people about the seriousness of our present situation and about the sacrifices and hard choices we must make now if we want to put our economy on the path toward long-term economic growth. We have to be extremely careful about how we impose pain. How we reduce the deficit — which programs should be scaled back, what kinds of taxes to impose — does matter. If program cuts are too deep, if tax hikes are too steep, if the time period to achieve balance is too short, we risk plunging the economy into recession.

Any approach that fails to foster growth cannot succeed. Further, any plan to reduce the deficit must have the support of the Federal Reserve in order to maintain economic growth. Credible, sustainable, and real deficit reduction should be met with an accommodating monetary policy. The combination will reduce inflationary expectations, reduce long-term interest rates, and increase economic growth.

If we stay on our present course, we and our children and grandchildren will pay an increasing price. If we begin to make the tough decisions now, the rewards and benefits will be felt for generations to come. The hard choices that confront us on budget reduction, however, cannot be faced in isolation They ought to be addressed within a larger framework that also takes into account the other half of our fiscal policy: our nation's tax structure.

6. THE NEED FOR RESTRUCTURING TAXES

Our tax policy has substantial influence over the economic growth of the country. Ideally, it should encourage saving, aid capital formation by reducing the cost of capital, stimulate investment in productivity-enhancing equipment and research and development and, in general, foster job creation. It should minimize distortion of private-sector investment decisions. Taxes must also be imposed in a fair and progressive manner.

The tax code should finance the amount of government that the American people want. But there are inevitably economic costs associated with taxes — a tax on labor inhibits work effort, a tax on capital inhibits savings and investment. The financing of government should be accomplished in the most efficient and equitable manner. In the best of worlds, a tax system should:

- raise necessary revenue while imposing the lowest costs on the functioning of the rest of the economy;
- be unbiased with respect to the choices that would otherwise be made in the absence of taxes;
- be considered equitable and fair by taxpayers;
- minimize compliance costs on individuals and businesses.

The Commission believes that the current income tax structure no longer meets these basic criteria. Successive Congresses debate annual revenue bills that seek, in varying measure, to provide cyclical economic stimulus, correct past mistakes, extend sectoral subsidies, promote incentives for saving, and finance added programs. But constant changes to the tax code do not allow industry or business to plan other than for the short term. The result is a continuous tinkering at the margin, which many observers believe misallocates resources. The time has come to reexamine how we think about tax policy and tax structure in the United States.

Because the tax system can strongly influence the allocation of savings and investments, and may contribute to or detract from the overall competitive strength of the U.S. economy, it is the closest thing the United States has to an industrial policy. As Commission member Barry Rogstad, president of the American Business Conference, notes:

> *Our highest priority must be to address the low level of saving in America and improve the allocation of that saving to its most productive uses. Until we do that, talk of sectoral interventions or even wider reforms is simply a waste of*

time for the same reason that you don't worry about tacking in a new direction if your sails are full of holes and the water is over the gunwales. First things must always be first.

To use Barry Rogstad's analogy, our sails are full of holes, and tax code loopholes and incentives are rigged to take us in the wrong direction. Our current tax code is biased against saving, encourages companies to rely upon debt rather than equity financing, is extremely complex, and handicaps U.S. companies in the global marketplace. Each of the issues is discussed below.

BIAS AGAINST SAVING

Our current U.S. tax system is hostile toward saving and tilted toward immediate consumption. Savers are penalized, and consumers are not. Income that is saved is subject to double taxation: the income itself is taxed, and if income is saved rather than spent, most subsequent earnings on the savings are also taxed. The result is that immediate consumption escapes any imposition of later, additional taxation, and this is a powerful but misguided incentive to spend and consume now rather than save for future gains.

For example, an individual willing to wait to receive $1050 next year by foregoing $1000 of consumption this year should be ready to invest in any form of saving at an interest rate of 5%. But, under current tax treatment, an individual in the 33% bracket would not be willing to give up consumption now unless the return were *at least* 7.5% before taxes. The taxpayer knows he or she will have to pay $25 in taxes on the $75 gain (that is 33% or one-third of the amount realized) to end up with an extra $50 in hand next year.

This tax bias against saving causes all Americans (as individuals, as families, as businesses, and as a nation) to behave in a way that is short sighted relative to what we would expect under a tax system that left all economic decisions to market values. The result, in the aggregate, is a lower than desired level of national saving and investment.

The current tax structure does try to address the anti-saving bias of the income tax by allowing pensions, 401(k) plans, and IRAs, which allow buildup of saving on a tax-deferred basis, recognizes that removing this double taxation of saved income is beneficial. Expansion of these provisions is likely to become even more important if government caps on health care and other entitlements, as proposed by the Commission, require individuals to assume greater responsibility for their own health care and retirement.

TILT TOWARD DEBT INSTEAD OF EQUITY FINANCING

The current tax code discourages savers from investing in American companies. Corporate earnings are subject to taxation at the company level. If these earnings are distributed to shareholders as dividends, the dividends are taxable as income to shareholders. If the company retains these earnings, and the value of the stock increases, shareholders are required to pay tax on the capital gain when they sells shares. Even worse, taxes are due on all appreciation, including purely inflation-related gains. This "double tax" on corporate earnings reduces the level of savings committed to financing investments in American businesses below what would happen if the tax system were without its present bias against savings. At the same time, the current tax system's unequal distribution of tax advantages encourages companies to escape double taxation by relying upon debt rather than equity financing. The cost of debt to the corporation is lower than the cost of equity because interest on debt financing is deductible in the determination of corporate earnings. The tax code encourages CEOs to focus on cash flow and short-term profitability and, in many cases, to jeopardize the financial security of the company.

THE COSTS OF COMPLEXITY

The increased complexity of our tax code is now taken for granted. The current tax structure requires taxpayers to generate complicated calculations such as asset depreciation schedules, accrual accounting, and other burdensome requirements.

Simplification should be a major objective in tax restructuring and not merely receive perfunctory lip service. A tax program that allows for the full deduction of plant and equipment in one year (expensing) would eliminate most of the complexity on the corporate side. Similar gains are possible for individuals. A comprehensive program of tax simplification promises both a more efficient allocation of resources and potentially increased revenues.

Under the current tax code, corporations face a great deal of complexity because there are three major corporate codes rolled into one: the regular tax, the alternative minimum tax, and the foreign tax provisions. Every domestic corporation must calculate its tax liability under the regular and alternative minimum tax schemes and pay the greater amount. This can penalize companies that invest and modernize. The same investment made, for example, by a corporate alternative minimum taxpayer (AMT) and a regular corporate taxpayer can result in 10 to 22% higher capital costs for the AMT firm.

A HANDICAP IN THE GLOBAL ARENA

An ideal tax system should provide equal tax treatment of income earned by U.S. companies regardless of geographic origin. However, changes in the tax code over the past 15 years have left many U.S. companies at an increasing international disadvantage. With the globalization of the world economy, concerns over a level playing field have highlighted the relative inadequacies of the U.S. tax policy compared to that of our trading partners. For example, U.S. exports to Europe bear the burden of both U.S. direct taxes (income taxes) and European indirect taxes (the European VAT), while European exports to the United States bear the burden of neither European indirect taxes nor U.S. direct taxes.

A comprehensive effort to address all these problems raises a host of practical, technical, and political issues, not the least of which is the transition from one tax structure to another and the maintenance of both revenue and equity during this transition. But the task in all its magnitude must be faced. The Commission fully recognizes that overhauling our current tax structure requires every bit as much leadership and courage in making the hard choices as are involved in the spending side of the deficit equation.

Blueprint for Action

The Commission's assessment of what it will take to put the U.S. fiscal house in order has led us to three basic conclusions:

First, there are no quick fixes. The challenge facing America is structural in character. The Commission recommends a realistic target date of 2002 — a 10-year plan — to meet it. Our best prospect for doing so, given the intense short-term pressures exerted by the two-year election cycle and the many vested interests in a status quo, is through a solid core of bipartisan support. The Commission does not propose significant deficit reduction during the next two years while the economy is recovering from the recession. But the Commission believes that the Congress and the president should use this time to undertake comprehensive reform of our health care and tax systems.

Second, budget deficit reduction alone is not enough to get our nation from where we are to where we want to be. Instead, mutually reinforcing deficit reduction and tax restructuring strategies are needed to generate growth through increased savings and investment.

Third, while the private sector must be the primary engine for growth, some important new federal expenditures on education, child care, infrastructure, technology, and R&D will contribute to our overall economic performance. A plan of action must take account of these legitimate needs, whether through the setting of new spending priorities or on a pay-as-you-go basis.

* * *

RECOMMENDATION: **A Public Education Campaign**

Even more important than the date or the specifics of any plan to balance the budget is the urgent need to first educate the public about the problem. The Commission applauds the initiative by Senator Warren Rudman and former Senator Paul Tsongas to begin this public education process. The Commission recommends that deficit reduction and tax restructuring issues be fully aired and debated during the presidential and congressional campaigns of 1992. Fiscal policy should be the number one campaign issue. Elected officials and candidates well understand that the traditional route to public office is to promise more services and no new taxes, while also pledging to get the deficit under control. But the preceding examples make clear that these are simply impossible promises to keep. Unless an honest and realistic debate takes place, and simplistic sloganeering is exposed, there will be no consensus for action in the next administration and Congress, whoever is elected.

Voters cannot hold candidates accountable unless the media does as well. The Commission encourages the candidates and the media to follow up on the effort led by Senator John Danforth to challenge the presidential candidates to a substantive debate on the budget deficit. Accordingly, the Commission urges that each of the major media assign to both presidential campaigns a full-time journalist trained in economics or fiscal policy who can quiz the candidates with detailed questions on how they propose to put America's fiscal house in order. A refusal to answer these questions, or the use of budget projections based on unrealistic assumptions of high growth and very low interest rates, should be exposed to the public. The candidates should be required to lay out specifics, including their economic assumptions. This type of news coverage and analysis must also be carried by state and local media in races for the House and Senate.

PRINCIPLES FOR GETTING OUR HOUSE IN ORDER

The Commission's approach for getting our economic house in order combines a comprehensive strategy for budget deficit reduction with the replacement of the current tax code by a consumption-based income tax. The predominant view of the Commission is that this strategy should be based upon these 10 major principles:

1. Balance the budget by the year 2002 without using the Social Security surplus;
2. Promote long-term economic growth without undue short-term economic disruption;
3. Base projections for deficit reduction on credible, realistic economic assumptions;

4. Follow a step-by-step agenda, legally locking in spending controls before raising revenues;
5. Limit revenue increases to a ratio of no more than $1 for every $2.75 of spending reductions;
6. Bring mandatory spending under control by putting a cap on the growth of spending on non-Social Security entitlement programs;
7. Enact comprehensive health care reform that controls costs and insures the uninsured;
8. Restructure the tax code to promote growth by encouraging savings and allocating resources more efficiently, while preserving the over-all progressivity of the code;
9. Make room for increased investment in education, children, R&D, and technology by reducing or terminating lower priority programs;
10. Fully implement the "good-government" measures — such as sunsetting programs, using the "total quality" approach to management, collecting revenues from tax cheats, and reducing waste — to make government more efficient.

BUDGET DEFICIT REDUCTION STRATEGY

The Commission bases its strategy for budget deficit reduction on realistic assumptions about economic growth: the CBO's projections of 2.5% annual real GDP growth from 1993 through 1997, and 2% growth thereafter; an inflation rate averaging 3.6% annually; an unemployment rate averaging 6% from 1993 through 1997 and 5.5% from 1998 through 2002; and a 10-year Treasury note average interest rate of 7.1% annually.

These are baseline assumptions that assume no changes in policy. There is a significant probability that the Commission's proposed policies to reduce the federal government's borrowing demands by locking in controls on federal government spending and encouraging savings by removing the anti-savings bias in the tax code will result in more economic growth than assumed in these baseline assumptions. The Commission's recommendations if fully implemented should result in GDP growth averaging at least 2.5% after 1997 and possibly more. Further, long-term interest rates should decline by at least another 1/4% each year after 1997. We believe both growth and reduced long-term interest will occur and that deficits will be lowered in the last six years of our plan by a minimum of $150 billion.

The Commission believes this package will increase economic growth, but we have not assumed higher growth in our budget plan. To merely assume significantly higher growth would be self-defeating, because such optimistic assumptions would make our fiscal policy proposal less credible. America's current fiscal situation suggests that discipline is needed and that growth must be earned, not assumed. But should our action plan result in the higher growth that is potentially within reach, the dividends to the country would be all the greater and would permit lower tax rates, increased public sector investment or the retirement of part of the national debt.

The Commission's plan contains a balanced package of deficit reduction totaling nearly $2.0 trillion over the next 10 years. Reductions in projected spending would be 8%, saving nearly $1.5 trillion. Projected revenue would increase by 3% over the decade or $376 billion. Interest rates resulting from the Commission's recommendations would reduce the deficit by an additional $150 billion over the latter six years of the 10-year plan.

The Commission's plan includes increased spending of $160 billion on investment programs such as education. R&D, child care, and technology that would be included in the domestic discretionary category of the federal budget. The plan also calls for increased spending of $100 billion over a 10-year period for highways, airports, and other physical public infrastructure that would be paid for with increased energy taxes or user fees dedicated solely to these new expenditures. This additional $100 billion in spending and revenue financed on a pay-as-you-go basis is not included in the deficit reduction package.

It should be stressed that *unless all of the key elements of the fiscal plan are implemented as a package. the country risks the real possibility of undermining America's international position without achieving its goal of a strengthened America at home. If we attempt to balance the budget by slashing national security and international programs. without restraining and reforming domestic discretionary and mandatory program spending, we will weaken ourselves both abroad and at home.*

The goal of the plan is to balance the unified budget without using the Social Security surplus by the year 2002. America would then be saving its Social Security surplus, helping to avoid a fiscal "train wreck" 25 years from now when the General Fund must begin repaying the Social Security Trust Fund. Continuing to divert the Social Security surplus to fund current spending instead of building up reserves for the future is bad fiscal policy and bad social policy.

* * *

RECOMMENDATION: **A Budget Plan to Put our Fiscal House in Order and Promote Economic Growth** *Although there are other credible options. the predominant view of the Commission is to recommend the following budget blueprint for restructuring our nation's fiscal policy:*

1. Allowing two years for enactment and a gradual phase-in, cap spending on non-Social Security mandatory programs (see Figure 22 for what such a cap would entail) beginning in 1995 — saving $660 billion over 10 years, or 10% of such projected spending over the 10-year period.

2. Abolish the present tax code and enact progressive consumption-based income taxation within two years (see discussion under Tax

FIGURE 22

Capping The Growth of Mandatory Programs

What's the Problem?

■ In 1992, the federal government will spend more than $423 billion on non-Social Security mandatory programs such as Medicare, Medicaid, the student loan program, and agricultural subsidies.

■ CBO estimates that spending on these programs will more than double by the year 2002, to $912 billion. That is an average annual growth rate of 8%. Most of the new costs will be associated with the health care programs — Medicare and Medicaid, which are projected to grow at a rate of between 11% and 13% annually.

■ Spending on these programs consistently exceeds projections, yet no action is taken when this occurs.

■ If the growth of non-Social Security mandatory spending is not controlled, the deficit may well grow from its current level of about $350 billion per year to $620 billion in the year 2005.

What's the Proposal?

■ The Commission proposes placing a cap — a ceiling — on the growth of non-Social Security mandatory spending.

■ A cap does *not* freeze expenditures on mandatory programs. Rather, the cap allows non-Social Security mandatory program spending to increase for

—the growth in the number of beneficiaries.

—inflation growth.

—a small additional growth allowance in the early years, as cost-control measures are phased in.

■ The purpose of the cap is twofold: first, it would force Congressional committees that have jurisdiction over mandatory programs to review their programs and report legislation that would limit growth so that the overall cap is adhered to. Options for limiting growth include, among others: legislating measures that would make mandatory programs more administratively efficient and cost-effective; requiring providers to be more efficient or beneficiaries to bear a greater cost burden; restricting the eligibility or reducing the benefits of people in higher-income brackets.

The second purpose of the cap would be to provide a further incentive for system-wide health care reform. The goal of that reform should be providing universal coverage in a cost-effective mannner. A number of plans are now before the Congress. The president and the Congress should make the choice and implementation of a health care reform plan a top priority of the next administration.

■ Ultimately, controlling the growth of non-Social Security mandatory spending will require *both* the reform of federal healthcare programs as well as system-wide health care reform.

■ The cap would be enforced through a sequestration mechanism: increases in non-Social Security mandatory spending above cap level would be eliminated through either an across-the-board or a selected sequester of the specific programs that break the ceiling

Restructuring Strategy: The Consumption-Based Income Tax, page 82). This decision would include a commitment to implement a progressive consumption-based income tax before the year 2002 and to specify the tax restructuring that would provide for transition. This restructuring should be permitted to raise an additional 3% in revenues (nearly $376 billion) by the year 2002 but no more than $1.00 in taxes for $2.75 in spending cuts.

3. Reduce defense spending in an orderly fashion from 20% to 13% of the federal budget, with the goal of saving $290 billion over 10 years, an additional 10% reduction in projected spending.

4. Allow international spending to increase at half the rate of inflation, growing from $20 billion in 1993 to $24 billion in 2002, while placing a greater emphasis on supporting newly emerging democracies and market economies — saving $21 billion by the year 2002, a 9% reduction in projected spending.

5. Permit domestic discretionary spending to increase from its current level of $234 billion to $255 billion in the year 2002. The Commission believes that domestic discretionary spending should be reprioritized so that it emphasizes investment-oriented programs that promote economic growth in the following manner:

   —In particular, the Commission recommends $160 billion of *increased spending* over currently projected levels for the 10-year period on education, children, R&D, and technology. This public investment package is detailed in the next section of this report.

   —To help pay for these high priority investments, the Commission recommends terminating, scaling back, or streamlining lower priority programs. The Commission recommends a number of programs that should be reviewed for possible termination (see Figure 23).

   All told, this reprioritization of domestic discretionary spending will produce net savings of $243 billion over a 10-year period, nearly a 9% reduction in projected spending.

6. From 1993-2002, increase spending on physical infrastructure — roads, bridges, airports, and tunnels — by $100 billion over current projected spending to be paid for by increased energy taxes or user fees (no net effect on budget over 10 years).

7. Interest payments would be reduced — saving $237 billion over the 10-year period, an 8% reduction. Lower interest rates, brought

FIGURE 23

Domestic Discretionary Spending Options

Federal spending represents a decision to deploy revenues raised from tax dollars to support programs and policies that require national priority. This Commission believes that tradition, inertia, and political horse-trading have contributed to a lack of rational focus in assigning and enforcing spending priorities in the domestic arena. We recommend that certain program areas receive an increase in funding, reflecting their potential contributions to building a stronger America for the future. These programs constitute a positive investment in generations to come and will ultimately promote economic growth. Examples of such high priority programs follow:

Examples of High Priority Programs

Program	Recommended 1993-2002 Increases Over Current Projected Federal Investment (in billions of $)
1. WIC (prenatal care and nutritional programs for women, infants and children)	11.5
2. Head Start	46.0
3. Even Start	0.2
4. Funding for schools that serve disadvantaged children (Chapter 1) (assuming reform of Chapter 1 program as suggested in this report) plus increased research and development	87.0
5. Childhood immunization	15.0
6. Programs to enhance teacher quality	0.8
7. Manufacturing and critical technologies [through the defense budget]	[10.0]
8. Dual use technologies [through the defense budget]	[5.0]

The Commission believes that there are a number of areas in which projected federal spending cannot be justified as we move to put our fiscal house in order. For example, programs such as mass transit operating subsidies, now funded federally, may be appropriate governmental expenditures, but for reasons both of efficiency and fairness, the spending should take place at the state or local level. Although each program obviously has had its strong merits, the following programs are lower priority in terms of their contribution to building a stronger economy and should be critically reviewed with an eye toward termination:

Examples of Lower-Priority Programs to be Reviewed for Possible Termination or Reductions

Program	Potential Savings From Termination (1993-2002) (in billions of $)
1. NASA space station[a]	19.4
2. NASA advanced solid rocket motor	4.8
3. Postal subsidies for nonprofit organizations	3.9
4. New highway demonstration projects	4.4
5. Mass transit operating subsidies for large cities (capital subsidies would continue)	14.4
6. Economic Development Administration[b]	2.3
7. Appalachian Regional Commission[b]	1.5
8. Special purpose HUD grants	1.0
9. Davis-Bacon Act reform	8.2
10. Federal crop insurance (administrative expenses)	3.2
11. Low-cost timber sales	0.5
12. Prospective non-merit based federal grants, buildings, housing projects	1.8

[a] *A majority of the Commission believes as a general rule that [illegible] such as the Space Station [illegible] multilateral sharing of costs and benefits rather than being funded entirely by the United States. The Commission notes that many of the scientific activities planned for the Space Station can be carried out far more inexpensively by unmanned missions or by using the existing Russian station until such time as the cost-effectiveness of a larger space station has been demonstrated.*

[b] *Three-year phaseout*

about by large deficit reductions, would increase these savings to $387 billion, for a total reduction of 13% in projected interest costs..

These are hard recommendations. *Other choices are possible, but they are no less hard.* Balancing the budget without using the Social Security surplus by the year 2002 is a reasonable goal. Given adequate time to reform federal health care programs and implement cost controls, the proposal would have as a major benefit a reduction in program costs just as these programs would otherwise begin to create their greatest pressure on the budget.

There is no magic in the choice of 2002 or any other year — credibility and certainty are more important than specific dates. What matters is to set the budget on a clear, understandable course toward balance while laying the foundation for long-term economic growth.

"I believe ideas do have consequences. If we are to change fiscal policies to improve our saving performance, we need to extricate ourselves from the notion that saving is bad for the economy and adopt a longer term growth-oriented perspective. We need a framework in which the beneficial effects of saving, investment and long-term growth receive prominent attention and in which incentives to save and invest are recognized as important."

Commission Member
Manuel H. Johnson,
Former Vice-Chairman,
Federal Reserve Board

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RECOMMENDATION: **The Commission recommends that its fiscal plan be enforced through binding legislative changes.** *Enforcement legislation should be enacted by the end of 1993. We propose that the following steps be taken:*

STEP 1 - Not later than December 1993, Congress and the president enact the following budgetary and enforcement reforms:

- Extension of provisions setting multiyear caps on defense, international, and domestic discretionary programs.
- A new cap on non-Social Security mandatory programs.

After a phase-in period, caps would be established to limit the growth in mandatory spending to inflation plus the growth in the beneficiary population. Legislation would include enforcement mechanisms for automatic reductions (sequestration) if spending caps are exceeded.

STEP 2 - Not later than December 1993, Congress and the president enact a 10-year, $100 billion infrastructure investment package funded by selective increases in energy taxes and user fees, with the proceeds earmarked only for this program, but not effective until December 1995.

STEP 3 - Not later than December 1994, Congress and the president decide to adopt the consumption-based income tax in full and specify appropriate transition strategy that assures that revenue requirements can be met through consumption/cash flow taxes.

STEP 4 - Not later than December 1994, Congress and the president enact comprehensive health care reform in line with the principles outlined in this report.

STEP 5 - Enact a comprehensive consumption-based income tax by December 1995, with rates established to produce, in conjunction with the spending cuts mandated in STEP 1, a balanced budget in 2002. Revenue increases would take effect ONLY upon enactment of spending restraints called for under this plan.

* * *

RECOMMENDATION: **Tax Restructuring Strategy: The Consumption-Based Income Tax** *The Commission recommends abolishing the current income tax system and replacing it with a progressive consumption-based income tax system that would exempt all savings and investment from taxation.* This proposal has gained increasingly wide support from leading economists and tax experts of varying political persuasions. Since the Commission started its work, there has been significant new interest in structural tax reform. Our views on these issues are being clearly paralleled by other efforts in the private sector, in academia, and in government. In fact, Senator David Boren (D-OK) and Senator John Danforth (R-MO) have established a study group to develop a legislative proposal on a specific consumption tax.

The preponderant view of the Commission is that the time has come to begin implementing this structural alternative, reorienting our tax system toward the taxation of consumption. Our findings are consistent with a growing interest in a broad array of consumption tax proposals being advanced as either additions to, or replacements for parts of, our current tax structure. These proposals range from value-added taxes, to a business transfer tax, to cash flow taxes of many types, to a consumption-based income tax. Although each of these proposals substantively improves our current tax structure, the Commission strongly supports the complete adoption of a consumption-based income taxes for the following reasons:

- ★ It addresses many of the key issues of concern to the Commission and the major problems of the existing tax code.
- ★ When fully implemented, it emphasizes a long-term structural solution and avoids reliance on continuous tinkering with the tax code.
- ★ It is completely consistent with the current income tax structure and administrative framework.
- ★ It provides a fair and efficient basis for raising additional revenues.

DEFINITION

There is little depth or uniform understanding by the public of what is meant by a consumption tax. The standard response is "you mean a VAT," and the discussion stops. In fact, the term consumption taxes generally is used to describe three broad types of taxes: retail sales taxes, value added taxes, and the cash flow taxes on individuals and businesses that reflect the principal thrust of the Commission's recommendations.

Why base a tax structure on consumption rather than on income? Most experts argue the case on the basis of fairness and equity. Commissioner Rudy Penner notes, "Consumption can be thought of as the result of a household's own judgment as to what it can afford to spend, and it provides a good indication of the ability to pay. That may not be true for poor households, but a consumption tax would provide generous exemptions for the poor and the near poor at very low rates." Michael Boskin, chairman of the President's Council of Economic Advisers, has argued that "Household consumption patterns are a better reflection of permanent income than are fluctuations of current income."

Such a consumption-based tax would exempt savings from taxation. By removing the bias in favor of consumption inherent in the current

FIGURE 21

Illustrative Consumption

TAX RETURN

Receipts	Amounts
1. Wages, salaries, tips, etc.	
2. Dividends	
3. Interest	
4. Rents and royalties	
5. Pensions and annuities	
6. Net receipts of sole proprietorships	
7. Withdrawals	
8. Receipts from:	
a. sales of financial assets	
b. gifts and bequests	
c. insurance	
9. Net decrease (if any) in bank accounts	
10. Total (add lines 1 through 9)	
Saving	
11. Purchases of financial assets	
12. Capital contributed to partnerships in bank accounts	
13. Net increase (if any) in bank accounts	
14. Other investments	
15. Total (add lines 11 through 14)	
16. Gross Consumption (subtract line 15 from line 10)	
Deductions	
17. A. Itemized deductions	
or	
B. Standard deduction	
18. Federal taxes paid during the year	
19. Total (add lines 17 and 18)	
20. Net Consumption (subtract line 19 from line 16)	
21. Exemptions	
22. Taxable Consumption (subtract line 21 from line 20)	

Source: Murray Weidenbaum, The Case for Taxing Consumption, Contemporary Issues Series 54, Center for the Study of American Business, Washington University, St. Louis, July 1992, p. 8.

income tax code, neither consumption nor saving would be subsidized. The Commission believes that significant new savings or other benefits will result from this change. What is important to all members is to remove all tax-based bias from the decision to consume or save income.

From an administrative perspective, the consumption-based tax would be levied in very much the same way as the personal income tax. A taxpayer would take annual income, add gifts and bequests as well as net borrowings, and subtract all savings—basically net investments and the net change in his or her bank balance. The remainder would equal consumption, and the resulting amount minus exemptions would be taxed. Figure 24 illustrates how Murray Weidenbaum, former chairman of the Council of Economic Advisers, anticipates an actual tax return might look.

Under this structure, all sources of income are treated equally. Wages are not differentiated from interest or dividends or capital gains. None of these sources of income is taxed, and the income itself is only subject to tax if consumed, rather than saved. To some, the notion that capital gains would not be taxed is a problem. But consider the equally innovative, perhaps revolutionary, idea that wages would not have to be subject to tax for the same reason. Indeed, what is taxed is consumption over a lifetime.

The administration of a consumption-based income tax would rely on cash receipts and outlays. It would eliminate complex accounting measurement of income flows such as depreciation and amortization because investment outlays would be expensed immediately. Because it focuses on current receipts from asset sales and current expenditures, controversy over how to tax—or even define—capital gains would be eliminated. There would be no need for the current, complex indexing for inflation because the new tax system would focus on income and expense a year at a time.

Every effort must be made to ensure the new tax system is fair to middle and lower income taxpayers. A consumption-based tax can be as progressive as policymakers desire because, like the current income tax, it would use a rate table. The new approach could incorporate personal deductions and income exemptions to shield people with lower incomes from inordinate tax burdens. Under a pure consumption-based tax, business would not be subject to taxation. To reduce the burden on individual taxpayers, the Commission recommends a tax on business cash flow as a key element of the new tax structure.

With respect to international trade effects, border adjustments would occur automatically. Imports that were consumption items would be taxed to consumers. Income claims generated by export production would be taxed only if used for domestic consumption.

In summary, the compelling features of the consumption-based tax include its simplicity, efficiency, equity, contribution to net national savings, and boost to international competitiveness.

TRANSITION

The Commission recognizes that, under the best of circumstances, it will take time to design, discuss, and implement a consumption-based income tax system. But achieving this objective within the framework of our 10-year blueprint is both realistic and appropriate.

Restructuring is realistic because such reform does not start from ground zero at the Internal Revenue Service. The present tax code already contains elements that point toward consumption-based taxation, such as set-asides of certain income toward retirement that is not taxed immediately. Such savings are often deposited in IRA programs. Consumption-based taxation might be thought of as a way of allowing every wage earner in the country a universal and unlimited IRA. Moreover, converting from an income tax to a tax on consumption does not require setting up another collection system. The IRS can readily handle the conversion.

Restructuring is appropriate because the last major tax reform act, passed in 1986, has not provided sufficient basis, nor stimulus, for any increase in the savings pool. Saving is absolutely essential to economic growth. Many would welcome removal of the tax code's bias toward consumption, while realizing that the tax-ingrained behavior of individuals and private industry must first be overcome and national attitudes changed to put the public trust behind such reform.

Toward those ends, the Commission offers four key principles to guide the transition from the present tax code to a total consumption-based tax:

- Progressivity. Any tax on consumption must preserve equity, so that all citizens, no matter what their income level, share the tax burden fairly. This can be accomplished, as indicated above, through a progressive structure.

- Fiscal Responsibility. Over the transition, revenues must be raised consistent with the goal of increasing the projected revenue base by 3% ($376 billion) over the next ten years, to be used for deficit reduction.

  Additional tax measures now under discussion such as investment tax credits, capital gains differentials, and R & D tax credits, if implemented, should not increase the deficit over a five-year period. If these growth incentives are put into play during the phase-in of the consumption-based tax, they must be paid for on a progressive basis by broadening of the tax base, rate increases, or reduction in subsidies to high-income taxpayers.

- Transparency. Progressive changes and adjustments in the tax code during the transition must be clearly understood by all taxpayers, so that there is no sense that tax reform is another set of "tax gimmicks."

- Internal consistency. During the shift to a consumption-based tax, changes in the code must be all of a piece with the new consumption-based tax structure, deficit reduction, and economic growth.

Other, more immediate taxpayer concerns must also be ironed out during the transition, such as tax treatment of housing, interest income, interest expense, inheritances, and charitable contributions. But Congress and the president must first decide on the pace and scope of reform once a commitment, which the Commission recommends, has been made to a consumption-based tax.

CONCLUSION

The Commission understands full well that the preceding recommendations may not be initially popular, nor easy to implement. Requiring that mandatory programs keep within strict spending limits and subjecting them to sequestration if they do not is strong medicine. Imposing austere caps on defense and domestic discretionary spending for the next 10 years will require many tough choices. These spending reductions will require that some government programs be eliminated. And making the transition to a whole new tax system — taxing consumption instead of income — will be extremely difficult.

There will be those will say that these recommendations are too hard, that we cannot save that much money. But if we do not adopt this plan, or a viable substitute, we will be faced with two alternatives: huge tax increases or runaway deficits that will continue to deplete our savings and erode our competitiveness and our standard of living.

II. AN INVESTMENT PROGRAM TO PROMOTE ECONOMIC GROWTH

Restructure Education and Training

The key component of a public investment strategy is investment in human resources. In 1909, President Theodore Roosevelt said in a special message to Congress, "Each of our children represents either a potential addition to the productive capacity and the enlightened citizenship of the nation, or if allowed to suffer from neglect, a potential addition to the destructive forces of the community." More than 80 years later, we are even more convinced that Roosevelt had it right. If adequate resources, wisely deployed, are devoted to children and young people, the nation will have a productive work force; if children and young people are neglected, poor productivity, a disaffected citizenry, and rising crime will be the results.

> "More than half of our young people leave school today without the knowledge or foundation acquired to find and hold a good job."
>
> *William E. Brock, President, The Brock Group*

Strong schools, strong work force training programs, and strong families are the components of a strong educational system. We cannot be a first-rate country with a second-rate school system. We cannot compete successfully in a global economy with a low-skilled, low-wage work force. Without supportive, involved families, we will play constant catch-up with children ill-prepared to learn.

School systems and schools are rarely rewarded for improving student achievement, rarely helped when they don't, and rarely held accountable when students persistently fail.* Schools should be held accountable, but they should also be given resources and incentives to produce better results. The public might be more willing to invest in education if there were measurable achievements tied to tax dollars.*

In the United States, education has historically been the responsibility of the state and local governments, although since Sputnik the role of

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*The Commission will deal with 'school choice,' school finance equity, governance, and other educational issues in its future work the federal government has received increased attention because of the urgency of global competition. The Commission, however, believes that promoting and supporting quality education is a responsibility not just for government, but for business as well. The private sector's view must extend further than just to the next graduating class of prospective employees. Government, the education community, and business must be partners in a long-term effort to revitalize the American education system.

A NEW SYSTEM OF NATIONAL STANDARDS

FINDING: Compared to our competitors and to our own national needs, America's expectations for what the vast majority of our students should know and be able to do are minimal. Not surprisingly, those minimal demands are being met by minimal achievement.

"The problem with our [educational] system and structure is that there is no reward for change, for creativity, for initiatives. We have a system that cherishes mediocrity ..."

William H. Gray III, President and CEO, United Negro College Fund

To the extent that we have educational content and student performance standards, their quality and rigor vary enormously by state, district, and school and are generally below the levels demanded in other advanced industrial societies. By and large, our elementary school students are fed a steady and repetitive diet of low-level basic skills, our college-bound students are not being prepared for college-level work, and our work-bound students get the kind of low-level educational fare that has dubbed them "the forgotten half."

RECOMMENDATION: To achieve both excellence and equity, our nation should develop educational content and student performance standards in core subjects such as mathematics, English, civics, the physical, natural, and social sciences, and the arts. The standards should draw on exemplary work being done by the states, subject-matter specialists, other professional organizations, and our competitors. Although the federal government should not directly develop these standards, Congress should establish an entity to coordinate and ensure the quality of this effort and monitor its results.

RECOMMENDATION: All students should be expected to meet a rich common core of standards by the time they graduate from high school, though they should be enabled to do so as early as they wish. Meeting those standards would earn students a certificate of initial mastery that signified preparation for democratic citizenship and readiness for high-productivity employment. Other certificates or diplomas certifying that students had met more advanced or specialized standards than those called for by the certificate of initial mastery should also be available to any college- or work-bound student willing to pursue them. All students should have multiple opportunities both for demonstrating proficiency in the core subjects required by the initial certificate and for pursuing and meeting higher standards, not only during their formal school years but throughout their careers.

* * *

FINDING: To prepare our youth for life in the real world, schools need to do more than teach formal academic subjects. Students must also learn communication and thinking skills (such as decision making, reasoning, and problem solving), as well as values (such as responsibility, integrity, and discipline), to be successful in adult life and work.

RECOMMENDATION: The Secretary of Labor's Commission on Achieving Necessary Skills (SCANS) has identified skills and qualities that students need to succeed in the labor market. These competencies include the ability to (1) identify, organize, and allocate resources; (2) engage in interpersonal communication and work with others; (3) use, organize, and maintain information; (4) comprehend and design systems; and (5) work with a variety of technologies. The SCANS competencies should be integrated into the school curriculum, with employers, professional associations, and the education community guiding the development of curriculum.

* * *

FINDING: Educational testing in the United States is currently a vast but unproductive enterprise. Elementary and secondary school students take 127 million standardized tests each year, an average of three per child, according to the National Commission on Testing and Public Policy. Standardized achievement tests are not linked to the school curriculum and do not reflect academic effort and achievement. Current tests do not provide a meaningful guide to employers for assessing competencies of young people entering the job market.

RECOMMENDATION: The Commission recommends that high-quality educational content and student performance standards be supported by high-quality student assessments. Most other industrialized nations subject students to demanding exams that require advanced knowledge and critical thinking; we should move toward a new type of assessment process and away from exclusive reliance on the standard multiple-choice format. Assessments should be linked to school curricula, should measure student achievement rather than aptitude, and should require that students demonstrate not only the recall of facts but also their application.

"The U.S. labor market allocates entry-level jobs more or less like a lottery. Less than 15 percent of employers...examine the transcripts of recent high-school graduates when choosing which ones to hire."

Isabel V. Sawhill, Senior Fellow, Urban Institute

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FINDING: One of the reasons that some of our students do not work hard and achieve in school is that they, unlike students in many other countries, have few external incentives for doing so. Students know that some colleges will admit them no matter what their courses and grades were, and they also know that most employers are even more indifferent to their record of high school achievement.

RECOMMENDATION: To support the shift to higher expectations for student achievement at the secondary level, colleges, professional schools, and technical programs should raise their entry-level standards over a 10-year period. Financial aid should be based not only on financial need, but also on solid academic achievement in secondary school. The nation — through student assistance and national service programs at the federal level, through scholarship programs of colleges and universities, and through scholarship programs of foundations — should ensure that financial need no longer be an obstacle to higher education for students who have performed well in school. In addition, employers, working with employees, employee associations, and unions, should reward high-achieving youngsters with better entry-level jobs at better wages.

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FINDING: Demanding content and performance standards and high-quality assessments are necessary but not sufficient conditions for dramatically improving school and student performance. Schools and students must also be given the tools and opportunities necessary to meet new standards.

Access to such basics as high-quality curriculum and materials or professional development is extremely limited. For some schools, preparing their teachers and their students to meet high standards will require additional resources.

RECOMMENDATION: Federal and state governments should ensure that poor schools have the requisite resources to prepare their students to meet new and more rigorous standards. The federal government's Chapter 1 program helps educationally disadvantaged elementary and secondary schoolchildren from poor families. However, only 65% of educationally disadvantaged children are now being served. Federal investment in the Chapter 1 program should be increased over the next 10 years by $87 billion more than currently projected increases, contingent upon the reform program spelled out by the Commission. Some portion of these funds should be earmarked to support the nation's R&D, as well as to meet the need of educating disadvantaged children.

The National Science Foundation, prominent educators such as Professor Jim Comer of Yale, Commission members Joseph Fernandez, head of New York City Schools, and Mayor Norman Rice of Seattle have all argued strongly for rebalancing power toward principals, teachers, and parents. A high degree of school autonomy encourages teacher initiative, promotes ownership, and puts important decisions about the particular needs of children in the hands of people closest to the situation. Therefore, the Commission recommends that schools with a high ptoportion of educationally disadvantaged children that receive Chapter 1 funds should be permitted flexible use of funds *if* those funds are used to make major educational reforms and if schools are held accountable for achieving results.

Continued flexible use of funds would be contingent upon improved student academic achievement.

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FINDING: As the quality of American K-12 education has declined relative to other industrialized countries, the U.S. educational bureaucracy has continued to mushroom. It is clear that in many school districts, resources are being diverted from the classroom by administrative bureaucracies. This administrative excess has a twofold negative impact on classroom education: first, large central administrations consume funds that are urgently needed in the classroom; second, bloated bureaucracies hamper the diagnosis of problems at the local level and slow new reforms and initiatives to tackle them.

Because of the diversity of student educational needs, there is no one set of solutions that will prove effective throughout the nation, or even throughout individual school systems. We need national standards, but local educators must be given flexibility in attaining them. Resources, authority, and responsibility must be returned to the schools and classtooms.

RECOMMENDATION: Educational administrators, from the U.S. secretary of education down to school principals, should be instructed to cut administrative overhead and return these funds to the classroom. Bureaucracies should be streamlined to allow for more classroom and school-level initiatives. The recent cooperative effort of Cincinnati's business leaders, school administrators, and teachers should be a model for other school districts. Over a two-year period, Cincinnati will save $16 million, or $170 per student, by slashing administrative costs. The organizational and decision-making flow has been altered as well — 51% of central administration personnel have been eliminated. The revamped system puts principals in far closer contact with the superintendent and deputy superintendent. As in Cincinnati, business leaders and taxpayers in school districts around the nation should initiate debate over bureaucratic reform and then join with educators and administrators to suggest changes.

IMPROVE TEACHER QUALITY

FINDING: Students require teachers who are capable of helping them meet proposed demanding educational content and student performance standards. However, chronic shortages of qualified teachers are endemic. For example, few elementary school teachers who are now teaching were required to have a background in science and math or in how to teach those subjects, and current state licensing requirements have improved little over the years. Few constructive steps have been taken to deal with the problem.

A combination of factors has worked in recent years to diminish the allure of the teaching profession. In the past, intelligent women, denied opportunities in other professions, turned to teaching if they wanted to pursue a career. Opportunities for women have grown during the past two decades, however, and many intelligent women have chosen to pursue other career paths. Moreover, in the past, teachers held a position of high esteem in communities. Today, when quality education is more vital to students than ever before, there is little incentive for creative, talented people to teach: many of the nation's best and brightest students pass up the teaching profession in favor of more prestigious, less stressful, and higher paying professions.

RECOMMENDATION: To improve the caliber of America's teachers, the Commission recommends the following:

- Incentives should be provided to attract new teachers into subject areas in which teachers are in short supply, such as math and science. The education community — including school boards, principals, parents, teachers, and unions — should offer higher pay to teachers qualified to teach subjects for which teachers are in short supply, rather than making do by hiring out-of-field teachers. Incentives also should be provided to current teachers to requalify in areas of shortage.

- The education community should develop and integrate pay-for-knowledge systems into school staff salary schedules. Currently teachers' advancement is based in part on post-secondary degrees and credits, but there is great latitude in what programs and courses they may take. Those choices should be narrowed by actual need. Knowledge and skills that are necessary to enhance students' abilities to meet higher standards should be identified. After successfully demonstrating these new skills and knowledge, teachers should get more pay.

★ States should encourage teachers to become certified by the National Board for Professional Teaching Standards (NBPTS), a non-profit organization that has established high and rigorous standards for what expert teachers should know to be able to teach well. Congress has authorized $25 million for the NBPTS, a portion of which has been appropriated. Congress should appropriate the balance of the funds. Salary differentials for Board-certified teachers should be negotiated at the local level. States and districts should take steps to ensure that districts serving poor children have a fair share of Board-certified teachers.

★ Immediate incentives should be offered to recruit and encourage the best and brightest students to pursue teaching careers. Beginning in the second or third year of high school, as students begin to weigh career options, teaching should be encouraged as a profession. Career fairs should expose students to the opportunities and benefits of teaching. All groups tied to the educational system — from private companies and community groups to school districts and the federal government — should be encouraged to offer scholarships and loans to those pursuing K-12 teaching careers. The federal government should inaugurate a new program to help pay for the undergraduate education of any high school student who ranks in the top 10% of his or her high school graduating class and who is willing to teach in public schools. The assistance would be in the form of $4000 per year in convertible loans, to be forgiven by the federal government when the student accepts a teaching position in a public school after graduation. The federal government should appropriate $25 million annually for this honors program.

★ National standards should be developed for state alternative-teacher certification programs to allow qualified individuals who do not have an education degree to enter the teaching profession. Archaic state teacher certification requirements pose a barrier to attracting qualified people to the teaching profession. Only a few states have quality alternative-teacher certification programs that allow non-certified professionals from other fields to enter the teaching profession even in periods of non-shortage. New Jersey has had excellent results with its program; it should be examined as a model for the development of national standards for alternative certification.

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FINDING: Personnel reductions in our uniformed and civilian military services and in defense industries will provide an opportunity to bring highly trained individuals into the teaching profession. It is estimated that more than one-sixth of all military officers have advanced degrees in math, science, or engineering. Today's armed forces also have a corps of non-commissioned officers experienced in training and motivating young disadvantaged men and women. These separated military personnel could be a valuable resource as teachers or teacher assistants working with at-risk youth. The Department of Energy has instituted a partnership between the national weapons laboratories and the education community; national laboratory scientists are deployed as teacher trainers, instructors, and curricula developers.

RECOMMENDATION: The Commission recommends creating incentives to attract separated military and defense industry personnel to the teaching profession. Retirement benefits can be a powerful incentive to teach. Military retirement benefits are secured after 20 years of service and increase until 30 years of service. One incentive to teach would allow those with at least 15 years of service to leave the military while continuing to earn retirement benefits on a one-to-one basis. The costs would be shared by the armed services, school districts, and teachers' pension plans. Before they begin teaching, many service personnel may need or want to take course work in education. The G.I. Bill should be extended and complemented by funds from school districts to provide additional education and stipends for veterans who agree to teach.

Some separated military personnel lack college degrees but have extensive instructional and disciplinary experience, especially with disadvantaged males. These veterans could alleviate the dearth of role-models and mentors for inner city children. A program should be established to place these veterans as teaching assistants and program leaders at community service centers.

STRENGTHEN THE WORK PLACE

If we were to *design* a system guaranteed to produce a declining standard of living, it could not be any more brutally effective than the process we already have to prepare our people for work. Seventy percent of the jobs in the United States do not require a college education, yet we pay little attention to the preparation for those jobs: 50% of our young people do not go to college, but our public resources are devoted almost exclusively to those who do. Unlike our competitors, the United States has no system to assist the transition from school to the workplace or to educate and train its front-line workers. Such a system was not necessary for a mass production that demanded little of its front-line workers, but the information and technology revolution, which requires constant modification and improvement in products and services, has changed the situation.

FINDING: The majority of high school and college students work while they are still in school, but that experience rarely has any relationship to classroom learning and rarely offers career paths for students. In contrast, our European competitors have a structured system of school-to-work transition that combines academic instruction, apprenticeships, and workplace experience.

"...much of our effort, I think, has been directed more at the supply side of the educational system rather than at the demand side, which is the job."

Howard D. Samuel, President, Industrial Union Department, AFL-CIO

RECOMMENDATION: Structured on-the-job learning is the missing link in the partnership between schools and employers. Business and industry must be full parrners in providing work site experiences.

Government, business, and labor should work together to establish apprenticeships that combine certifiable skill training, academic instruction, and work experience. Current projects combining secondary vocational education with two years of post-secondary education — "tech-prep" — should be expanded. Apprenticeship programs should be expanded in high schools, colleges, and universities. Occupational training should provide broad-based skills and offer opportunities for further training and occupational advancement.

National Service Demonstration Program

The National and Community Services Act of 1990 marks a bold new way of meeting critical social needs in our local communities, while providing young people a chance to earn money for college. This legislation established a three-year demonstration program that will make a $5,000 education voucher available to young people who perform a year of service on projects from home health care to solid waste management. In June of 1992, the Commission on National and Community Service awarded approximately $60 million in grants to test new and expanded community service projects in nearly every state.

For example, Georgia was one of the states selected to host a full-time national service demonstration program, through a new state initiative called the Peach State Service Corps. Georgia's program will begin operating in the fall of 1992 at two rural test sites where both young people and senior citizens will work on projects identified as critical to the local community's strategy for self-improvement.

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FINDING: In the United States, there are only minimal standards to measure skill competencies. Most occupational training certifies only program completion or graduation. Such certifications are not necessarily recognized by employers or transferable from job to job or state to state.

RECOMMENDATION: The Commission supports the efforts by business, trade associations, educators, and labor that are already under way to develop a system of technical and professional standards for occupational training. Technical and professional certificates, which are recognized by employers and post-secondary institutions, should be available for the entire range of services and industries and should include rigorous qualifications and standards.

* * *

FINDING: Many of our best companies recognize that investment in the skills of their workers is essential for survival, but other employers are unwilling or unable to spend substantial resources on training. Although front-line workers are the backbone of our economy, they are the least trained members of the work force. Employers spend an estimated $30 billion on formal training, but only 8% of front-line workers receive any formal training. Japanese auto workers get more than 300 hours of training in their first six months of work, compared with fewer than 50 hours for U.S. auto workers. Our competitors devote an average of 3 to 4% of payroll on formal training; U.S. employers spend an average of 1.4% of payroll, and most of that is spent by the largest 100-200 U.S. companies.

RECOMMENDATION: U.S. employers should be encouraged to invest in their workers. A target of 2% of payroll for training is reasonable. Congress should develop incentives and technical programs to increase training and upgrading of the work force, not just for top management but also for front-line workers. Programs receiving government funding should be benchmarked against the most effective in the world. Existing programs that do not meet these standards should be eliminated.

PREPARE YOUNG CHILDREN AND THEIR FAMILIES FOR LEARNING

FINDING: Most parents are concerned about the well-being of their children, but there are only 24 hours in a day, and the competing obligations of work and home and the fragmentation of the family put parents under unrelenting time pressures. The loss of community leaves young children without the support they need. A 1991 Carnegie Foundation survey found that 35% of the nation's children lacked the physical well-being, social confidence, maturity, language skills, and knowledge for school readiness. These deficiencies are most devastating for the least advantaged children, many of whom come to school with the added burdens of family violence, drugs, and poor health.

The most effective interventions for at-risk children involve very early services, beginning with prenatal care and infancy and continuing through pre-school programs such as Head Start. Research has shown that every $1 invested in quality preschool education saves $6 in later costs related to special education, public assistance, and crime-fighting.

By far the most influential teachers are parents. Parents' attitudes toward education, their expectations for their children, the values they impart, and the environment they provide for learning all have an enormous impact on educational success.

Thus, the very best programs focus on the parent as well as the child. Teaching parents to read, encouraging them to complete their education, and training unemployed parents for work increases their self-esteem, makes for better parenting, and provides for increasing economic self-sufficiency. Preliminary results point to great benefits from these "inter-generational" programs.

Regrettably, family services are fragmented and uncoordinated. Parents are faced with a bewildering array of federal, state, local, and private programs and services. The multiplicity of service programs results in redundancies in some areas and gaps in others. Moreover, compared to our major competitors, we have very few of these programs. Clearly, programs that strengthen the family and provide early childhood education have not "broken the bank" in other countries; on the contrary, they have served as investments.

RECOMMENDATION: The Commission strongly endorses the following programs that promote school-readiness in young children and support families and urges increased support for them:

★ WIC (Special Supplemental Food Program for Women, Infants, and Children). The federal government should expand its support for prenatal care and nutrition programs for women, infants, and children through the WIC program. WIC is highly cost-effective: studies show that for every $1 invested in WIC, $3 is saved in later health costs. The prenatal component of WIC is absolutely essential in improving the health and learning prospects of children; infants whose mothers do not receive adequate prenatal care are more likely to be physically at risk, intellectually deficient, and restricted in their capacity to learn.

Federal school breakfast programs should also be expanded to target nutrition assistance to poor families with children.

★ Childhood immunization programs. Six million children are not immunized, and the incidence of immunizable disease has increased. All school-age children should be immunized: for every $1 invested in immunization, $10 is saved in later medical costs. Those who cannot afford such immunizations should be provided them through existing federal programs such as those administered by the Center for Disease Control, the Community and Migrant Health Centers, and the National Health Service Corps. New programs should be developed to provide outreach through preschools and elementary schools and through mobile facilities to ensure that every child in America is immunized.

★ Head Start. This federally funded program should be made available to all three- and four-year old children, with non-disadvantaged children participating on a completely reimbursable basis. A full-day option should be provided and follow-up made available to children most in need. As these programs are expanded, the Commission strongly recommends careful monitoring to ensure that quality is maintained. Pre-school programs, including Head Start, should be closely integrated with the schools to ensure continuity in learning.

★ Federally funded "inter-generational" programs. During the past two years, enriched Head Start and Even Start programs have provided or arranged for education, employment, and parenting skills programs for mothers, as well as on-site developmental childcare. These programs show some early successes, and the Commission recommends their expansion.

"New partnerships between cities, schools, businesses, and neighborhoods...are the only way we're going to move forward at the local level, and the modest expenditure of seed money to encourage new partnerships will bear tremendous fruit in the years ahead."

Commission member Norman Rice, Mayor of Seattle, Washington

★ State-funded parent education programs. States should make these programs available to help parents give their children the necessary foundation for learning. Minnesota's Early Childhood Family Education Program and Missouri's Parents as Teachers programs are models of parent education programs that not only enable parents to learn more about child rearing, but also involve parents in the schools (see box below).

★ Local "one-stop shopping". Communities should investigate providing family services at a single site. Schools, libraries, recreation centers, or other institutions can serve as community centers, providing health clinics, child care, recreation, and family support services. Experience has shown, through the innovative "Cities in Schools" program, that a coordinated array of such services can be provided to the community through independent, local public/private partnerships, usually located at the schoolhouse. Relevant federal and state agencies should review their regulations and service structures for barriers to coordination and efficiency and rationalize them accordingly.

Helping Parents Nurture and Teach their Own Children

Minnesota's Early Childhood Family Education Program serves children under the age of five. Currently 180,000 children and their parents attend a two-hour session each week at a school or work place. During the first hour, parents and children meet together with a teacher-observer who gives development advice. During the second hour, parents meet alone with teachers to discuss their successes and failures.

Missouri's Parents as Teachers program serves all families in the state that have children under the age of three. Parents are recruited at childbirth classes, doctors' offices, and health clinics. The program provides home visits, monitors the health of children, and gives instruction in child development. The program is reported to have dramatically increased the knowledge of parents and the school performance of children.

Taken from Ernest L. Boyer, *Ready to Learn: A Mandate for the Nation* (Princeton, NJ: The Carnegie Foundation for the Advancement of Teaching, 1991), pp. [illegible]

FINDING: In order to "touch the future," as the teacher-astronaut Christa McAuliffe said, parents must be with their children more. Most children are raised in families in which both parents work, or in which a single working parent is the head of the household. Conflicting demands on time and energy place inordinate stress on the family, and children frequently are the losers. Providing adequate child care and finding the time to be with their children are major challenges for working parents.

RECOMMENDATION: Pro-family policies on parental and medical leave should be established. Some Commissioners believe that employers should be encouraged to provide incentives voluntarily; other Commissioners believe that companies should be required to provide parental and medical leave, per legislation passed by the House and Senate. In addition, companies should consider allowing flexible work scheduling, working at home, and career sequencing to enable working parents to spend time with their children and meet family obligations. The Commission is united in advocating that parents should be given greater opportunity by the business community to spend more time with infants and young children.

CREATE A MORAL CLIMATE FOR CHILDREN

FINDING: The National Commission on Children reports that "too many young people seem adrift without a steady moral compass to direct their daily behavior or to plot a thoughtful and responsible course for their lives." This is not our children's fault; it is ours.

Messages from the media, advertisers, and the entertainment industry directly or implicitly glamorizing alcohol, greed, violence, sexism, and drugs are often stronger than the messages about morality that children get from their parents. More than ever before, children need the strong guidance that family, friends, places of worship, schools, and communities can provide.

RECOMMENDATION: Parents should teach their children about moral behavior and should monitor the values to which their children are exposed. Although they are no substitute for the parents' role, schools should adopt strong programs on values and ethical behavior. Honesty, ethics, self-discipline, and community and individual responsibility should be stressed. Ethical behavior — not merely ethical dilemmas — should be taught by example and precept.

Although teaching values is important, actual behavior and its consequences are what count in learning those lessons. Every school and school district should develop and enforce clear and fair codes of conduct and discipline. It may sound old-fashioned, but schools should once again make attendance and promptness count, because those are the precursors to a work ethic. Districts should review their interpretations of students' rights rulings to see if educators are being too cautious and lawsuit-shy, thus holding the majority of our youngsters, especially in urban schools, hostage to chronically disruptive and violent students.

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FINDING. Commercial television is a pervasive influence on children, both as an educator and a molder of values. A five-year old is likely to have watched more than 4,000 hours of television by the time he or she enters kindergarten. Television can be a valuable tool for education and enrichment, but far too little television programming serves the best interests of children.

RECOMMENDATION: Parents should monitor the amount and content of their children's television viewing. Publication of a television guide for programs of value to children would help parents guide the viewing habits of their children. The television industry must take responsibility for its enormous impact on children and provide suitable programming and suitable messages about the value of school work. The Commission calls on all CEOs to personally review all programs their companies sponsor and all advertising for their companies' products and services, considering the messages such programs and advertising impart to children and families. The Commission calls on all American companies to develop companywide policies about programming and advertising to promote values that serve the best interests of children.

Strengthen The American Industrial Base

In the United States, the primary responsibility for producing competitive goods and services rests with the private sector. At the same time, government can and should provide an economic environment that allows companies to maximize their abilities to become more productive and produce high-quality products. Although the U.S. industrial base is one of the strongest in the world, clearly U.S businesses and the U.S. government must take measures to strengthen it.

Within some business sectors, American firms excel in management, quality of product, and rapid delivery of services. For example, in the pharmaceutical, chemical, aerospace, industrial and analytic equipment, and information services sectors, our companies lead the world, and strong worldwide demand exists for American products.

In other areas, however, our companies are struggling. American companies that produce telecommunications equipment, computers, motor vehicles, and electronics are being challenged by Asian and European companies. In these industries and others, management must develop new attitudes and strategies and learn new techniques to remain or become globally competitive.

WHAT BUSINESS CAN DO

The Commission notes the tremendous amount of research and study that has been done on the subject of competitiveness and points in particular to the pathbreaking work produced by the MIT Commission on Industrial Productivity, *Made in America*. which documents how the 30 "best practice" American companies are meeting the global challenge. Total quality management, just-in-time manufacturing, constant refinements in process technologies, and continuous training of front-line workers are among the management strategies that these companies use to become global competitors. Rather than attempting to generate increased earnings through ventures in unrelated business, successful companies give priority to expanding and

"As America practices its strategy of return on investment, it abandons areas of lower return for greater profit. But products and markets become interconnected over time, and what is abandoned often becomes essential to that which is left. The resulting fragmentation of America's industrial base ensures its lack of competitiveness."

Richard J. Elkus, Jr., Chairman, Prometrix Corporation innovating in their core areas. These companies invest for the long term in the development of technologies, products, and markets that are related to their specialties, rather than looking to make a "quick buck" investment in other companies outside their product area.

> "Our main problem, quite simply, is motivation. We need to work harder and more systematically. It is all too tempting to comfort ourselves that some simple reform — changing the tax structure or the management structure, teacher certification, or spending more on 'critical technologies' — will solve our problem. Such mechanical devices may be useful, but will not suffice. Compared to our principal competitors, we have become lackadaisical, if not rather sloppy. In addition to any 'package' of reforms, we need something more — a new dedication, a new seriousness."
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> *James Schlesinger, Counselor, CSIS*

WHAT GOVERNMENT CAN DO

The federal government can take some important steps to strengthen the American industrial base. As noted earlier in this report, the federal government must put its fiscal house in order to increase the availability and decrease the cost of capital for productive business investment. It must overhaul the tax code so that it encourages saving and stimulates investment in productivity-enhancing research and development, equipment, and work force training. Federal, state, and local governments must help strengthen our schools and our families. All of these measures would strengthen the American industrial base.

> "I believe that the singular most significant thing that this Commission could do would be to advocate that the president declare that it shall be a national policy for all companies of a minimum size to go for the Baldrige Award."
>
> *Robert W. Galvin, Chairman of the Executive Committee, Motorola, Inc.*

This section discusses additional measures that government could take to leverage the work of private industry. Effective allocation of federal R&D resources, increased government investment in infrastructure, and improved government statistical capabilities would all help to increase the productivity and profitability of private companies. The federal government has an important role to play in linking diverse organizations (such as the national laboratories, private companies, and universities) that are needed to foster innovation. Finally, government should eliminate, overhaul, or clarify procurement and antitrust regulations and policies that discourage the marketing of technological innovations. Clearly, an integrated apptoach to strengthening the U.S. industrial base is missing — and is needed.

R&D Spending in Japan and the United States

For the first time since the 1970s, American spending on R&D, including government and private money, has begun to shrink. Although the U.S. government far outspends the Japanese government on R&D (by between two-and-one-half and five times, depending on how calculated), about 55% of U.S. R&D funds go to defense. In Japan, the government devotes virtually all of its R&D to practical commercial applications.

The more interesting question is whether Japanese private companies are now outspending U.S. private companies on R&D. The answer depends, in part, on how dollar-yen exchange rates are calculated. By one measure (purchasing power parities), Japan spent the equivalent of $41.9 billion, or a little more than half the American sum, on research in 1989. Using market exchange rates, it appears that Japanese companies spent $61.8 billion. As calculated by the Japanese, it jumps to $71.1 billion, or roughly what American business spent.

No matter how calculated, however, the trend line is clear. Annual R&D growth has been consistently over 10% in Japan during the past three years. Meanwhile, growth rates in industrial R&D in the United States have been stagnant.

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FINDING: More than half of U.S. R&D is funded by U.S. industry. R&D investment and efforts require a long-term commitment, but that commitment has become increasingly threatened by the financial markets' insistence on short-term results. The government tax credit for research and experimentation has, for the past several years, been extended to business in short-term increments. This greatly diminishes its effectiveness, complicates business planning and investment decisions, and exacerbates the tendency to think short term instead of long term.

RECOMMENDATION: To encourage sustained private sector commitment to R&D, the Commission recommends extending the current 20% research and experimentation tax credit through the transition to a consumption-based tax. Its provisions should be amended expressly to include expenditures on process technologies and cooperative research done at the national laboratories.

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FINDING: Advanced manufacturing technology receives little government R&D funding, although it is of tremendous importance to many sectors of our economy. In fiscal year 1991, the U.S. government spent $68.8 billion on R&D, allocated primarily to defense, health, energy, and space technologies. Less than 2% was devoted to manufacturing technology, and 80% of that was defense related.

RECOMMENDATION: The Commission recommends that manufacturing technology should be added as the "fifth horseman" to defense, health, energy, and space R&D. Recognizing that manufacturing technology spans all R&D areas, each responsible federal agency should review its programs and support the development of manufacturing process technology as a concurrent and important aspect of ongoing R&D programs. Compared to what the federal government now invests in manufacturing R&D — less than 2% of its total R&D budget — even an additional 1% allocation to manufacturing technology from existing agency R&D budgets would amount to a significant increase in current funding. Rewards to the U.S. economy from such a small reallocation would be very large.

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FINDING: The national laboratories, an invaluable asset in meeting the military challenges of the past, must now be given a new mission: helping us meet the economic challenges of the future. Many national laboratories must continue to devote much of their resources to defense-related work, but all laboratories can and should channel their excess capacities into strengthening America economically. Industry can leverage its research budgets by entering into partnerships with the laboratories and benefit from their expertise in contributing immediately to large-scale projects such as environmental restoration and waste minimization, energy efficiency and supply, advanced manufacturing, high-performance computing, and health care.

"[The National Laboratories] must find ways to establish closer ties with industry by developing shared goals and by collaborating on a much larger scale than we've done in the past. This can be done through cooperative R&D arrangements and personnel exchange."

Al Narath, President, Sandia National Laboratories

With federal support, the scientists at the Department of Energy National Laboratories and the National Institutes of Health are on the cutting edge of health and biotechnology research, including research into our "genetic inheritance." The research has the potential to eliminate scores of deadly diseases that have a basis in our genetic-make-up. The elimination of these diseases could be achieved within this decade.

The challenge for environmental protection and economic growth is to achieve both while compromising neither. Environmentally conscious manufacturing and waste minimization programs focus on working with U.S. industry to bring environmental considerations into play at the beginning, planning, and design of manufacturing systems. Because pollution and waste would not be created in the first place, the manufacturing process would not result in clean-up problems in the future. Environmentally conscious manufacturers should design products from the cradle to the cradle — from the beginning to the point at which the product is reincarnated as something else. The interdisciplinary resources of the national laboratories make them a vital partner if we are to achieve this goal and other futuristic innovations.

RECOMMENDATION: The United States has made a major investment since the end of World War II in its Department of Defense and Department of Energy national defense laboratory infrastructure — an investment that cannot be allowed to atrophy in a dramatically changing national defense environment. The Commission recommends that the White House science and technology adviser, the national security adviser, appropriate cabinet members and representatives of the private sector establish a senior level working group to review and revise the missions of these laboratories to permit their best use to support both national security and economic growth. In addition, this group should address impediments that currently exist (such as the time needed to negotiate R&D agreements, the cost to industry to use laboratory facilities, and the assignment of intellectual property rights) and recommend changes to remove them.

The Commission also supports legislation pending before Congress that would promote the transfer of technologies developed in national laboratories to the private sector and encourage increased partnerships between industry and the national laboratories. This legislation would establish the legal framework for business-laboratory partnerships and mechanisms for shared research. It would increase businesses' access to the laboratories so that their role would be more like that of a business partner than a government bureaucracy.

FINDING: Technological leadership is absolutely vital to national security and national economic performance. Although our government has provided much support for technology critical to national security, far fewer resources have been allocated to technologies with significant commercial potential. Moreover, in fast-moving dual-use technologies — those with both commercial and defense applications — the Department of Defense has gone from being a technological leader to a follower. Although defense technology investments still have a powerful impact on commercial technology, the defense technology base is increasingly dependent on developments in the more dynamic commercial sector.

In contrast to the U.S. government's pattern of R&D allocation, our trading partners have spent most of their R&D funds on efforts to commercialize technology. The Japanese government, in particular, emphasizes commercial applications and supports industrial needs.

RECOMMENDATION: The Commission recommends the passage of legislation that would transform the Defense Advanced Research Projects Agency (DARPA) into the National Advanced Research Projects Agency (NARPA) in order to help integrate defense and commercial technologies into a strong, unified national technology

Civilian R&D Priorities

Civilian R&D priorities have changed significantly during the past 40 years, reflecting changes in our economic conditions and priorities.

- In the 1950s, nuclear energy absorbed over 50% of the nondefense R&D budget.
- In the 1960s, we raced to put a man on the moon. At one point. NASA received over 60% of the nondefense R&D budget.
- In the 1970s, reflecting concern about two "oil crises," the percentage of funds directed toward space declined as a greater percentage of R&D shifted to energy conservation and alternative energy programs.
- In the 1980s, the federal civilian R&D budget was less skewed toward one program. Energy received 30% of funds, health received 20%, space 20%, and general science 8%.
- The 1991 R&D budget, in terms of allocation, is very similar to the budget of 1980, with one exception — health R&D has increased to over 30% of the nondefense R&D budget.

Source: Manufacturers Alliance for Productivity and Innovation, *Restoring Manufacturing Competitiveness: Why Current Research and Development Programs Should Be Changed*, MAPI Policy Review PR-117, November 1991, p. [illegible] base. While NARPA would remain within the Department of Defense and would continue to support technologies of potential military importance, it would focus more heavily on dual-use technology and reach out to commercial firms that traditionally have not worked with the Department of Defense. DOD would benefit by getting faster and cheaper access to commercial technology, and commercial firms would benefit by the availability of additional federal R&D dollars. In addition, NARPA would be allowed to support advanced technologies that are primarily aimed at the missions of other federal departments and agencies, but only when other agencies request and pay for that support.

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FINDING: Federal procurement policies and regulations slow down the commercialization of technology and widen the manufacturing gap. They have forced many major U.S. companies to split their operations in two: one part of the company handles commercial activities, the other handles federal government (mainly defense) business. In these companies, products are designed, developed, engineered, and produced in isolated plants or independent divisions. Little or no technology transfer takes place between defense and commercial divisions.

RECOMMENDATION: The federal government should overhaul its procurement regulations to remove regulatory and legal barriers that create a wedge between commercial and defense business and needlessly hinder the commercialization of technology. Regulations concerning cost accounting requirements, technical data rights, unique contract requirements, and military specifications should be amended.

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FINDING: Although part of the economic landscape for a long time in both Japan and the European Community, the R&D consortium of private firms is a relatively new phenomenon in the United States. Sematech, receiving government and private industry funding, is perhaps the most well-known U.S. consortium; others include the National Center for Manufacturing Sciences, Microelectronics and Computer Technology Corporation, and Computer-Aided Manufacturing International.

Most forms of consortia and technical cooperation among companies do not violate U.S. trade or antitrust laws, but they are seldom used because they buck an American corporate tradition of independence and involve some legal uncertainty. In 1984, Congress passed the National Cooperative Research Act, which makes it easier for firms interested in pursuing joint research and development to do so without becoming targets of antitrust suits and punitive treble damages. Still, research jointly developed in a consortium laboratory cannot currently be coproduced without legal risk, because its antitrust status is uncertain.

RECOMMENDATION: The Commission recommends extension of the National Cooperative Research Act's antitrust protections to production joint venture agreements in the United States to help U.S. companies become more competitive by allowing them to bring important new research from the consortium laboratory to the marketplace.

> "We must rebuild our infrastructure by reinvesting in the partnership between the federal, state, and local governments. The federal government has a critical role to play in working with states and localities to provide solutions to long-term socioeconomic problems. Local governments alone lack the resources and authority to meet the public's needs for housing, transportation, health care, and education."
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> *Mayor Jerry E. Abramson, Louisville, Kentucky*

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FINDING. Current infrastructure spending is clearly inadequate: the condition of streets, highways, bridges, tunnels, airports, navigation facilities, and water and sewage systems throughout the United States has been deteriorating from lack of investment. Many economists believe that a deteriorating infrastructure has also dampened productivity growth.

RECOMMENDATION. Selected investment in infrastructure can enhance productivity growth and improve the quality of life by reducing congestion, environmental pollution, and accidents. The Commission recommends that increased federal and state resources be devoted to highways, mass transit and aviation, including innovative technologies such as high-speed rail (both magnetic levitation and steel-rail) and intelligent vehicle systems.

The Commission recommends that the federal government increase total spending on such programs by $100 billion over a 10-year period. Funding for these new physical investments would come from infrastructure taxes, energy taxes, and fees. Such receipts could be achieved, for example, by increasing the motor fuel tax by 11.5 cents. (Currently, the motor fuels tax is 14.1 cents per gallon, scheduled to decline by 2.5 cents beginning in 1996. The net effect of the proposed new tax would be to assume a continuation of the 2.5 cents tax and add an additional 9 cents per gallon beginning in 1996). To take another example, a $5 per barrel oil import fee would raise approximately the same amount of receipts.

RECOMMENDATION: The Commission recommends that the Congress create a new category of tax-exempt bonds — infrastructure bonds. These bonds would be an obligation, issued by a state or local government, that would be used to finance wastewater treatment, solid waste disposal, hazardous waste disposal, water supply for public use, and facilities required for a public agency to achieve compliance with regulations issued by the Environmental Protection Agency — or for mass transit facilities needed to meet Clean Air standards.

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FINDING: Our government has traditionally promoted the development of national networks of highways, railroads, and voice-based telephone service. Advances in computer technology will require that America's telecommunications infrastructure support increasingly higher-speed data and image communications, particularly if educational institutions, smaller businesses (including at-home entrepreneurs), and individuals are to have access to telecommunications capabilities that are today available to global businesses.

A 21st-century infrastructure will allow smaller enterprises to become partners of global businesses. It will allow the American economy to maximize the competitive advantage of a culture based on the free, open, and entrepreneurial exchange of information. This infrastructure is absolutely essential if companies are to transform themselves from isolated, assembly-line plants into high performance workplaces linked to other companies, as products and services demand.

The 21st-century infrastructure also will facilitate telecommuting, distance learning, and economic opportunities for physically challenged individuals and will extend the benefits of our new high-speed computing initiatives to many more users.

RECOMMENDATION: The United States should adopt a policy to encourage the development of public communications networks that will meet the advanced telecommunications needs of all Americans, including deployment of fiber optic systems or other efficient broadband technologies. Particularly if existing legal and regulatory restrictions on competition between cable TV systems and telephone companies are not removed, both state and federal regulations regarding telephone companies should be revised to permit them to upgrade their networks to support high bandwidth digital communications, while protecting ratepayers' interests in the reasonable pricing of both existing and advanced telecommunications services.

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FINDING: The service sector generates almost three-quarters of our GDP and employs more than three-quarters of our work force, but the data show that productivity growth in this sector is less than one-sixth the rate of manufacturing productivity growth. Lagging service sector productivity is a real drag on the nation's standard of living.

However, the data on service sector productivity are not very good; statisticians and economists have yet to come up with good measures for the productivity of the various service sector professions, from government bureaucrat to doctor to receptionist. Moreover, many U.S. service sector companies are very competitive in the global marketplace, causing a growing minority to question whether productivity growth is really a problem for this sector. Because good data are not available, it is very hard to determine the causes of slow productivity growth, if it is slow; if the causes cannot be determined, then it is even more difficult to develop sound remedies to solve the problem.

RECOMMENDATION: A deteriorating economic statistics system undermines the functioning of the U.S. economy. Sound government policy-making depends on good statistics; so, too, do business decisions involving billions of dollars about investment, production, marketing, and salary and wage adjustments. Therefore, the Commission recommends that Congress authorize and appropriate funds to improve the quality of economic statistics, especially on service sector productivity. It further recommends that data be disaggregated into several categories: for profit industries, nonprofit government, nonprofit nongovernment, international tradable services, domestic tradable services, business services, consumer services, and infrastructure support services.

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FINDING: America has over 350,000 small and medium-sized manufacturing firms, many of which could profit enormously from expert guidance on improving their manufacturing processes. Small firms have few engineers, particularly few manufacturing engineers. Preoccupied with the day-to-day problems of meeting delivery schedules and payrolls, managers of small firms often do not know what hardware and software are available; they often do not have the time to learn new technologies. A narrow focus on potential labor savings leads firms to ignore much larger opportunities for improved quality and reliability, greater manufacturing flexibility, shorter product development times, and less machine downtime.

Manufacturing extension services can help small and medium-sized firms deal with these challenges. These services can take the form of in-plant assistance and the establishment of teaching factories and act as regional computer-integrated manufacturing centers and advanced manufacturing technology testbeds. They can provide training to front-line workers on the application of manufacturing technologies and the use of new plant and equipment. They can also teach managers about new ways of managing and provide advice on becoming a "high performance" workplace.

Financial Support for Technological Development and Application

Many small and medium-sized enterprises have insufficient access to capital that would help them commercialize critical technologies. Although these companies can build "one of something" in their laboratories, they lack the capital to learn how to build thousands of them at competitive prices.

A number of ideas have been recommended to support pre-commercial technology development and downstream application in key technology areas. There is currently legislation before Congress that would create an Advanced Technologies Capital Consortium, which would serve as a publicly funded, privately run venture capital consortium investing in research, development, application, and commercialization of critical technologies.

An innovative approach that merits serious consideration is GUILD (Government-University-Industry-Laboratory-Development), which was developed at Sandia National Laboratories and embraced by Los Alamos National Laboratory. GUILD employs large-scale multisector partnerships directed to broad national problems and objectives. Emphasizing a unified method of dealing with complex national problems, GUILD would utilize a national team approach, which would be more efficient than the current piecemeal methods. It would reduce risk to industry and the nation by means of carefully integrated strategic alliances that exploit and demonstrate precompetitive technologies that can be matched to recognized national needs. Using such a model, the national laboratories can effectively employ their extensive technology base to help address important national technology needs.

In addition, a National Academy of Sciences (NAS) panel recently recommended creating a Civilian Technology Corporation, a private but quasi-governmental institution, to perform a similar function. The NAS recommends an initial $5 billion appropriation from the Congress for this Corporation.

While basically supportive of these kinds of ideas, the Commission recommends that any program of this type be evaluated regularly to determine that there is a return on this government investment and urges that the private sector share costs in all such ventures.

Several manufacturing extension programs are now in place at the state level — in Georgia, New York, Ohio, and Pennsylvania, among others. In addition, the Omnibus Trade and Competitiveness Act of 1988 authorized $20 million per year for federal technology extension activities through the National Institute for Science and Technology, although appropriations for these programs have been well below this level — $6.6 million in 1989 and $7.5 million in 1990.

RECOMMENDATION: Just as agricultural extension programs were successful when America was a more rural nation, manufacturing extension programs can help today's small and medium-sized manufacturers meet the economic challenges of tomorrow. The federal government should increase its support of manufacturing modernization initiatives, providing funds to match state and industry contributions. Continued and expanded support should be dependent upon evidence that such programs increase the productivity and competitiveness of participant firms.

III. MAKING WASHINGTON WORK: RESTRUCTURE THE WAY GOVERNMENT MAKES ECONOMIC POLICY

Restructure The White House

"We have about 40,000 {people}...in Washington employed every day to figure out how we keep the president's attention focused on international problems. The first document {the president} gets each morning is created by the CIA telling him what the problems were overseas last night...{but} you have to go through about three layers of calls to have a discussion about what's going on at the domestic level."

— David R. Gergen, Editor-at-Large, U.S. News & World Report

FINDING. One obvious lesson in the fall of the Soviet Union is that a nation cannot achieve national security without economic strength. To be successful in the future, our economic policy must be given the same coordinated attention as our defense policy.

At present, however, economic policy-making and program implementation is dispersed across the federal agencies with no one agency in the lead. Economic policy does not get the attention in the White House or from the president that it deserves. The Council of Economic Advisers, composed mostly of visiting scholars on two-year leaves from universities, gives the president advice on macroeconomic issues, but does not coordinate the government's economic policy. The Domestic Policy Council's economic policy role is extremely limited.

RECOMMENDATION: To bring focus and coordination to economic issues at the highest level of government, the Commission recommends creating a National Economic Council (NEC), headed by a national economic adviser, which would be the economic equivalent of the National Security Council and the national security adviser.

The national economic adviser would develop a broad strategic road map for national economic policy equivalent to the policy developed between 1948 and 1950 that guided the conduct of American defense and foreign policy during the Cold War. The main job of the NEC would be to prepare and monitor a comprehensive strategy for sustained growth.

The Adviser and the Council would bring to the president's attention issues affecting economic growth and productivity, including savings and investment, technology, infrastructure, and education. The Council of Economic Advisers and the Office of Science and Technology Policy would provide macroeconomic and technological analysis for the National Economic Council.

The National Economic Council, like the National Security Council, would have no direct operational role. Instead, its mission would be to coordinate economic affairs that today are spread across the government, thus ending the fragmentation of economic policy.

Like the NSC, the NEC would be chaired by the president. Its members could include, among others, the vice president, the secretary of state, the secretary of education, the secretary of the treasury, the attorney general, the secretary of health and human services, the secretary of commerce, the secretary of labor, the secretary of energy, the director of the Office of Management and Budget, and the U.S. trade representative.

To ensure the needed breadth of vision and effective interaction, the national economic adviser and the national security adviser would be included *ex officio* in the meetings of both councils. The NEC would be the focal point to permit the president to integrate and coordinate U.S. economic policy.

The private sector itself would be an essential partner in this process, communicating to government how U.S. business can best compete in the world and identifying key barriers and opportunities the government can address. A critical aspect would be finding practical ways to give a broad range of companies, large and small, convenient and effective channels for communicating that information.

The members of this Commission recognize that creating new structures does not guarantee effective solutions to problems. Ultimately, good government requires competent and courageous leaders and staff. But a dramatic change of structure is required to symbolize and facilitate the fundamental rethinking of attitudes and breadth of analysis that this country needs.

Restructure The Congress

FINDING: Americans are increasingly frustrated by Congress's inability to do its job. So are many members of Congress themselves. Congress is attempting to meet 21st century challenges with an overgrown mutation of a 19th century structure. With its quagmire of committees and its budget, authorization, and appropriation panels, the legislative branch is fast losing its ability to make long-term policy.

The power to act, and accountability for these actions, is lost in a maze of competing jurisdictional claims and redundant procedures. Our major problems are not being coherently addressed because Congress spends too much time on process and not enough time on substance.

The result is declining respect for the Congress and growing calls for a true non-solution, term limitation.

"Political stresses in Congress dealing with the deficit have led to the enactment of bizarrely complicated procedures for arriving at a federal budget."

Alice M. Rivlin, Senior Fellow, The Brookings Institution

A one-year budget cycle is simply not long enough to accomplish the multitudinous tasks of the modern Congress. The repetitious and overlapping nature of the annual budget, with its authorization and appropriations cycle, is a waste of the members' time and of the taxpayers' money. Every step in the process is an opportunity for special interest groups to lobby and prevail, often at the expense of the nation's best interest. The uncertainty and stop-and-go nature of the annual process also needlessly increases the cost of everything from B-2 bombers to school lunch programs for children.

In addition, the repetitious annual ritual for setting budget priorities, developing programs, and passing legislation leaves too little time for Congress to exercise meaningful oversight responsibilities.

RECOMMENDATION: The Commission endorses the efforts recently launched by Senators David Boren and Pete Domenici and Representatives Lee Hamilton and Bill Gradison to make the Congress more effective and accountable through reorganization. We believe any reorganization plan should seriously consider:

★ Creating a Joint Budget Committee appointed by the leadership of both houses. Having the right decision makers on this committee would be important to its effectiveness. One approach to membership would ensure that key chairmen and ranking members of various committees serve on the Budget Committee.

This committee will replace existing budget committees and produce and enforce two-year binding budget resolutions. All appropriation bills would provide two years of funding. Emergency supplemental appropriation bills within the two-year period would be allowed.

★ Combining, where appropriate, the authorization and appropriating processes in each house.

Under the current system, before a spending bill becomes law, it must be considered by three layers of committees in both the House and the Senate: budget (which sets budget priorities at the beginning of the year and enforces those priorities in authorization and appropriations bills during the year), authorization (which *approves* programs), and appropriations (which *funds* programs).

Under the proposed new system, programming and funding decisions now split between — and largely duplicated by — authorization and appropriations committees would be combined into single legislative committees where appropriate.

This streamlining could drastically reduce the time required to consider and dispose of the budget and could significantly decrease the congressional staff required.

★ A two-year cycle for binding budgeting and appropriations bills would also allow programs to be run more efficiently and would make time for meaningful congressional oversight. In this era of tight budgets, Congress should improve its oversight to guarantee that federal dollars are being spent wisely and efficiently and are accomplishing their intended purposes. Congress also needs the time to evaluate continually whether existing programs are still needed. Congress can perform its oversight functions effectively only if it has the time to do so.

★ Streamlining the committee structure. The number of congressional committees and subcommittees has risen dramatically, from 38 in 1947 to over 300 today. The current division of labor is fragmented, overlapping, and confusing.

★ Limiting the number of committees on which a member may serve.

Change The Culture of The Federal Agencies

FINDING: Although there are a great many good and dedicated government employees, the general quality of America's government work force is eroding. The National Commission on Public Service, headed by Paul Volcker, noted that only 13% of today's senior government executives recommended that young people begin their careers in the public sector. More than half of federal personnel officers report that recruiting quality people has become increasingly difficult. Civil service morale is at an all-time low, and the quality and efficiency of many government departments has declined.

RECOMMENDATION: The Commission recognizes that it will continue to be difficult to attract high-quality people to civil service and to public office as long as "Washington-bashing" continues to be one of the country's most popular sports and as long as potential candidates are subjected to intense public scrutiny about their personal affairs. Nevertheless, the Commission endorses the following measures to strengthen the government work force:

★ Rebuild student interest in government service. While government pay is now more competitive with private sector and state and local government pay than it was before passage of the Federal Employee Pay Comparability Act of 1990, qualified young people who may be attracted to government face considerable barriers to entry: a wait of up to 6 to 12 months to come on board while the Office of Personnel Management completes paperwork; a "fast track" program —the Presidential Management Intern program (PMI) for the best and brightest students — that is too small; and limited timely channels of communications concerning job openings. Clearly, streamlined and more decentralized recruitment procedures and an expanded PMI program would help rebuild student interest in government service.

★ Reinvigorate executive-level exchange programs between the public and private sector. As economic and technological issues grow in complexity, it has become increasingly apparent that sound policy-making depends on good advice from the private sector. One way of promoting such interchanges would be through an expansion of executive level public/private exchange programs, many of which have been curtailed during the past several years because of existing and ambiguous conflict of interest laws. Congress should take the necessary steps to promote such programs and overhaul, where necessary, the rules regarding these programs.

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FINDING: Since the onset of the Cold War, the training, culture, and work experience of our diplomatic and information services have been oriented toward the East-West conflict. Long-time government employees learned their crafts during an era in which political-military power was seen as virtually the sole determinant of the course of history. Promotions and ranks were determined by proficiency in these areas.

The extraordinary performances of our career professionals in those dangerous times contributed to the victory for freedom and democracy. However, post-Cold-War diplomacy has changed, with a new emphasis on business and economic matters. A different bureaucratic culture must be developed.

Beginning in the 1970s, even before the demise of the Soviet Union, there were calls for such changes in orientation. In 1976, the Murphy Commission on the Organization of the Government for the Conduct of Foreign Policy noted the new international emphasis on economic issues and called for corresponding skills to be developed by the diplomatic corps.

The foreign services of our trading competitors, such as the United Kingdom, France, Germany, and Japan, are far ahead of us in this area. In Great Britain, for example, a prerequisite for becoming a deputy chief of mission at an embassy is prior commercial service. The diplomats of other member states of the Organization for Economic Cooperation and Development routinely give priority to commercial interests.

In contrast, U.S. policymakers remain steeped in the old political-military bias. For example, the director of the U.S. Information Agency (USIA) is charged with coordinating all foreign information activities — including information about economic trends and commercial activities. Yet the rank and file of the USIA have been trained in the old culture. To take another example, the State Department historically makes personnel reductions in the economic area before it makes reductions in the political area. Our diplomatic services' emphases and priorities have not kept up with the times.

RECOMMENDATION: The Commission recommends that the president develop and implement an action plan to effect a cultural transformation of our diplomatic and information agencies, enabling these agencies to meet the economic challenges of the post-Cold War era. Promotions and rankings must be determined not only by proficiency in traditional political-military issues, but also in economic and commercial issues. Government should be explicitly encouraged to promote U.S. exports more effectively, in these agencies, through our embassies abroad, and through the Commerce Department.

WHAT WILL IT TAKE TO PUT OUR ECONOMIC HOUSE in ORDER?

"It occurs to me that one of the strange circumstances in our country is the lack of awareness among business, labor, and government of their common economic interests. Possibly it is a result of having had for so long such a significant advantage over the rest of the world in natural resources, technology, productivity, etc., that we could not but come out ahead regardless of how badly we managed or abused our system. Unfortunately, those days are rapidly passing, and we can no longer rely on some divine destiny that will mandate that our position in the world community or our standard of living be maintained."

— Thomas H. Cruikshank, Chairman of the Board and CEO,
Halliburton Company

We of the Commission could hardly be described as revolutionaries, but we are demanding a revolution in American thought and attitudes. Are we advocating a complete disruption of the American way of life? Indeed not; in fact the steps needed to carry out our recommendations are not exceptional ones. We *can* do this.

To accomplish our objectives does not require the grueling hardship that so many other peoples in the world face on a daily basis. Our situation is not like that of the Commonwealth of Independent States, where a whole society must be reorganized, or that of Ethiopia, where there is widespread famine. The actions needed to ensure America's future abundance pale in comparison to what is required in other countries.

But we do need a commitment to plan strategically and a measure of discipline and sacrifice.

Strategic thinking is necessary not only to planning our defenses but also to making our economic life more prosperous and secure. We should apply the same comprehensive approach to our economic well-being as we do to our national security and foreign policy.

In this first report, we have tried to offer such a comprehensive approach. But strengthening America will require more than passage of laws, creation of programs, and repeal of burdensome regulations. It will require some fundamental changes in attitude.

Business people who have restructured their companies so that they are more competitive in the global marketplace stress that a long-term effort is required. People who want their children and their neighbors' children to be better educated do not just talk about it — they get involved in local schools and communities, and they pay for better education by voting to raise new revenues for schools. Politicians who care about the long-term future of this country do more than pay lip-service to the idea — they vote for programs that may cause some short-term pain, but that are worth the long-term gain.

The development of a comprehensive strategic approach is the purpose of this Commission. With a long-term approach, we can give this country a strategy for strength. We hope this report will be a step in that direction.

THE CSIS

STRENGTHENING OF AMERICA COMMISSION

1991 Commission Meeting Agendas

January 25, 1991 Defining the Challenge: Making an Impact

Professor Michael Porter, Harvard Business School
"The Competitive Advantage of Nations"
Kent Hughes, President, Council on Competitiveness
"How to Strengthen U. S. Competitiveness"
Dwayne Andreas, Chairman, Archer Daniels Midland
"A Business Perspective"

March 1, 1991 Manufacturing, Technology and Total Quality Management

Ed Artzt, Chairman and Chief Executive Officer, Procter & Gamble
"The Quality Approach"
Bob Galvin, Chairman, Sematech; Chairman of the Executive Committee, Motorola
"Technology Policy and Strategy"
Al Narath, President, Sandia National Laboratories
"The Role of the Federal Labs"

April 12, 1991 Capital Formation

Jim Jones, President, The American Stock Exchange; Chairman, American Business Conference
"Taxation and Capital Formation"
Professor Manuel Johnson, George Mason University; Cochair, G-7 Council
"Safe Banking in the 1990s"
John Imlay, President and Chief Executive Officer, Dun & Bradstreet Software
"Capital Formation for Small Businesses"

June 28, 1991 Building Human Resources

David Kearns, Deputy Secretary of Education
"America 2000: An Education Strategy"
Lou Gerstner, Chairman and Chief Executive Officer, RJR Nabisco, Inc.
"American Business's Commitment to Education"
The Honorable William Brock, Chairman, The Brock Group
"The School-to-Work Transition: Addressing the Needs of the Forgotten Half"
Mayor Norman Rice, (D-Seattle, Washington)
"Education for the 21st Century: New Challenges and New Partnerships"

September 20, 1991 Making Government Work

The Honorable Lawton Chiles, Governor of Florida

"Making Government Work: A State Government's Perspective"

Paul O'Neill, Chairman and CEO, ALCOA

"Government's Competitive Advantage"

Alice Rivlin, Senior Fellow, Brookings Institution

"Sorting Out the Functions of Federal and State Governments"

The Honorable Paul Volcker, Chairman, James D. Wolfensohn, Inc.

"Improving the Culture of Performance in Government"

November 15, 1991 The Strength to Lead Globally

James Blackwell, Director of Political-Military Studies, CSIS, and Don Snider, Deputy Director of Political-Military Studies, CSIS

"U.S. Global Leadership in the 1990s"

The Honorable James Schlesinger, Counselor, CSIS

"After the Cold War: Facing New Instabilities and Priorities"

Robert Hormats, Vice Chairman, Goldman Sachs International

"What We Need to Do at Home to Lead Abroad"

THE CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES

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APPENDIX:
SEPARATE OPINIONS OF COMMISSION MEMBERS

★

JACK GARDNER
Gardner Group, Ltd.
Milwaukee, Wisconsin
July 29, 1992

I support the Strengthening of America report as a tool to focus this country on the task we have to keep our leadership role.

The report covers the major issues—the deficit, the debt and our educational system. These are the issues of Small Business because we cannot succeed if the country fails. However, Small Business needs special help. The size and diversity of entrepreneurs has long been a disadvantage in being heard in Washington.

Small Business needs access to capital. This is the basis of achieving efficiency of modernization of plant and equipment, research, training and expanded markets, including export.

The Commission's support for incentives to encourage the banking system to lend to Small Business is required.

JERRY E. ABRAMSON
Mayor, Louisville, Kentucky
July 30, 1992

I want to commend CSIS and its excellent staff on the superb job you did in drafting the Strengthening of America Commission First Report. I am pleased with the final recommendations that we have made in the report, and I think that they effectively reflect the complex and wide-ranging discussions that we have had over the past eighteen months on critical policy areas.

However, in the section dealing with fiscal policy, I must differ with the Commission majority in its conclusion that certain federal discretionary spending falls into the lower-priority category under our plan to emphasize investment as we put our fiscal house in order.

In an era when states and localities have absorbed the most drastic and draconian reductions in federal assistance, I cannot agree with the conclusion that while certain expenditures aimed at cities "may be appropriate governmental expenditures...the spending must take place at the state and local level." In particular, I would exempt federal mass transit operating subsidies for large cities, special purpose HUD grants, the Economic Development Administration and highway demonstration projects from this judgment.

These programs provide important incentives for economic development in cities. For example, the mass transit operating subsidies create vital incentives for increased development of transportation links critical to the movement of goods and to the creation of more environmentally sound alternatives. Similarly, programs such as special purpose HUD grants have allowed cities like my own to leverage both public and private investment to improve infrastructure and to revitalize our communities despite drastic reductions in federal aid. Programs under the Economic Development Administration have provided small business much needed start-up capital to establish firms in economically distressed areas.

Given that the Commission's underlying conclusion is that America must focus federal spending on investments geared to generating economic productivity, it is a grave mistake to ignore the vital role cities play as the economic engines of our nation and the important role the federal government has in supporting such investment. A strategy built around investment designed to generate economic productivity should enhance investment in the nation's cities, not reduce it.

But for this, I am strongly supportive of the report's conclusions. I have enjoyed working with you and the other Commission members on a product that I hope will be the legislative cornerstone of change for our country.

I pledge my support of all efforts to implement these recommendations and look forward to working with you and others as we continue the Commission's work.

JOSEPH A. FERNANDEZ
Chancellor
Board of Education
City of New York
August 4, 1992

I want to congratulate everyone who contributed to the first report of the Strengthening of America Commission for the breadth and depth of the scholarship. The report offers a comprehensive analysis of the current economic challenges facing the United States and offers a multi-faceted approach to reform. Unfortunately, my own experience does not include the broad range of issues that are addressed. Although I am not in a position to endorse this entire report, including the many recommendations on fiscal and tax policy that would certainly have a complex effect on public services in urban areas, I do support the recommendations on education and training.

In particular, I appreciate the report's recognition of the inextricable link between education and economic reform. The Commission's investment approach to restructuring, with an emphasis on at-risk students and early childhood programs, should produce the high quality labor force the nation systems must restructure to reduce administrative costs and unnecessary red tape while moving decision-making into the hands of school staff and parents.

Our experience in New York City has demonstrated the potential for substantial savings (we reduced full-time headquarters staff by more than a third and slashed spending in every overhead area) and the opportunity to increase parent involvement and cultivate instructional innovations once schools have the power to make their own decisions. In fact, School-Based Management/Shared Decision-Making is restructuring our schools in exactly the same way as industry is redesigning itself. We are providing our students with models of the type of problem-solving and communication skills and accountability they will need to succeed in the workplace.

I look forward to the future work of the Commission. Thank you for the opportunity to participate.

RICHARD J. ELKUS, JR.
Chairman
Prometrix
Santa Clara, California
August 11, 1992

The first report on Strengthening of America provides many interesting and important insights into problems and their potential solutions regarding the industrial base of the United States. I would like to add, however briefly, some remarks regarding a fundamental issue not elaborated on within this first report. I believe this issue is fundamental to the success of the United States of America as world economic power. It affects our past and current business practices to a degree which is almost cultural and goes to the very core of economic thinking and planning in our country. I am convinced that if not addressed, this issue will rob us of the economic strength necessary to correct those issues so well described in the first report on Strengthening of America.

In previous discussions relating to this issue, I defined the word "chaos" as fear without strategy. When I gave that definition, I noted that if you get a significant negative change in the standard of living of a population such as that of the United States in a relatively short period of time, and there is no appropriate strategy to deal with such a problem, you will create all the conditions necessary for chaos. The chaotic events that seem to be evolving in Washington today are occurring in my estimation for only one reason: the people of the United States of America are beginning to see in all kinds of ways, many of which they can't explain, that their current and perceived level in standard of living is out of control and going down. At the same time, they are listening to rhetoric that flies in the face of reality. On the one hand, political figures of consequence suggest that we must contain if not reduce the growth in entitlement. On the other hand these same leaders deny that what they are asking for is at least a perceived if not actual future decline in the standard of living of the people. To be sure our general concerns about large budget deficits coming at the same time as we see our standard of living decline is obvious and perplexing. But the real problem that we face is far deeper than any of the discussions associated with most of this rhetoric. The fact of the matter is that we are practicing an economic strategy which is becoming ineffective in a world of global competition defined largely by the emergence of Japan since 1945.

Strategic thinking behind most economic policy in the United States is based on the concept of return on investment. If you can make more money in this investment than on that one, you get out of this and into that. But as the Japanese are clearly showing us, this strategy does not work. As all things—including products and markets—are becoming interconnected, those products and markets that we abandon in our short-term search for profits cause those that remain to become incomplete and deficient. Under these circumstances, the United States is forced to buy key components of that infrastructure from its major international competitors. Slowly the nation's ability to negotiate strategic relationships is reduced as it cedes the competitive viability of its product infrastructure. In this environment, productivity means nothing if all you can do is manufacture products others won't buy.

Carry the current economic strategy of the United States to its logical extreme, and you liquidate your country for a profit. On the other hand, try to rebuild your infrastructure of products and markets, and the cost appears overpowering. That's the track we are on, and it's a killer. People see it, but they don't understand it. The events surrounding most individuals seem uncontrollable. Washington refuses to talk about it, assuming they understand what, in fact, is happening. This is a problem indigenous to both parties. To alter our thinking and patterns of behavior will take immensely strong and charismatic leadership based upon bold strategic initiatives. It is possible that in any case the solution to this situation will be a lower standard of living for years to come. This is because of the amount of investment in future productivity that will be required plus the cost involved in paying off existing debt created largely to maintain our current standard of living rather than investment in productive assets. The time to address this issue is now. Several more years down this road and the cost of change may be our political system as we know it.

The Strengthening of America report is an important contribution supported by tremendous effort from extremely capable people. But I do not believe the results of that effort adequately address the point of this letter. I urge the Commission to consider in future reports how this might be done.

FRED KRUPP
Executive Director
Environmental Defense Fund
Washington, DC
September 22, 1992

I am pleased to add my signature to the Strengthening of America Commission's first report. The report is a valuable document that makes many important recommendations regarding America's future. However, there are two points which I feel need some clarifying:

On page 57, the report states that the Superfund program was "badly-conceived." It would be more accurate to say that the Superfund program has been mismanaged. In fact, it has been a powerful incentive making individuals and businesses careful in their practices. Since I was involved in all the discussions the Commission had on environmental issues and Superfund was never discussed, I was surprised to see the reference in the final report.

Secondly, mass transit subsidies are described as a low priority in figure 23. Here again, this was not discussed during the meetings, and I would have to disagree with the suggestion, as these subsidies are vital for both economic and environmental interests in urban areas.

These points aside, you have my full support and congratulations on this effort.

SUSAN RASKY
Graduate School of Journalism
U.C. Berkeley
September 22, 1992

The Commission's recommendation for a consumption based income tax is an important and worthy attempt to address the flaws, inequities and misguided economic incentives in our current tax system. But readers of our report should understand that no amount of tax code restructuring eliminates the basic political and philosophical problems of raising sufficient revenues to pay for the programs and services we want or of finding consensus on how the tax burden should be distributed. In order to achieve the same level of progressivity as our current system, or indeed to increase it as some of us would favor and to provide health care coverage for the uninsured, it is likely that a consumption based income tax would a) require higher tax rates and b) increase the economic burden on some sectors of the population—for example the elderly on fixed incomes who are "consuming" out of past savings or younger working people who by virtue of their station in life are devoting most of their current income to consumption rather than saving. These difficult issues should not make us shy away from consideration of what may be a significant step toward a more sensible tax policy, but it is imperative that as policymakers debate a new tax structure, the media and the public understand the full implications of what is being considered.

HOWARD D. SAMUEL
President
Industrial Union Department
AFL - CIO
September 22, 1992

I submit the following revised comments for the appendix of the report of the Strengthening of America Commission:

I think the first report of the Strengthening of America Commission represents a remarkably successful effort to achieve a consensus among an unusually diverse group. I have no problem with the general thrust of the document or with most of its recommendations, but as I indicated to you I find myself at odds with some of them, which is the reason I submit the following paragraph for the appendix:

■ "The impact of cutbacks in discretionary programs would overwhelmingly fall on low and middle income Americans, who have already suffered reductions in their standard of living. As an example, subsidies for mass transit programs are equally important as other infrastructure improvements, such as highways and bridges, which the Commission supports—and have an added utility in helping to overcome some of the problems faced by inner cities. Reducing Davis-Bacon standards would simply lower the earnings of construction workers, at a time when working people already are suffering from falling incomes—which the report condemns in its opening pages.

- The effect of a consumption tax on the progressivity of our tax system needs careful examination."

ALBERT SHANKER
President
American Federation of Teachers
AFL - CIO
September 22, 1992

I am honored to be associated with this courageous report, and I concur that tough measures are needed to bring the American fiscal house in order. However, the lacerating pain that would be caused by the capping and cutting measures outlined in the report does raise the question of the relative costs and benefits of entirely eradicating the budget deficit by the year 2002, on the one hand, as opposed to using a slightly longer time frame for achieving a balanced budget and reducing the pain of fast-track deficit reduction, on the other hand. We did not explore these tradeoffs in this face of the Commission's work. I hope they are taken up in the next phase of the Commission and with the same rigor and intelligence that marked the work leading up to the first report.

LAWRASON D. THOMAS
Vice Chairman
Amoco Corporation
September 23, 1992

Although I applaud the efforts of the Strengthening of America Commission to find a bipartisan consensus on economic policy, I would put different emphasis on several points in the Report.

First and foremost, America will not be decisively strengthened until the role of the federal government shrinks relative to the private sector. I believe the real economic program that is needed today is to halt and even reverse the growth in the share of our nation's and our people's resources that are preempted by federal spending. The process can and should be gradual. There is no need to achieve any particular budgetary balance at any date certain, although slowing the growth in federal spending will certainly help to bring the budget closer to the balance.

Second, Americans have been hit repeatedly with budget "reform" programs that have promised big spending cuts along with "modest" tax increases. These programs have been consistent: we have always gotten the tax increase, but the spending cuts somehow fail to materialize. The final effect of these past "reforms" was an even bigger deficit.

Third, the report makes only passing reference to the positive role that the competitive market system could and should play in controlling costs and improving results in the problem areas discussed.

Fourth, there are valid concerns about the state of parts of America's road and highway system, but substantial federal, state, and local tax revenues are already devoted to the problem. And I have no disagreement with earmarking direct motor fuel tax revenues for maintaining roads and highways. But the Commission should note that the federal highway trust fund has been running a growing *surplus* for the past decade, and the current unexpected balance exceeds $20 billion. In light of this, the Report's call for spending another nice, round $100 billion over 10 years for federal infrastructure spending leaves the Commission's commitment to cutting spending in question.

Fifth, I agree that in the abstract a true consumption tax places a lower burden on savings than an income tax. But the Commission's enthusiastic advocacy of a U.S. consumption tax offers few details and may overstate the likely benefits. I fear that a U.S. consumption tax will simply be a net addition to the present array of federal taxes and not a replacement for the personal and corporate income taxes.

Finally, I am skeptical that a new National Economic Council can improve the performance of our competitive, market-driven economy. I suspect that it would only add another layer to the White House bureaucracy.

ANNE ARMSTRONG
Chairman
Board of Trustees
CSIS
September 24, 1992

CSIS deserves high praise for the boldness of this report and the extraordinary coalition that has been put together. Personally I would like to have seen an endorsement of choice as a key component of the Commission's recommendation on education. I also would have preferred a strategy for budget deficit reduction with heavier emphasis on spending cuts, especially in entitlement, and less emphasis on additional revenues. If additional revenues are unavoidable, the consumption based income tax deserves serious study. Overall the report makes an important contribution, and its bi-partisan approach is especially welcome in these politically polarizing times.

JOHN D. ROCKEFELLER IV
Senator - West Virginia
September 24, 1992

It is my privilege to join you in releasing the first report of the Strengthening of America Commission. I applaud the leadership and energy you have invested in this effort, and I look forward to tackling the other issues that remain on our future agenda.

While I differ with a number of specific ideas recommended or raised in this report, I strongly endorse its call for action aimed at fiscal order, promoting growth and investment, and strengthening government.

Unless we act quickly to achieve these goals, I fear the consequences will be extremely costly. Unless we meet these challenges, our children will be the first generation in our history to have a lower standard of living than their parents. That matters because we are the stewards of their future. It also matters because the end of the Cold War means that economic leadership now defines global leadership. To be an effective world leader, we must get our economic house in order and chart a course that will create the jobs and opportunities needed to sustain a strong nation.

One of the most important and far-sighted sections of this report is the discussion of strengthening our industrial base. The Commission recognizes the critical relationship between manufacturing and research. Simply put, if we don't make anything, ultimately we won't invent anything either. I have appreciated the chance to participate in identifying the series of specific ideas laid out in this report to restore and improve America's industrial competitiveness.

I also want to highlight the emphasis that our report places on investing in the education of our children and the training of our workers. The fact that a Commission of this diversity and size all agree on such vigorous action should galvanize decisionmakers to follow through.

Our national goals must give high priority to economic growth, but it can be achieved in different ways. What we need is a growth that is based on putting people first, a growth that is based on fulfilling the long run basic needs of our people, a growth that is based on broad based opportunity for all, not special breaks for the few. This means not only good old fashioned, balanced macro-economic policy, but good health care, good education, good job training, and public and private investment in the cutting edge technologies we need to compete. Rather than competing with low wages and by moving plants abroad, we must compete with high wage jobs and by arming our people with the technological tools to retake the lead in the markets of the world. A fundamental truth that has too often been ignored in recent years is that economic growth and fair opportunity for all our people are goals that can reinforce each other. As this report says, making sure they do is the way to achieve the strongest America.

Finally, I will only highlight two of the areas of the report where my views differ somewhat, at least in emphasis.

First, when it comes to the need for getting our fiscal house in order, I agree with the suggestion that we need to move toward a more balanced budget. However, there are places in the report where this is stated in more rigid terms than I might. For example, in working toward balance, we need to consider questions relating to defining balance, such as how capital spending is treated. Also, many economists would work toward balance over the course of the business cycle, rather than at any given moment.

A second issue is the recommendation of a consumption tax to replace our current income tax system. While I believe that through the tax code and other means we need to encourage investment and reduce and eliminate wasteful spending, I have many questions about the idea of a consumption tax. A host of issues relating to equity, implementation, and impact need to be thoroughly considered before I could consider supporting the changes recommended in this report. Nevertheless, I commend the Commission for the seriousness with which it has considered the issue and the constructive contribution it has made to the debate.

In the ideas laid out to reduce the deficit, I simply have to note my strong support for the Appalachian Regional Commission. It may be a small item for the reader, but this agency plays a vital role in helping my own state of West Virginia and this region build its infrastructure and economy. And I am not prepared to endorse any specific cap on entitlement programs, in the absence of a clear commitment to comprehensive health reform.

I am enthusiastic about the work of the Commission, and proud to be one of its active members. Whatever differing views I may have on some points, I believe the Commission has developed an important series of recommendations. They are hard hitting and realistic and they deserve the serious consideration of all those who wish to restore the strength of America.

I hope we are at a turning point in our nation's history. We have clear choices to make, and need the leadership, the direction, and the will to chart a prosperous and peaceful future. I pledge to do all I can to work with you and the rest of the Commission in fulfilling our vision.

ISABEL V. SAWHILL
Senior Fellow
The Urban Institute
September 24, 1992

I want to commend CSIS and our two co-chairs for the outstanding work you have done in putting together a report on the domestic problems facing the nation and what we can do about them. I think the report contains many good suggestions and recommendations, especially in the area of education.

At the same time I remain concerned about the fiscal policy section of the report for two reasons. First, the report calls for domestic spending cuts of over $1 trillion by the year 2002, two-thirds from entitlement and one-third from domestic discretionary accounts. (On an annual basis, this is over $100 billion by 2002.) Cuts of this magnitude are bound to inflict real pain, especially on lower-income citizens. Yet, with the exception of some suggested program terminations which account for only 6 percent of the total savings, the report fails to specify where and how savings of this magnitude are to be achieved.

Second, the report calls for reform of the health care system, including coverage of the currently uninsured, but the only kind of reform that would subtract rather than add to the budget deficit would be one that mandated employers to cover their employees and/or had its own earmarked financing mechanism. The Commission never discussed either of these. Instead, the report implicitly assumes that health care reform can produce very large budgetary savings without explaining that this is either going to necessitate higher taxes or some rationing of the health care people receive.

The problem with all of this is that, after aggressively calling for tough choices, the report is incredibly vague on what those choices are and, in the process, leaves the impression that they will be far more easily and less painfully achieved than is actually the case. Although I appreciate how difficult it is to reach a consensus on these issues, I wonder how much of a service it is to suggest to the public that we have the tough choices that we rightly urge others to make.

Thank you for giving me the opportunity to participate in this important effort. Despite my reservations about some of our recommendations, I believe the report will contribute to the on-going debate about how to strengthen America.

WILLIAM E SIMON
Former Secretary of the Treasury
Morristown, New Jersey
September 25, 1992

I have reviewed the final report of the Strengthening of America Commission. The issues addressed in this report are of the greatest importance to the nation's future. The problems described require the urgent attention of all Americans.

This report, like all reports drafted by committee, has both strengths and weaknesses. Some proposals in the report would, if implemented, be very helpful; others would take us down the wrong road.

The overall thrust of the recommendations, however, is in the direction of more government and higher taxes. If all the recommendations were adopted, government would be bigger and more expensive than it is today, and the federal government's influence in our economy would be significantly expanded. This emphasis, in my judgement, takes us in the wrong direction. If we hope to restore the vitality of our economy, promote economic growth, and impose fiscal discipline on the national government, we should be taking a different path by reducing the burdens of government, by cutting spending and eliminating unnecessary programs, curbing taxes, and removing regulatory barriers to growth.

I'd like to elaborate briefly on the above conclusion, and comment in more detail on the strengths and weaknesses of the report.

■ The report deserves credit for the careful attention it gives to the federal budget deficit. Persistent deficits, combined with the sheer magnitude of federal spending, are among the most significant challenges facing the United States of America. I never dreamed I would live to see the day when, in peacetime, the federal budget deficit would approach half the size of the budget itself (excluding social security) and when interest on the debt would take up one-fifth of our annual spending. We are approaching a fiscal catastrophe, if we are not already in one. Strong measures are needed to put our house in order. This report, to its credit, recognizes that this cannot be accomplished without painful measures. In particular, the report recognizes that we must control expenditures on entitlement, which are growing at an explosive rate. These recommendations for curbing the growth of entitlement are most welcome. The report, however, should have gone further in recommending cuts in government programs and spending. Decisive steps are called for, in keeping with the seriousness of the problems we face.

■ The report, also to its credit, recommends that our current tax system be abolished, and replaced by a consumption tax. This recommendation is highly welcome as a means of removing the bias in our tax system in favor of consumption and against investment. This is one of the key recommendations in the report, and one I hope will be seriously considered by the public and the Congress. I have long favored a consumption tax, for the reasons outlined in this report, and, indeed, this was an important element in my *Blueprints for Basic Tax Reform*, which I published in 1977 at the close of my tenure as Secretary of the Treasury. A consumption tax properly designed, would simplify the system for the average taxpayer, and would encourage saving and investment.

■ There is a great deal of rhetoric in the report about progressive taxation, which I believe is misguided. There is no economic rationale for a progressive tax. The case for it is entirely political, and depends on egalitarian sentiment which appeals to politicians. There is little doubt that a progressive tax would be far less effective than flat rate taxes, when judged in terms of the effects on the economy and the size of tax revenues.

■ The report further deserves credit for calling for higher standards of achievement in our nation's schools. This is a much needed step—indeed, an essential one if our young people are going to prosper in the increasingly competitive economy of the next century.

- I was disappointed that the report did not embrace parental choice as an agent of educational reform. I do not see how we are going to induce reform and innovation in our bureaucratized educational system without the incentives introduced by school choice. I note that this view is shared by several other members of the Commission, and I hope that further experiments with parental choice will continue in states and localities across the nation.

- The report points out that government regulation is gradually strangling our economy, destroying jobs and imposing heavy costs on businesses large and small, but it fails to recommend any concrete measures to deal with it. We need to stop the cascade of new regulations coming out of Washington, and we need to recognize that we cannot have a growing economy and a highly regulated one at the same time.

- The report is mistaken in dismissing congressional term limitations as a "non-solution." Many Americans, including myself, take a different view. I have long advocated term limits as a means of encouraging office-holders to look beyond their prospects for re-election to the long range interests of the nation. Our current fiscal crisis is a clear sign that something needs to be done to change the incentives of the Congress, and that term limitation is a reform that is long over due.

- The report proclaims the need for a comprehensive economic strategy, but such a grand strategy, dominated by the federal government, is not needed and would never work. The private enterprise system, whatever its shortcomings, has given the United States the greatest prosperity, the highest standard of living, and, most important, the greatest freedom of any system known to man. Our people, left to their own enterprise and working within the framework of free markets, can easily dispense with comprehensive strategies concocted in Washington. We will prosper far more if we placed more confidence in our people, than in government plans. If we free our people from the shackles of government, they will begin to take charge of their own futures. Government has its role, to be sure. but its role is not to promote comprehensive plans for our people to follow.

- The report thus fails to recognize that government is often more the problem than the solution when it comes to productivity and economic growth. The report instead envisions a vast role for government in promoting "investment," but such an approach is bound to backfire.

- The serious problems outlined in this report (especially the deficit and over-regulation) are entirely within the power of the Congress to correct. Measures could be adopted today which would improve our situation. Many such measures are listed in the report; few of them are new. Congress should not require a report like this to persuade it to meet its responsibilities to the public, and to our children and grandchildren.

- The report, unfortunately, flirts with "industrial policy" with its suggestions for partnerships between business and government, especially in the "high tech" area, in its calls for $100 billion in spending on infra-structure, and in its descriptions of education and child care as "investments." This is the language of the industrial policy set. If we take these theorists at their word, they are eager to expand government's role in managing the economy—which is exactly the wrong direction for the nation to take.

- The discussion of capital formation is flawed by the assumption that interest rates and savings are the key factors with influence investment decisions, when economic research shows that after-tax rate of return is far more important.

- The section on education suggests that educational achievement is directly related to spending on education—a claim clearly contradicted by the experience of the past 25 years.

- The report criticizes mergers during the 1980s, though economic research does not support this conclusion.

- The report condemns Gramm-Rudman, but this was the only measure which demonstrably slowed the growth of federal spending. The deficit has soared since it was abandoned.

- The report sets up a straw man argument to claim that the budget cannot be balanced without higher taxes. It uses current services projections to magnify the amount of spending discipline which will be required.

- The report endorses $160 billion in more domestic spending, above and beyond the amounts already in the baseline—this is at a time when the deficit has reached record levels.

- The report endorses $376 billion in new taxes, above and beyond the additional revenues already projected (p. 78). The report also endorses another payroll tax on business to support training programs.

- The report naively accepts government figures purporting to show that money spent on certain programs saves money in the long run.

- The report mistakenly recommends adoption of a "manufacturing extension service" to establish a system of government agents to provide advice to businesses. This would not be helpful to business. Business would be far better off if government put its own house in order first, before it claims new responsibilities which it is ill-equipped to perform.

- The report endorses higher pay for government employees, at a time when government is far in debt, even though measures of turnover show that such employees are not under paid.

- In the discussion of productivity and its relation to income, the report suggests that family incomes have fallen continuously since 1973, even though family income reached record levels during the 1980s. The report also fails to correct these figures for changes in family composition.

- The teport, to sum up, incorporates a governmental perspective on our economy, with its recommendations for a comprehensive economic strategy, business and government partnerships, and a manufacturing extension service. It calls for more taxes, and an expanding role of government in managing our economy. Many of the problems outlined in this report have their roots in an overly expansive role of government. The American people will have to decide, as they have in the past, how much individual freedom they are prepared to give up in return for security provided via government. They will also have to face squarely the fact that these services provided by government will increasingly be paid for, not simply by higher taxes, but also by reduction in economic growth and prosperity. We cannot heal problems caused by our excessive reliance on government by expanding government's embrace over our lives.

WILLIAM BROCK
Chairman
The Brock Group
September 26, 1992

I wanted to add an additional comment as one who has served in the House of Representatives, in the Senate, and then in the executive branch. The active, involved leadership of two sitting Senators in this exercise has been quite remarkable, as have been the contributions of the other Members of Congress and mayors. It is easy for those not in political life to pronounce on what should be done, but it is far more difficult for a politician who must pay a price for courage.

There are generally two kinds of policy studies: first, those done by people of the same mind who often simply speak to their own kind; second, those broad-gauged, diverse, bipartisan groups that then so water down their findings that they become "pap."

This Commission is neither.

It is indeed a broadly-based and diverse group, both politically and in expertise. Yet it has come through with a detailed, agreed-upon plan that asks for immediate action.

One hazard may come in part from those unable to participate in the extended discussion of all possible alternatives, permutations and combinations—for the Commission's choices were not made in isolation from the political and social context of modern America. Those who did not work their way through the last 18 months with us may be tempted to read our product selectively or superficially. Perhaps being subject to such a response is the fate of this type of endeavor, but the magnitude of our current problems demands more from those who would find fault because the proposals do not fit neatly into one ideological niche.

It is patently obvious that issues like the deficit/national rate of savings are not subject to solution by using a few "silver bullets." We say so, and tell why.

It is equally clear, given the reality of the composition of our society and its representative government, that solutions will require the participation of people and leaders from all walks of life, both political parties, and a range of political philosophies. The report tells us why, and lays out a road map.

We did not seek some mythical "middle ground," we sought answers. We rejected the easy cliches like "industrial policy," "just cut waste, fraud, and abuse," and "tax the rich." All have been tried—none have worked. They are the tools of the demagogue, and we must resist such facile promises.

America, our America, has been living beyond its means. The bill has now come due. It must be paid, as our fathers paid theirs.

The most important thing to know is that we can do it. We are still the most productive people in the world. We can do whatever it takes to put our house in order.

We must begin now.

MANUEL H. JOHNSON
Koch Professor
of International Economics
George Mason University
September 28, 1992

I would like to commend the efforts of the CSIS Strengthening of America Commission. While I do not agree with all aspects of this report—which is only natural for a bipartisan effort of this scale—there is much here with which I do agree.

I have focused my efforts and contribution to the Commission primarily in the area of entitlement reform, savings and investment incentives, and the benefits of moving toward a consumption-based tax system. It is perhaps in this area where I feel the report's proposals will make the greatest contribution and its recommendations are closest to my own.

Again, I have enjoyed my participation in the Commission and look forward to continuing my involvement.

ALAN SIMPSON
Senator - Wyoming
September 28, 1992

I am very pleased to have this additional opportunity to articulate further some of my concurring, as well as my dissenting views concerning the contents of the Strengthening of America Commission report. As the Commission has brought together a truly wide range of viewpoints from across the political spectrum, it has been necessary for each of us to associate ourselves with some specific policy recommendations with which we may personally disagree, in the interest of advancing others that we consider to be of the utmost importance. I do wish to express my strong personal support for the general tenor of the report, even as I use this opportunity to describe certain particular disagreements with it.

I am strongly supportive of the report's findings pertinent to the immediate threats to this nation's future, in the forms of varied and several interdependent trends: the spiraling national debt, a shortage of national savings, slow economic growth, and the need for educational reform—among other issues. Each of these threats, if not met and resolved, exacerbates the others, and they must, as the report suggests, be dealt with "together."

Perhaps the single most important recommendation in this report, in my view, is for a cap on the growth of federal mandatory spending. The principal authors of this report, my able colleagues and friends, Senators Pete Domenici (R-NM) and Sam Nunn (D-GA), attempted to accomplish this legislatively in the spring of this year. That proposal was defeated by a legislative tactic involving a series of amendments, each exempting a very sensitive political constituency from the program controlled growth, and clearly designed to subject the authors of the proposal to a series of politically embarrassing votes. When there are only 28 votes against exempting the first of these powerful groups, disabled veterans, the fate of the rest of the exemptions had been well divined, and the sensible and responsible proposal had to be withdrawn.

The correlation between national savings and the rate of economic growth has long been apparent to economists. It is a regrettable truth, however, that savings incentives in the tax code will do very little to bolster our saving rate so long as the federal government continues to soak up hundreds of billions of dollars in the form of interest payments on the debt. It is my hope that this report will contribute to public understanding of exactly what is driving the deficit. It needs to be so much better understood that revenue increases, and indeed even serious discretionary spending restraint, will do little to reverse the trend of increasing deficits if the problems of "automatic-pilot" mandatory spending increases are not meaningfully addressed.

I would stress that time is a critical factor in attacking this problem. Annual "entitlement" spending topped $700 billion in this fiscal year, and could pass $1 trillion as early as 1997. This is spending that is not appropriated, and which increases "automatically" unless changes are made in the law. There is so little public understanding of the principle that all of Congress's appropriated spending could be frozen in a given year, and yet the deficit would still rise because of inaction rather than action. A dollar "saved" in the category of mandatory spending amounts to many, many dollars over time, as it lowers the "baseline" from which all future increases are made.

There are humanitarian as well as economic reasons for swiftly meeting this threat. The Congressional Budget Office estimates that fully 80% of current entitlement spending is not "means-tested" (being measured by the beneficiaries' net worth and revenue). Eventually mandatory spending must be reined in, as there is no possible level of taxation which can keep up with the one-ended increases that are currently built into the system. The sooner we address this problem, the greater the likelihood that we can assuredly hold harmless that spending which is given to individuals truly on the basis of need.

Therefore, those interest groups who claim that mandatory benefits for the wealthy should be inviolate, and are always but a prelude to "an attack on benefits on the needy," have it exactly wrong. The budgetary reality is that an unreformed federal mandatory spending system compounds the probability that benefits for the needy must eventually be cut.

For these reasons, I strongly support the provision in the report that indicates that spending restraints must be "locked in" before any revenue increases occur. I would stress that this principle is not purely the product of a philosophical preference for a low level of taxation and spending. It is a recognition that, within the current process, revenue increases in the absence of mandatory restrictions will not eliminate the threat of mounting deficits, with all that they portend for our children's chances to lead prosperous lives.

Indeed, there are certain particulars in the report that I do not endorse. One such example would be the suggested increase in the gasoline tax in order to finance work on transportation infrastructure. In general, I support the findings of the report that the tax code needs to better encourage savings as opposed to consumption, and that this must be combined with other changes in order to keep the total effect on the tax code from being regressive. However, to me a gasoline tax is plainly regressive, and the "incentives" it would be intended to provide against unwarranted gasoline consumption just simply cannot be workable when the traveler has no plausible alternative to car travel. In my own vast, rural state of Wyoming, this is true in almost all cases.

It is worthy of note, too, what this report has to say about "getting our money's worth" in health care and education. While the report demonstrates the necessity of putting these matters at the fore of our national agenda, it also demonstrates that the problem is not merely one of a failure to spend money. Indeed, health care reform including a program of cost containment is necessary if mandatory spending is to be brought under control, as the huge increases in Medicare and Medicaid are in large part reflective of uncontrolled health care cost increases throughout our country.

In general though, I commend the report's prominent attention to repairing and restoring our national fiscal affairs, and its clarity in exposing the serious threats to our federal fiscal future and to our nation's manufacturing base. I trust that we will be able here to provide an example by detailing the common ground in our thinking, in a year when it has become more common for progress on these common threats to be held hostage to other policy disagreements. Put very simply, our national future depends on our ability to develop a consensus for action in these areas where the answers are well known but not politically popular. As I often relate, "We all know what we have to do." It is so. We must be about it.

LEO CHERNE
Chairman Emeritus
International Rescue Committee,
Former Executive Director
Research Institute of America
September 29, 1992

None of the gifted members who undertook to work on this study — the experts, scholars, legislators, businessmen — could have reasonably hoped that the contribution they made would offer to the nation as it faces its critical competitive test such a remarkable demonstration of sober and demanding wisdom and guidance. Nor is it likely that each individual who participated in this study will readily yield agreement on every point. It is, however little short of remarkable that the many aspects of their work succeeded in achieving the widest range of fundamental and effective forward thought. Most importantly, the report makes a superb contribution in the area of those American values which require strengthening if our country hopes to benefit from economic success in the future.

The CSIS Strengthening of America Commission Members

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Al Narath, President, Sandia National Laboratories

Paul H. O'Neill, Chairman and CEO, Aluminum Company of America

Richard E. Peck, President, University of New Mexico

Rudolph G. Penner, Director of Economic Studies, KPMG Peat Marwick; former director, Congressional Budget Office

Heinz C. Prechter, Chairman and Chief Executive, ASC Incorporated

Frank Press, President, National Academy of Sciences

Thomas J. Pritzker, President, The Hyatt Corporation

Susan F. Rasky, Visiting Professor, University of California at Berkeley*

Norman B. Rice, Mayor, Seattle, WA

Alice M. Rivlin, Senior Fellow, The Brookings Institution; former director, Congressional Budget Office

John D. Rockefeller IV, U.S. Senator (D-WV)*

Barry K. Rogstad, President, American Business Conference

Warren Rudman, U.S. Senator (R-NH)

Howard D. Samuel, President, Industrial Union Department, AFL-CIO*

Isabel V. Sawhill, Senior Fellow, Urban Institute*

John C. Sawhill, President and CEO, The Nature Conservancy

James Schlesinger, Counselor, CSIS

Albert Shanker, President, American Federation of Teachers*

William E. Simon, Chairman, William E. Simon and Sons, Inc.*

Alan Simpson, U.S. Senator (R-WY)*

Lawrence D. Thomas, Executive Vice Chairman, Amoco Corporation*

Barry A. Wigmore, Private Investor and Author

Andrew Young, Chairman, Law Companies International Group; former Mayor, Atlanta, GA 1982-1990

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*Commissioners who have separate statements in the Appendix