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Heritage Fiscal Plan Saves American Dream for America's Veterans

Baker Spring

How a nation treats its veterans says a great deal about the kind of nation it is. To provide an adequate defense, America has to achieve three vitally important objectives with respect to compensation and benefits for those who serve and have served in the armed forces:

- Ensuring continued recruitment and retention of the top-quality personnel the armed forces need,
- Honoring the country's obligations to members of the armed forces, and
- Applying taxpayer resources devoted to veterans concerns effectively.

Establishing programs that are sustainable can best be accomplished under the policies outlined in *Saving the American Dream: The Heritage Plan to Fix the Debt, Cut Spending, and Restore Prosperity*.¹ The Heritage plan provides a long-range budget blueprint that balances the federal budget within 10 years, leaves every class of Americans better off than they are now, and fully funds defense for decades—without raising taxes. This plan has important implications for the nation's veterans.

Securing the Next Generation. The Heritage plan would permit veterans to build wealth for themselves and their families in ways the current system does not. This is achieved by restructuring the federal tax code to reward savings and investment by permitting the establishment of tax-preferenced, all-purpose savings accounts.

America's veterans serve not because they receive special treatment but because they wanted to serve their country. What they want and deserve is fair

compensation for their service and the recognition that the nation values and honors their sacrifice. Meeting that obligation in a responsible manner should be Washington's priority, and there is no better time than now to address this pressing issue. In the decade since 9/11, a whole new generation has joined the ranks of America's veterans. They should know that when it is time to claim their benefits, there will be a sustainable and fair system in place to serve them and their families.

Freezing Spending: A Difficult Issue. Spending on veterans benefits is growing at an unsustainable rate. The fiscal year (FY) 2010 budget for the Veterans Affairs Department (VA) was about \$108 billion. The estimate for the current fiscal year jumps to more than \$141 billion. This represents an increase of more than 30 percent in a single year. Nevertheless, the Heritage plan uses the current year's estimate as the starting point for the freeze. The Obama Administration currently proposes that VA outlays grow to more than \$150 billion in FY 2015.

Saving the American Dream makes a difficult choice. Under the plan, spending in the VA-related account would be frozen at the FY 2011 level

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(202) 546-4400 • heritage.org

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through FY 2015. After FY 2015, the account would be permitted to grow at the rate of inflation.

Although the Heritage freeze proposal would “reduce” outlays in this account by a little more than 6 percent in FY 2015 from the Obama Administration’s requested level, it would increase funding by about \$33 billion from last year’s budget. The freeze, in other words, is a reduction only when measured against the Obama Administration’s *proposed* increase. The fact is that the Heritage freeze proposal will keep veterans spending at this year’s current dollar level through FY 2015 and then permit it to grow thereafter. It is not in any sense a cut in benefits.

The Big Picture. The greatest benefit of *Saving the American Dream* is that it would give veterans the most important benefit of all: saving America from economic collapse. The Heritage plan seeks to save the American dream by freezing many elements of federal spending because the government’s fiscal posture is so precarious. Accordingly, it is necessary that all Americans make some contribution toward restraint when it comes to spending taxpayer dollars. The Heritage plan acknowledges veterans’ service by asking them to contribute to spending restraint in ways that are relatively modest.

While *Saving the American Dream* does not specify how the veterans budget account will meet its targets for a budget freeze, several options are being examined:

- Accepting the Obama Administration’s own proposal to reduce funding for income security for veterans in fiscal 2012;
- Applying a different method for calculating cost-of-living adjustments (COLAs) to income security benefits for veterans along the lines proposed in the *Saving the American Dream* plan for future Social Security benefits; and
- Targeting the generous investments in the veterans medical care system to meet the unique medical needs stemming from military service, such

as treating traumatic brain injuries or other combat injuries resulting from attacks with improvised explosive devices (IEDs).

The Benefits of a Comprehensive Approach.

Saving the American Dream would give all Americans, including veterans and their families, the opportunity to achieve a more secure future—a real chance to accumulate wealth in amounts that would far outstrip the value of the limited benefits they receive today under current and projected budgets. These opportunities are provided through the following provisions:

A simplified federal income tax system for individuals with a flat rate between 25 percent and 28 percent. Not only is this flat-rate system fairer and more transparent, but it also creates an incentive for veterans to save and invest. It does so by deferring federal taxation on funds put into an all-purpose savings account. Increased saving and investment is the means for veterans to build the nest egg that provides for their future needs and those of their dependents.

A key component of this tax plan is that it eliminates payroll taxes. The current tax system imposes a tax on employers’ payrolls of 15.3 percent—half applied to employees and half applied to the employer. These taxes are supposed to be earmarked to fund the Medicare and Social Security trust funds, but Congress has routinely raided the trust funds and left them holding only IOUs. For most Americans, the payroll tax is onerous and a barrier to hiring. The *Saving the American Dream* plan would eliminate the payroll tax and collect revenues for Medicare and Social Security through the flat-rate income tax system.

Tax reforms designed to end double taxation on savings. The *Saving the American Dream* plan contains two components for encouraging savings. The first is an improved version of the existing IRA/401(k) employment-based retirement savings system. Under this plan, 6 percent of each worker’s income would be placed in the savings plan that he

1. Stuart M. Butler, Alison Acosta Fraser, and William W. Beach, eds., *Saving the American Dream: The Heritage Plan to Fix the Debt, Cut Spending, and Restore Prosperity*, The Heritage Foundation, 2011, at <http://savingthedream.org/about-the-plan/plan-details/>.

or she—and not Congress—controls. This uses an approach called automatic enrollment, which would be applied unless the worker specifically declines it. No one is mandated to save, but the evidence shows that Americans want to save, and auto-enrollment makes that the default. The money put into these accounts would not be double-taxed.

Second, the flat-rate tax system would permit all savings to remain completely free of taxation until they are actually spent. There would be no limit on contributions to these accounts and no tax penalty for withdrawing the money. Because only money that is actually spent is taxed, gifts are exempt from taxes. That means there would be no estate (death) tax. Moreover, while most deductions would be eliminated, the mortgage interest deduction is retained. There would be a new deduction for up

to four years of higher education for each child. So veterans with children would have significant help for their family needs.

A Time to Act. The *Saving the American Dream* plan would give veterans the opportunity to build their personal net worth in ways that would outstrip the financial benefits provided to them by the federal government. It offers the right blueprint for ensuring that the nation honors its contract with the next generation of American veterans.

—*Baker Spring* is F. M. Kirby Research Fellow in National Security Policy in the Douglas and Sarah Allison Center for Foreign Policy Studies, a division of the Kathryn and Shelby Cullom Davis Institute for International Studies, at The Heritage Foundation.