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PART II: ADDRESSING ENTITLEMENTS, TAXATION, AND REVENUES

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P R O C E E D I N G S

MR. RUBIN: Good morning. I wasn't looking for a response, but nevertheless good morning. (Laughter)

I'm Bob Rubin, and on behalf of the Hamilton Project and all of my colleagues at the Hamilton Project, I welcome you to today's discussion, which is entitled "Real Specifics: 15 Ways to Rethink the Federal Budget." This is Part II, which deals with entitlements and taxation revenues. We did Part I on Friday, which dealt with the defense budget. It was a remarkably robust discussion with the former chairman of the Senate Armed Services Committee, former head of Naval Operations, former director of the CIA, and others.

Let me say a few words about the Hamilton Project before we get to today's program. We began about 6 years ago. A group of us who were very concerned about the direction of economic policy at the time came together with what we thought was a different idea, a different way of supporting policy development and serious economic discussion. And the idea, which to the best of my knowledge at least is unique, was to form not an institution but a small group -- a partnership of policy experts, former government officials, academics, and business people -- organize an advisory council and then, in that context, to commission papers and to provide a forum for serious discussion on economic issues on a periodic basis. The Advisory Council has a wide range of experience, a broad array of views and, with that, I think has given the Hamilton Project a distinct and pragmatic perspective.

We began by putting out a broad economic strategy paper. It was organized around the policy objectives of growth, widespread sharing of the benefits of growth, economic security, and the belief that all three can reinforce each other. We strongly supported market-based economics, but we also and equally advocated a vital role for government: form the functions that markets, by their very nature, will not perform.

Since then, we've had a series of events on specific economic issues. We do not endorse proposals, but we do take the work product of our panels, such as today, and work intensely to bring that work product to the media and to government. When our events involve papers, they are subject to rigorous academic review.

As all of us know, the American people have experienced great hardship and continue to experience great hardship, and it's been going on now for quite some time. In that context, the Hamilton project has had commissioned policy development in the area of stimulus, mortgage relief, and other areas.

But our focus is, at least for the most part, long-term economic policy. We believe strongly that our country has enormous economic strength, a dynamic, entrepreneurial culture, vast natural resources, flexible labor and capital markets, and much else and that, with that, we are well positioned to succeed over the longer term.

However, in order to realize that potential, we also believe that three hugely consequential policy challenges must be met: a sound physical regime; strong public investment; and reform in areas that are key to our economy: immigration, health care costs, energy, and much else.

There's broad agreement across the political spectrum that our country has an unsustainable and dangerous fiscal outlook, but once you get beyond that, as all of you know so well, there is wide disagreement about what to do and when to do it. These are complicated matters substantively, but a conservative economist, a well-known conservative economist, said to me recently, and I think rightly so, that the adherence of different views that are committed to effective governance and committed to its requisite, which is compromise, could bring this together and relatively readily arrive at a sound fiscal plan for the 10-year budget window that is currently at issue.

However, as we all know, the politics are very difficult. As the usually counterproductive sequester, with arbitrary cuts and with a steep fiscal drag, so sharply demonstrates, the ultimate challenge for our economy is effective government, and the greatest threat to our future as a country is our long-time, now, increasing governmental dysfunctionality.

Focusing on our fiscal outlook, I believe strongly that the debate about job growth and recovery now versus deficit reduction is a false choice and that that false choice complicates resolution of our fiscal issues. I speak, on a pretty regular basis, to people involved in running large companies, and almost always in those discussions there's expression of the view that our current fiscal situation undermines confidence by creating uncertainty about future policy and by heightening concern about the effectiveness of our political system.

A well-constructed fiscal program could promote confidence in the short run and could meet the absolute imperative for sound fiscal regime for the longer term. That longer-term imperative involves avoiding what will otherwise, I think, be a high probability of severe destabilization at some unpredictable point in time either in the form of fiscal crisis or in the form of serious inflation.

Moreover, there are some analysts who feel that our current unconventional monetary policies may pose similar risks -- again not now but at some future time -- and possibility heighten our vulnerability.

I would define a well-constructed fiscal program as one that stabilizes debt to GDP and perhaps even begins to bring it down over the next 10 years, and that includes critical public investment, balanced funding from increased revenues and cost constraint, and possibly a moderate stimulus. The program would be enacted now and implemented either gradually or with deferral and effective enforcement measures.

There are many who would disagree with the views I've just expressed on fiscal matters, and certainly many would disagree with respect to my view at least as to the role of government in our economy and our society. But what we should all be able to agree on -- and this gets to the heart of our program today and last week -- is that our fiscal resources should be used thoughtfully and officially in order to get the greatest possible benefit from the resources that we expend and to design revenue measures in terms of critical economic and social criteria.

Achieving these objectives on the revenue side and the expenditure side has two dimensions: number one, reducing the role of politics in allocating resources and designing revenue -- and that gets back to this central question of the effectiveness of our government -- and number two, designing policies that serve those purposes.

In that context, our program will start today with a panel of three former directors of the Congressional Budget Office: Don Marron, Director of the Tax Policy Center; Bob Reischauer, Distinguished Institute Fellow and President Emeritus of the Urban Institute; and Alice Rivlin, Senior Fellow, the Brookings Institution. The moderator will be Roger Altman, Chairman of Evercore Partners. Then Michael Greenstone, 3M professor of Environmental Economics at MIT and Director of the Hamilton Project, will provide an overview of the Hamilton Project Budget Book.

And following that, we'll turn to our three panels. The panels are based on 13 briefing papers. But there will not, at the panels, be presentation of those papers. Instead we'll have moderated discussions.

The first panel deals with improving our social safety net and putting on sound financial footing, and that panel will be moderated by Laura Tyson, former chairman of President Clinton's CEA, Council of Economic Advisors, and professor of

Global Management, the Haas School of Business, University of California at Berkley.

The second panel deals with innovative approaches to that elusive goal of tax reform, and that will be moderated by Bob Greenstein, President of the Center on Budget and Policy Priorities.

And the third panel will focus on new sources of revenue and also on trying to optimize our revenue regime in terms of social and economic objectives, and that will be moderated by Michael Greenstone, the director of the Hamilton Project.

Let me close my remarks by thanking three people for all that they've done in constructing the intellectual construct for this program and also for putting the program together. Michael Greenstone, I've already mentioned, is the director of the Hamilton Project; Karen Anderson, the managing director of the Hamilton Project; and Adam Looney, the policy director of the Hamilton Project.

And again, and let me close with this, let me thank, as I always do at our events, the hardworking and extraordinarily talented staff of the Hamilton Project, which works with tireless effort and tremendous talent to put together these events and without whom none of our work would get done.

Thank you very much, and with that I will turn the forum over to Roger.

MR. ALTMAN: Good morning, everyone.

ALL: Morning.

MR. ALTMAN: I, too, want to thank Michael and Karen and Adam and all of the staff of the Hamilton Project for, once again, conceiving what I think will be an important and extraordinarily timely discussion here this morning.

Now, the stated topic for this panel is "The State of the Budget." Jimmy Fallon probably would like that. But we're very fortunate to have with us, as Bob said in his introduction, an extraordinarily talented and experienced group of panelists. I don't think we could possibly have a better one. And I'm going to focus this discussion, to the best of my ability, at least for the beginning of the discussion, on two aspects of the budget that I hope are as timely as they could possibly be. One is the sequester. And the other is the recent and possibly quite profound change in the cost curve involving health cost inflation and the implications of that on the federal budget.

But let's start with the issue of the moment, the sequester, and I just want to begin by saying this. The present moment in Washington, this moment, perhaps better illustrates the uniqueness or the silly, generous nature of Washington itself than any moment I can remember over many years.

I was sitting in a cab this morning coming in from the airport, and the cab driver was listening to CNN radio, and just as I settled into the back, the CNN host said, now we're going to talk about the only issue that anybody is talking about here in Washington today, sequestration. And I thought to myself, imagine someone living in Asia, a very aware and worldly person but not a political junkie, who is on a business trip to the United States, comes to Washington, gets into that same cab and hears that word. Imagine how confused that person would be: wait, did the CNN host say defenestration? (Laughter) Oh, no, no, that was reforestation. (Laughter) Only in Washington.

But it is important. So, I'm going to try to ask some questions here that frame this in a particular way and I hope a helpful way. And let me start with two that just hopefully put it in some perspective.

One is the history in terms of how we are dealing now with the idea of a sequester and the degree to which actually -- unless you correct me -- it's not a brand new idea. And the second is the real size, over the short term, of the impact of the sequester. So, maybe I could start with Alice.

I'd like to say, Alice, I've enjoyed working with you so much over so many years, and I'm happy to be here with you.

Give us some sense of how the whole idea of "sequester" evolved over the past 10 or 20 or 25 years, because in doing some research recently in connection with this event, I learned that, no, it's not a new idea even though a lot of people think it is. So, can you give us some sense of that?

MS. RIVLIN: Yes, but not very long because it really doesn't matter how we got here; we shouldn't be here. (Laughter).

Back in the 1980s when the Congress and the President were struggling with what seemed like large budget deficits at the time and were by the standards of the time, though we've dwarfed them since, the Congress realized that it wasn't getting the job done, that it really had to find some way of compromising between the forces that wanted to keep taxes low and the forces that wanted to cut spending, and they had a standoff not unlike what we have now.

They passed something called the Graham-Redland-Hollings Law, which was a rather bizarre piece of legislation, and it said we will agree on a deficit path and if we don't get there we will cut across the board all except certain exempt spending, and that will force us to come to agreement, because it's so obviously stupid to cut across the board (laughter) that we will come to some kind of agreement.

It was a badly designed law, as we found out later when we designed a better one in the Budget Act of 1990, but it did come into effect I think only once but at a very small amount. They did a very tiny sequester one year but then decided, quite wisely, in 1990 that there were better ways of controlling the deficit.

MR. ALTMAN: Weren't the budget controls during the Clinton years, which we all know, among many other things, contributed to the best fiscal period we've had in 60 years. Weren't he caps on the discretionary side in those years backed up, at least in theory, by a sequester so that if the discretionary account effectively exceeded the caps, a sequester would kick in? My point in bringing all this up really is that it's historically, I think, been used as an enforcement mechanism. It's just been used in a small, tiny way or just on the shelf, and now we're being faced with it in a big way and perhaps a live way.

MS. RIVLIN: That's right. I think that's really enough said on the history.

(Laughter)

MR. ALTMAN: Okay, so let's turn to the size. So, Bob Reischauer, let me ask you. So --

MR. REISCHAUER: Well, I wanted to say something about the history (laughter), because --

MR. ALTMAN: Okay, we're --

MR. REISCHAUER: -- as a mechanism that stimulates more rational action, there have been points where it has been important, and in 1990 when the Congress and the President couldn't agree, we had looming before us a 30-odd percent cut in domestic discretionary and a 34 percent in non-Armed Service personnel cut in defense, which stimulated the 1990 agreement.

MR. ALTMAN: Okay, let me ask about the size. So, the number that we hear about or read about every few minutes is 85 billion as it relates to the remainder of this federal fiscal year -- through September 30th. But I have the impression, as usual, that there -- I mean, I have the impression that as usual there's an important distinction between budget and authority and appropriation. So, let's just talk about that.

What is the impact of the sequester? If it took affect and stayed on the books for the rest of this fiscal year on the appropriations side, is that or isn't that really the right way, at least over this next few months, to think about the real dollar impact?

MR. REISCHAUER: Well, it's a reduction of $85 billion in budgetary resources, budget authority, which is giving, through an appropriation bill, the agencies of government the legal ability to enter into contracts and commitments to spend money. It isn't the spending. You know, the shipbuilding account in the Navy might be cut by close to 8 percent, but that means the Navy can't sign contracts except those that would fit into the smaller budget. It would be spent out over a number of years in that account, and in a personnel account it will be spent out almost all within the current fiscal year. So, of the $85 billion in reduced budgetary authority, only about 45 billion would be seen in reduced outlays, actual spending, and of course actual spending then affects the economy most directly.

MR. ALTMAN: Okay, so is it correct, Bob, then, to say that the fiscal '13 impact of the sequester, if it took effect and stayed there, from a GDP point of view, for example, is really the $45 billion number not the $85 billion number?

MR. REISCHAUER: Well, it is and it isn't because, of course, in anticipation of work that the contractor might expect to get in 2014, they're going to be reducing their labor force maybe, and so there'll be some anticipatory reduction as well. The rest of that $85 billion that isn't spent in the current year will be spent, obviously, in fiscal 2014, which begins, after all, in October. So, from a calendar standpoint, the number will be higher than 44 or $45 billion.

MS. RIVLIN: In fact, there is some reason to think that some of that anticipation has already happened.

MR. REISCHAUER: --already happened.

MR. RUBIN: All right, well, that leads to a related question, which I must say I hear a fair amount, although you wouldn't probably hear it in a room like this or maybe much in Washington. But you do hear it elsewhere in the country. And I'll take what Bob just said and use it as the basis for the question, which is: If some figure like 45 billion is the impact for the rest of this general fiscal year, over the next 7 months, since the budget is 3.6 trillion and we have a roughly $15 trillion economy, you hear so many people around the country say why is that such a big deal. Why can't we -- even if it is across the board -- live with a reduction that is so small?

So, Donald, let me ask you that.

MR. MARRON: Sure. Well, I mean, the first is it's an incredibly blunt instrument, right? So, there's no thought that's going into this. This is purely a mechanical across-the-board thing, and so you're going to be cutting things you like and cutting things where there's room to trim some fat. And, you know, in a better world we would have policymakers who are focused on actually making policy choices rather than just incredibly blunt arithmetic.

The other is from a macro point of view; we have this very hard issue while we still have a weak economy. We had a certain amount of withdrawal of stimulus already this year, right? The payroll tax cut has expired; taxes have gone up at the high end; we've had some spending reductions. And so from a macro point of view, we've already done a certain amount of reducing the deficit, making progress on that front, and you don't want to do that too fast, right? You want to spread it out over time, and so there's a very serious question about, you know, whether now is the time to do more.

MR. ALTMAN: But if you were doing a town hall meeting today in some other part of the country and the question from the audience was: I appreciate your point on macroeconomics and fiscal drag, but just from a broader point of view, since a very high majority of Americans think that it would be a good idea if the federal government spent less not more, why is this amount -- putting aside macroeconomics and fiscal drag -- why is this amount, the 45 billion, to pick a number, such a hard thing to do. Leaving aside the desirability of the way we're cutting it -- I understand all that -- but if you were in the town hall meeting you would get a question like that I'm pretty sure. So, how would you answer that?

MR. MARRON: First is I think we're actually on a trajectory where it may be relatively easy to do, because it requires Congress to do nothing, kind of impractical harms. (Laughter)

I don't mean that quite as cynically as it sounded. (Laughter)

What's the right way to answer that? If you go by what people will ask in the town hall meetings and what the polling data tell us, they will suggest that American people have an appreciation that we have a significant deficit problem in the long run and that it may make sense in the abstract to reduce some spending. Then, if you go down the list of things, you discover that they're actually fans of the vast majority of them, right? And so the 45 billion, which becomes 85 billion, which then -- remember, this then starts again. The sequester is part of a $1 trillion set of cuts over 9 years. You know, those are going to be things that are showing up in defense accounts that people appreciate in the town halls and the places that have people who refer to defense establishments. They will be ones that affect Medicare. They will be ones that affect unemployment insurance. A whole host of things that people care about.

MR. ALTMAN: Well, I think this little discussion illustrates the part of the problem from a broad, political point of view, which is that on the one hand the American public seems to think, as you said, that not only do we have a deficit problem but spending is a big part of that problem and that we need to curb spending. On the other hand, as you say, when you get to specifics, they really like the national parks; they really like meat inspections; they really like air traffic controllers and so forth.

All right, let's turn to possible solutions, ways out of this thing.

And, Allison, I'm going to come back and ask you this.

The administration's position is the sequester, as you put it, is stupid. We should not let it take effect. We should substitute for it a balanced package of revenue-raising actions on the one hand and reductions in the area of spending, which actually is the problem, namely mandatory spending, on the other hand -- or entitlements.

And here's my question. I'll reveal bias. I think that is a reasonable position that the administration has. But I worry about implementing it as follows, and each of you I hope might comment on this.

The most popular area of discussion -- I think I can put it that way -- on the revenue side is various types of reforms, for example, reforming deductions. Now, it's been about 35 years since I first came to Washington to work, and over that period the only time I've seen tax reforms, they've taken a long time to do, most notably, the '86 Tax Act, but in general. So, is it really feasible -- I hope I'm wrong on this -- is it really feasible to rather quickly do a package of entitlement reform on the one hand and some type of tax reform on the other or some type of revenue-raising actions that don't involve higher marginal tax rates again? Is that possible?

MS. RIVLIN: Yes, I think it's possible. Let me just build on Donald's answer about why the sequester is a bad idea. It's just not -- not only is it a bad time to cut anything when we've got a drag coming from the budget anyway, but we've already cut the range of programs that are at issue here, the discretionary spending. The sequester falls mainly on discretionary spending. That has been cut already so that it's on a track to give us less discretionary spending in relation to the size of the economy than we have had in many decades.

MR. ALTMAN: About 50 years.

MS. RIVLIN: And that seems to me important. So, we're cutting the wrong things. And what's driving the deficits that we see looming in the next decade is entitlements and the fact that we aren't raising enough revenue. But to come to your question, we've now spent several years on commissions and gangs of this and that.

MR. RUBIN: Including your commission.

MS. RIVLIN: Including Simpson-Bowles, which I was on, and the --

MR. RUBIN: Rivlin-Domenici.

MS. RIVLIN: -- Domenici-Rivlin and the Gang of Six. They've all said the same thing, that you have to raise more revenue and have entitlement reform. And they have made proposals, very specific proposals. So, we have a whole library of proposals that people have thought about and even put into legislative language. They don't have to take effect right away, because, as we said, the deficit's coming down for the next several years. But we do need to put some things in place that will take effect in the next part of the decade. And some of them are fairly simple.

Bob Rubin referred to a conservative economist. I had a conversation with a conservative economist, namely Marty Feldstein, this week. Marty's got quite a good proposal, I think. It wouldn't be my first choice on tax reform, but it would be a strong second. It's very simple. It is cap the deductions and exclusions and other special provisions in the Tax Code, and you could do that with very simple language and it would be quite progressive, as Marty has described it, and it would raise quite a lot of revenue.

I think, if you could get agreement, that that's a good thing to do, and there's some support on both sides of the aisle so far.

MR. RUBIN: All right, let me ask Bob Reischauer. I'm going to sharpen my question, and I hope this is an important question, because the sequester is going to take effect any minute, and if we're going to push toward a substitute for it, it needs to be a substitute that is practical. So, sharpening my question, is it really legislatable now under today's right-here-and-now circumstances in Washington and in the Congress to say Marty Feldstein's idea or some version of it? Is that actually legislatable over the next 2, 3, 4 months. I'm skeptical, but I hope you're right and I'm wrong.

MR. REISCHAUER: First, let the record show that I haven't spoken with conservative economists for over a week. (Laughter) You might want to treat my answer as an unbalanced one.

MR. RUBIN: Don't feel bad, Bob. Allison, Bob, and Natalie spoke to the same one. Laughter)

MR. REISCHAUER: Marty's idea, which I have some sympathy for, is politically infeasible in the current climate, because while many of us in this room would say there's very little difference between spending outlays for various programs and tax expenditures, which provide the equivalent kind of benefit but simply by lowering your tax liability. You know, to most Republicans in Congress -- they would look at Marty's plan and say, look, this is all taxes and we dealt with taxes back with the fiscal cliff negotiation. That's really off the table. I don't have much sympathy for that argument, but that is the state of play.

Now, the other thing people should remember, and it's important for your question, is that we're looking for a solution to an $85 billion sequester and we're looking -- and we can say that solutions that offset that or can substitute for that can happen over a 10-year period. Nothing really has to happen.

Now, when we come up to these immediate crises, we look for ways to cobble together the same amount of deficit reduction, but we look at that over a 10-year period for a hit that's going to occur in a 7-month period. And so, in a sense, the solution is easier. There are packages of changes to Medicare or Medicaid. There are little adjustments that can be made in lower-priority discretionary spending maybe. But they would be phased in over a 10-year period. So, I think the practicality is there but the political environment is not.

MR. RUBIN: So, and I'll turn to you, Donald. So, what is a version of the administration's position, entitlement productions more or less equally matched with revenue-raising actions, that is legislatable over the near to medium term. And in particular, is there some type of tax reform, assuming it's balanced on some equal amount of spending, that one could envision actually doing now? And I'm asking this question, because I'm just skeptical. I don't see it.

MR. MARRON: Right. So, I personally don't know where the deal is to be done, and I think -- as Bob was saying -- I think the pressures to do short-term things that defer the problem but leave it unresolved are large. In principle, what you would want is not an $85 billion dollar deal but a trillion dollar deal to deal with the sequester in its entirety. That might include some scheduled discretionary cuts, but it would be an articulated plan.

On tax reform, as Alice and Bob said, there's a lot of interest, particularly on the right, about ideas of capping deductions, going after the moral equivalent of spending in the Tax Code. I think that is a good place to go fishing, and I think that's ultimately where -- if a revenue-increasing deal is to be done, that's the place to do it.

I think it's important to keep in mind though and to distinguish things that are good ideas as budget policy from things that are good ideas as tax policy. I think the idea of capping deductions makes a lot of sense as a budget policy, if you want to revenue, to go looking for it there. As tax reform, it's atrocious. It's a goofy, arbitrary policy that says, you know, a charitable deduction should be less valuable to someone who lives in a state with high state and local taxes than someone who lives in a state with low state and local taxes; a charitable deduction should be less valuable to someone who has a big mortgage than someone who has a small mortgage. It makes absolutely no sense as tax reform. And the kind of tax reform I think you have in mind is something that would require a longer process to go through the individual components of the Code and ask ourselves, as people on later panels today will, you know, what do you want the mortgage interest deduction to look like or support for housing? What do you want savings incentives to look like?

And go through it one by one, and that's not something that can be done on a sequester-like timelines.

MR. RUBIN: Do you want to comment any further?

MS. RIVLIN: Well, Bob's going to laugh, because he knows I'm the traditional optimist and it's time to be optimistic at the moment. But I think these continual conversations about why everything is impossible are actually not terribly helpful. (Laughter) I sense, among Republicans actually, that there is a lot of cutting fatigue and that there is given a graceful way to get back to the real issue, as you put it earlier, and hammer out some entitlement reforms that don't take affect right away but that actually change the trajectory in the long-term future. You might get some takers, and I would advise the President, get everybody back to Camp David, stop the blame game, and let's talk about what we really want to do for the economy over the next few years, and it might actually work.

MR. ALTMAN: All right, let me ask about one -- this is the last question on the sequester before we change the subject -- one particular idea that I've heard about that seems to me to be reasonable, but that must be why it can't happen, and that is this.

Take the $85 billion budget authority number, Bob, we were talking about at the beginning. Why couldn't you just say apropos the discussion we've been having in macroeconomic theory, fiscal drag, and so forth -- let's just stretch that out. Let's buy 7 months to give the two sides more time to try to work on a longer-term deal, and the remaining life of the sequester, I believe, is 9 years -- why don't we just take that 85 billion of cuts in discretionary and make it 9 billion a year for 9 years or 9+ billion a year for 9 years. So, stretch out the 2013 piece. The impact on the economy therefore, the impact on everybody's favorite department would be very small and you would still retain the total amount of deficit reduction but you'd buy a lot of time. What is wrong with that? Why can't we do that?

MR. REISCHAUER: You know, that would be kicking the can down the road.

MS. RIVLIN: Yeah.

MR. REISCHAUER: And we would then be faced with trying to figure out what the 2014 appropriation bill looked like and people would balk at that and we would have a situation as we have in the Defense budget this year with continuing resolution where more was appropriated than would fit under the caps that we were under.

Alice already mentioned this, and I will say it in a stronger way, that most of the deficit reduction that has occurred so far, which is about $2.7 trillion, a full --

MR. RUBIN: Including the sequester or excluding it?

MR. REISCHAUER: This is the actions taken over the last two or 3 years, which we have said, well, we've done part of the job already, and, you know, there was the tax increase and there were the discretionary spending caps and the sequester, and it sums to around $2.7 trillion.

MR. RUBIN: Including the sequester.

MR. REISCHAUER: Yeah. And of that, about 69 percent is lowered caps on discretionary spending, which you know, really is a promise to take hard action in the future. It's not something that we can pat ourselves on the back, you know, we've done. So, we should look and say, well, are these promises we've made realistic? And the answer is they aren't. There's, you know, very, very little probability that in 2021 when these caps run their course that we will have achieved them. And I'll just give you a few numbers here.

The defense-capped percent of GDP is 2.8 percent. The non-defense is also 2.8 percent. Over the last 50 years, the range for defense, the low point has been 3 percent. So, we're below any year we've had in the last 50 years. For non-defense, the 2.8 percent compares to the low point in the last 50-year range of 3.4 percent of GDP. In other words, we're shooting for targets that we have absolutely no track record of coming close to, and, you know, what this suggests is that maybe we won't be able to achieve even that deficit reduction that we have already taken credit for.

MS. RIVLIN: Nor should we come close to it if want to run a sensible government.

MR. REISCHAUER: I couldn't agree with you more, but this is supposedly the law of the land.

MS. RIVLIN: Yes.

MR. REISCHAUER: And it is backed up by a series of sequesters. And, you know, then you'll come along and say, well, why don't we take that which we haven't been able to do this year and spread it out over the next X years? And, you know, what we're doing is simply kicking the can down the road.

MS. RIVLIN: But that's the argument for coming back to entitlements and taxes.

MR. REISCHAUER: I agree with you.

MS. RIVLIN: As you know.

MR. REISCHAUER: Yes.

MR. RUBIN: Okay, I'd like to change the subject a little bit.

MR. REISCHAUER: Having resolved that one. (Laughter)

MR. RUBIN: Well, as you'll see, this is related. It's really related. And it's this. Over the past 3, 4, 5 months -- something like that, it's emerged that the longstanding trend of health care costs rising exponentially faster than broader costs throughout our economy has changed. There's been a dramatic drop-off in the rate of cost increase in a way that I think is fair to say was almost entirely unforeseen. In fact, it's caused, as you all know better than I do -- you're all former CBO directors -- it's caused already big changes in CBOs' long-term deficit estimates and, in particular, estimates of the long-term curve, so to speak, in Medicare costs, so much so that if I'm right -- I think I am -- the targets for Medicare cuts that the Simpson-Bowles Commission -- and, Alice, you sat on it -- sat in December 2010 for Medicare reductions is going to be exceeded without any policy changes. In other words, the Simpson-Bowles Commission said, if I'm right, we need to reduce Medicare costs and the target for the amounts we should be spending in future years is this, and now we're on track to actually spend even less than that, even though there's been no change in policy.

MS. RIVLIN: In the first 10 years.

MR. RUBIN: Yeah, even though there's been no change in policy. So, this gives rise to a series of pretty obvious questions, because this could be a very profound development. First, is it a blip, do we think? Or is this a really long-term trend? Is this essentially a cyclical response, or is it really a secular development? What role is the private sector having in this as so many employers are moving toward some form of defined contribution approach to the health care coverage they provide their employees?

And I could ask some others. Let's just take those on.

So, Donald, let me start with you. Do you think this is a blip, or do you think this is a real -- this is a sea change?

MR. MARRON: So, whatever Bob has to say I will trust. He's been following the numbers closer than I. You know, if you look at the history of this, you see blips that persist for a few years and then go away. My sense is that some of it's real, by my sense is really that one of the key lessons here is about the uncertainty in all of these projections. This is not something that Washington deals particularly well with, right? They like 10-year projections that have things down to the penny -- or actually the billion dollars which is but a penny here in Washington (laughter) -- and like to plan to for that kind of certainty. And we engage in budget exercises that assume we know all of that. But we have to really grapple with the fact that there's uncertainty. The good news is the recent uncertainty seems to be giving to making our lives easier on the budget front, but we shall also keep in mind that sometimes it goes the other way.

MR. RUBIN: What do you think, Alice?

MS. RIVLIN: Like Donald, I'd like to defer to Bob on those numbers.

(Laughter)

MR. RUBIN: Well, then we get to the --

MS. RIVLIN: But I think whatever the mix, and it's clearly a mix of cyclical effects and more serious reform, it can't encourage us to say, oh, we fixed it, health care's all right now, there's no problem. We've got plenty of evidence that there's a lot of waste in our system; that is, incentives in the way we incent providers are counterproductive, and we ought to continue with what is a very profound set of changes that are already happening in the public and the public sector.

MR. RUBIN: Well, Bob, apparently everybody's waiting breathlessly.

(Laughter)

MS. RIVLIN: We've heard him do this spiel before.

MR. REISCHAUER: First of all, the slowdown, as you pointed out, has been going on for four or 5 years. It undoubtedly was triggered by the, you know, economic problems we had.

Many people lost their jobs, and with that loss of jobs they lost their health insurance. Back between 2008 and 2011 the number of people with employer-sponsored policies fell by over 11 million people.

Medicaid rolls expanded by about 7 million, but employer-sponsored coverage is expensive. Medicaid for able-bodied people was relatively cheap. There was an increase of about 7 million in the uninsured. So, there's no question why officially health care spending goes down. People didn't have the kind of coverage they had before.

At the same time, as you mentioned, there is a transformation going on within employer-sponsored coverage, and there's been a rather substantial increase in people having high-deductible plans, which put more of their skin in the game and probably dampened the desire for spending on health care.

This necessarily doesn't explain why Medicare has slowed down, but if you look at what happened to the elderly population, they went without a COLA for a couple of years. Their house values, their assets, and everything probably declined along with those of the elderly population, making them sort of less willing to get health care where they had to pay the co-pays or had to pay the Medigap premiums.

The question really is, is something else going on, something more long term? And here I'm cautiously optimistic, although I wouldn't change my policy prescription that we work hard to moderate the road of not only Medicare but also of employer-sponsored policies. And what's going on in my mind is that for the first time in my life, I believe there is a change in the attitude of the provider community, that they're all talking about costs; they're all talking about this is unsustainable; they're all coming up with little ideas in their hospital and their clinic, whatever, for ways to save. You know, the vast majority of them will be failures, but some of them will bear fruit.

There's also demographic transformation going on in the health care industry. Thirty percent of the physicians practicing now are women; 45 percent of the residents are women. Men going into medicine, along with women, want a better balance between life and work. So, their attitudes, I think, about how one practices medicine and what to expect are gradually changing. And this is a really good thing. The complexity of medicine now, the difficulty with regulation and insurance, makes younger physicians more willing to work in organized, large groups or for hospitals or clinics where they don't have to deal with all of the business aspects, which they weren't trained to deal with and they don't like doing. So, we're getting the consolidation of health care very gradually that might be a positive force in holding down costs over the long run simply because we'll have a different organizational pattern.

Then there are all these new delivery systems. The Minute Clinic -- I pass three between my office and my home, which is four miles, and they didn't exist 4 years ago. Well, now, maybe that means I stop in more often, but the price per stop-in is lower, and I think the product of the two is lower. Is this something we should say, hey, problem solved, you know? Let's go on to something else. Absolutely not.

I see sort of three threats here. One of them is that the consolidation that I spoke about before that's occurring and will be encouraged by the Affordable Care Act is giving these larger institutions -- the hospital is buying the doctors' groups, the chain of SNIPs, whatever, more market power than they had before. And they could exploit that to try to raise prices.

We also have the old problem, which is rampant technological progress where we ask the simple question: Is the new device, is the new drug, is the new intervention better than the old one by a tenth of 1 percent? Even though it costs six times as much, we'll pay for it. And, you know, there's a lot going on in genomics, in new technologies that could burst out and cost us a whole lot.

And, finally, there's the Affordable Care Act implementation, and it could be quite rocky. It will increase demand, which will lead to price pressures, so with all of this sort of uncertainty I'm as cautious as I ever have been, notwithstanding the fact that if you look at the CBO projection for Medicare for 2020 in this March report and compare it to the 2010 report, it's 20 percent reduction in Medicare spending, which is precisely what you referred to.

So, there's been some very good news. We don't really understand all the factors that went into it, nor can we assume that it can be sustained.

Now ask them if they agree with me. (Laughter)

MR. RUBIN: Well, do you agree with him?

MS. RIVLIN: Do I agree? Yes. Definitely.

MR. RUBIN: Do you want to comment?

MR. MARRON: I agree.

MR. RUBIN: It seems to me, listening to you, that what we all ought to is the four of us should get up and we should go immediately over to one of those Minute Clinics and we should all walk in and say I hope you can help us, none of us feel well, we think we have a sequester. (Laughter)

MR. REISCHAUER: A malignant sequester.

MR. RUBIN: Malignant sequester. (Laughter)

We have time for perhaps a question or two from the audience. There are microphones in various places. Are there any questions?

Ma'am -- on the aisle here.

MS. SPANNAUS: Hi, Nancy Spannaus, Executive Intelligence Review.

I'd like to address an element of the budget, which really doesn't get counted, which is the bailout, which continues to go on with Wall Street. And as you probably are all aware, and what I'm mainly interested in, there is a major move and has been, even from people who were in favor of getting rid of Glass-Steagall back in 1999 to be in favor of its restoration because there's a danger of a hyperinflationary blowout with the quantitative easing now going on. This is an environment in which budget figuring can be blown out of the water in a matter of a few minutes, as you referenced, in terms of potential blowouts of the economy. So, there is a bill on Glass-Steagall to be renewed. There's a movement in the states. The question in my mind is how you would address that question of eliminating the quantitative easing input of the federal government, which is an input potentially of the taxpayer. There's been a major discussion. In fact, our biggest bond holder, Mr. PIMCO, has said it's a credit supernova on our horizon. We're ignoring -- we're looking at cutting things for people who need it while we're ignoring the explosion and the fact that our government is bailing out these banks that aren't lending into the economy. So, could you comment?

MR. RUBIN: I'm tempted to say thank God for the sequester, but -- (laughter). Alice.

MS. RIVLIN: I respectfully disagree. (Laughter) I think the Federal Reserve will have to worry about how to unwind the quantitative easing over time, but I see no danger of inflation exploding any time soon. We should be so lucky. Inflation happens when resources are fully used when unemployment is low and we're up against capacity. We are in none of those situations, and I'm not worried about inflation now.

MR. RUBIN: Last one. Yes, sir.

MR. CHANDLER: Gerald Chandler. You mentioned that everybody is against just about every cut that's mentioned. If we just took the 45 billion or the 85 billion or whatever and had it be half tax increase, we'd still have 22 billion or 45 billion to cut. Is there anything that you can name right now that you would be willing to cut?

MR. RUBIN: Well, if I could just make a slight correction. The idea -- or at least the administration's position is -- and Alice spoke very well about this -- no, we wouldn't be cutting -- we shouldn't be cutting discretionary spending. We should take that off the table. We should be focusing instead on where the spending problem is, which is mandatory payments or entitlements, and also add about an equal amount of revenue increases. So, I think one answer to your question is we shouldn't be cutting further at all in the discretionary area because, as Alice said, it's actually in the share of GDP about to be in a 50-year low.

Now, in terms of mandatory spending, and I'm going to just close the panel on this note to be on time without seeking additional commentary if you don't mind, there are all kinds of proposals on the table, for example, means of testing Medicare, which I think ultimately there will be agreement on in terms of reductions. I personally think there will be. I don't know how long it will take apropos of this question of what's feasible or not feasible, but I think there will be.

I want to thank our panelists. Really, a wonderful job. Thank you, Bob. Thank you, Alice. Thank you, Donald.

MR. GREENSTONE: Part of the beauty of having 13 different budget proposals is that breaks are forbidden for the rest of the day. So I'm Michael Greenstone. I'm the Director of the Hamilton Project. I'm going to just take a few minutes now to explain what we were trying to accomplish when we began work on this fabulous book, *15 Ways to Rethink the Federal Budget*, and we began about six months ago.

The first thing I want to say is before we start to describe the authors and the papers is this could not have happened without the incredible work of the 15 sets of authors and of at least equal importance this very small, scrappy, Hamilton staff who had a tsunami of 15 papers arrive over the transit more or less simultaneously.

So the starting point for when we set out on this project was the observation that the budget discussions are generally taking place at a very high level. And in the parlance of D.C., these discussions are about the super committee, the fiscal cliff, the debt ceiling, the continuing resolution, the sequester, Alice said the various gangs, and on and on and on. All of these discussions take place at the level of hundreds of billions of dollars. And, indeed, these high-level agreements are critical and, despite the political messiness, really are, to press a metaphor here, the poetry I think of budgeting. However, beneath this poetry is the nitty-gritty of actual policies that can make people’s lives better or more challenging. This includes decisions that determine how much pollution we’re going to put in the air, access to health care, the size of people’s paychecks, whether they can work in the U.S., and whether our nation is secure. These more micro decisions we like to call the pros of budget deals and they really matter for people’s lives.

There’s no question that the continuing consolidation of the federal budget is going to pose challenges, but we believe that it also offers opportunities, and these opportunities don’t present themselves very frequently. It can be very difficult to make fundamental changes in the way things operate during normal times; however, we’re in a period where larger changes can be contemplated, and this provides a special opportunity for policymakers to decide what type of country we're going to be in the coming years and decades.

But sound decisions require a budget debate rooted in facts, not ideology. And so it is with this background in mind that we went to experts around the nation and asked them for their single, favorite, pragmatic, and evidence-based policy proposals that both helped address the budget deficit and had broader economic benefits.

The folks we asked -- and you're going to meet them throughout the rest of the day -- are truly rock stars in a wide variety of areas. They include a retired 4-star Navy admiral who was formerly head of Naval Operations. Let me just add as an aside, one of my favorite parts of the process of producing this book was watching one of our young research assistants try to provide direction to the 4-star admiral over email.

Another author is a person widely credited with designing the Massachusetts health care system and deeply influencing the shape of Obamacare. We have faculty from leading universities around the nation with a leading expert on the economics of immigration in the nation, the president of the National Hazard Mitigation Association, foremost budget experts in D.C., a former Undersecretary of the Department of Transportation, and that's just to name a few of the authors you're going to meet today.

And what came back from these authors, I think, was truly astonishing -- 15 insightful policy proposals. While not intended to cover every budget category, these papers take on a wide-ranging set of topics that we've grouped into four categories. The authors on today's first panel who are about to come on stage focused on ways to improve entitlement spending by reforming disability insurance, Medicare, and natural hazard and mitigation programs.

The second panel's authors propose innovative approaches to tax reform by taking a close look at fossil fuel tax subsidies, the home mortgage interest deduction, and other aspects of the tax system.

The third panel's authors suggest new sources of revenue and efficiency, including instituting a carbon tax, auctioning work visas, and greater use of user fees for transportation infrastructure.

The fourth group's proposals were discussed in an event we held last Friday, and they offered plans for responsible cuts in the Defense budget.

Viewed individually, the proposals offer specific reforms and evidence-based policy ideas to achieve budgetary savings and broader economic benefits. Taken together, they offer a menu of policies that could contribute meaningful deficit reduction and help the country confront its many pressing economic challenges in the years ahead.

So with no further ado, I'll now turn it over to Laura Tyson who's going to moderate our first panel.

Panel 1: An Enduring Social Safety Net

MS. TYSON: Good morning everyone. It's a great pleasure to be here. As a member of the Advisory Board of the Hamilton Project, I much too rarely get an opportunity to be in Washington to chair a panel like this, so it's a real thrill for me.

I have an outstanding panel -- and I just want to go back to one thing Bob said and I think Michael said as well. The Hamilton Project has always been about fiscal responsibility, but it's been fiscal responsibility with progressive growth. So it's a very important panel to start with because this panel's looking at fiscal responsibility, but along with an enduring social safety net. That is what this is about. It's sensible deficit reduction for a social safety net that endures and works for our citizens. So that's the first thing I want to say.

Now, I want to just do a very quick review of the makeup of the panel. First of all, following right on from the last panel we have two papers that really deal with Medicare, which basically is the single biggest driver of our long-run deficit problem. There is, as we heard about, promising evidence, intriguing evidence, of a slowdown. But as you will hear from our panelists, there are still very significant issues of whether that slowdown will be sustained and whether it will be sustained in a way which gives the quality of service to our population that we want to achieve. We have a very ambitious baseline, and can we do it.

So first you'll hear from Professor Michael Gruber. He is the Professor of Health Care Policy at Harvard --

MR. CHERNEW: Michael Chernew.

MS. TYSON: Excuse me, Michael Chernew.

MR. CHERNEW: I could be Jon, though, that would be good.

MS. TYSON: These guys are -- they go right across the street from one another and they work on -- but you're absolutely right. Michael Chernew -- he is at Harvard and one is at MIT -- Professor of Health Care Policy at Harvard Medical School. His paper is co-authored with Dana Goldman, USC, and he is going to talk about proposals to actually work on the supplier side incentives through a global payment reform to try to achieve those very ambitious projections for Medicare savings that are in current law. And so we'll hear about how to do that.

His proposal looks at incentives among suppliers. And actually, Michael, one of the things I found most intriguing about the last panel was the suggestion that providers who are female are going to behave differently and that it may be easier to achieve this global payment reform as the number of women who are in the health care profession increases; a very intriguing idea.

We are then going to turn or shift to the demand side, and this is from Professor Jonathan Gruber -- now I have Michael and Jonathan by correct last names -- Professor at MIT. He is, as Michael indicated, if there's someone here who can be viewed as largely responsible for the Massachusetts health care reform and much of Obamacare, that's Jonathan.

Jonathan is going to talk about reforms on the demand side and in particular on the medigap or supplemental insurance system for Medicare. When I read his paper, which really talks about how aggressively to go after medigap insurance -- for example, by a very large excise tax -- I thought of myself approaching the age of Medicare and thinking about how I might feel about that. So that's a very interesting idea.

We're then going to be joined by Professor Jeffrey Liebman. Now he is a Professor at the Kennedy School. There's a lot of Boston and Cambridge concentration going on here. I can say that from Berkeley, California; however, I am an MIT alum so it's okay with me. Anyway, this really is to look at a different part of the social safety net, which doesn't get nearly as much attention. This is disability insurance. Now, as his paper points out, disability insurance, the big run-up, may be changing with the demographics because a lot of people from 55 to 65 have gone into disability insurance. They will then go into Medicare and to Social Security and off the disability roles.

But it is the case that if we could reform the system to provide better incentives for employers to train people to go back to work, to encourage states to work to identify the truly disabled from those who claim to be disabled, to identify with the federal government the way to actually make the federal disability insurance policies work better, we could save a substantial amount of money long term. So not an immediate, pressing, budgetary problem, but an area where reform would be terrific.

And then finally in a very different way altogether, we don't usually think of social safety nets as dealing with disaster relief, but two things are pointed out by our author, Edward Thomas, with his co-author David Conrad: Number one, more extreme weather events and disasters; and number two, a rising share of those costs of disasters being borne by the federal government, a significant increase in the share being borne by the federal government. And by the way, what's the moral hazard associated there? I live in California on a fault line. I have earthquake insurance. Most people tell me I am absolutely crazy to have earthquake insurance and probably that is correct privately speaking.

So this is basically the panel. I want to start with a general observation. I don't know how many of you read *Freakonomics* years ago, but *Freakonomics* was really based on the notion that crazy incentives lead to crazy behavior. In every single one of these papers the story is about crazy incentives leading to crazy behavior and if we reform, we get both budgetary savings and we get much better behavior.

So I am going to start with Michael Chernew to talk about his global payment reform, ask him to talk a little bit about these baselines, these two different baselines and savings from that, and then how do you see your reform encouraging improvements in the quality of care?

MR. CHERNEW: Well, thank you, and I'm thrilled at the attention Medicare is getting in general and agree that figuring out how we're going to address Medicare and preserve high quality care for the beneficiaries is a huge challenge.

So I told myself I wasn't going to talk a lot about math, and I'm really not going to talk a lot about math. But it turns out that how much money you save has a lot to do with what you compare it to. And a lot of stuff has been going into the current law, existing current law that has already reduced the trajectory of Medicare spending. So I'd like to think that in many ways we had Medicare reform.

Historically, Medicare spending per beneficiary has grown about 2 percent faster than GDP, depending on when you start and when you stop. Current law Medicare beneficiaries, spending growth per beneficiary, is about GDP minus .7. We've never come close to minus .7. Now some of that minus .7 reflects some nuances of the law, the physician payment system called the sustainable growth rate, which has consistently been overridden. So when we think about what you're going to save, the question is are you going to assume current law that has this reduction in physician fees, or are you going to assume history will hold and that will get overridden and you're saving relative to a somewhat higher baseline?

So our proposal is designed to change payment, but the scored saving number there is relative to what we consider the more realistic alternative scenario where there's about 100 billion -- it's really 138 billion -- as opposed to the current law baseline, which is much lower. What that means, of course, is if you want to think about saving money in Medicare -- and I can tell from the prior panel everyone wants to think about saving money in Medicare -- understand that the target you're shooting for is GDP minus .7 on a per beneficiary basis. That's astounding. My general view is the way that one is going to save money relative -- if you need it to save money compared to that, you're going to have to do a lot of shifting to beneficiaries, which I'm not going to talk about very much.

But I do think the motivation for our work wasn't to save money relative to GDP minus .7. We basically had two motivations: One is, try and find a way to get there or somewhere close to there that's efficient as opposed to just slashing prices. So that's the main goal.

And without going into a lot of the detail or anecdote, the way that the Medicare program is designed, as all of you know, is incredibly fragmented. We have a system for physicians. We have a system for hospitals. We have a system for long-term care providers of multiple types. The fees we pay for the same services vary based on where you're getting the services. And often if you have a surgery, for example, we're paying the physician separately from the way we're paying the hospital. There's complicated aspects of geographic adjustments that are going on and complicated issues of coding. Is this a -- there's 15 codes for office visits with remarkable details about which one is which. And we spent a lot of time arguing about how the coding is working and whether we need to claw back aspects of money from various providers because they somehow changed their coding to get more money out of the system.

In that fee-for-service world with all that fragmentation, the provider system does not have the incentive to reap any efficiencies. If you reduce utilization of the hospital, the hospital loses revenue. If you coordinate -- there's no incentive to invest money to coordinate care with some other provider that might reduce the total amount of care delivered.

And so the idea of a broader global payment that we discuss is really to set up a system that allows the provider structure in the United States, which is really the fundamental foundation of the health care sector, to capture the efficiencies that they might be able to gain. What I say when I speak to providers is when the money gets tight, which it surely will, you want to control the money. You want to allow the most flexible substitution across sites of care, across use of services, that you possibly can to promote efficiency.

Now I will say I'm under no illusion that this is a simple or easy thing to do. The organizational changes in many places are enormous. And I don't think that one should say that this is simple in any particular way, but I think compared to the alternative, it is a valuable way to go. And I think the experience in Massachusetts, which I was originally more skeptical of, has suggested the system, in fact, can transform itself reasonably well.

So the challenges are huge, but unless we have a system that allows people to have incentives to become more efficient in their provision of care, I don't see how we're going to get the high quality of care that we need with the budget cost of the --

MS. TYSON: Can I just -- a quick follow up because one of the other points made in the last session was that one of the consequences of the Affordable Care Act is going to be to create much more powerful provider groups. So you have pricing pressure being built into the system. And so if you have these global payment systems and you detach it from fee for service, what's not clear is what you would attach the payment growth to overtime, particularly with these powerful provider groups.

MR. CHERNEW: Well, so fortunately this was a paper on Medicare where you have some price regulatory authority, but the fact is true that almost all of the reforms we've seen both want to get rid of the fee-for-service system and then build payment on the basis of what's going on in the fee-for-service system.

MS. TYSON: Right.

MR. CHERNEW: So we have a ways to go in terms of thoughtful construction of how these systems will work and, in fact, a lot of our paper is devoted to how you might do the somewhat more mundane technical activities. But we believe that the right that the government can set in Medicare is a political decision, and we just picked current law so you could pick faster or slower. In fact, I think that would be important.

The point you raise -- and I agree with it completely -- is outside of Medicare as the provider system changes we have to worry a lot about the market power that goes on as the delivery system consolidates. And so maybe I'll be invited back to write another paper about how we're going to deal with antitrust outside of --

MS. TYSON: So basically what would happen is we have these powerful provider groups, but in Medicare you'd have the cap. And the cap you're basically saying is current law, current law at the trajectory --

MR. CHERNEW: In Medicare you could set the -- we propose that the government would set the fee, this global fee, and they will do that administratively as opposed to applying it to fee for service. But, of course, you would need to set faster or slower based on how much medical technology wanted to encourage or discourage or how much taxes you wanted to have. It's clearly a complicated political question, but at least whatever you decide, you can get efficiency within that.

MS. TYSON: It's better, yes.

MR. CHERNEW: Right, you certainly want to -- whatever you spend, you want to be efficient with it.

MS. TYSON: Within it, right. Okay, let's move to the demand side. So we have the incentives messed up for the supplier side. The demand side -- overutilization. The hospitals want to provide the service. The doctor -- the people want to use the service. Part of this is the fact that we have wraparound insurance, and we have employer-provided health care coverage to pensioners. What should we do? What should we do about that?

MR. GRUBER: So -- what are you pointing at?

MS. TYSON: We're pointing at you. You're up there. Usually these have a title.

MR. GRUBER: Oh, gotcha.

MS. TYSON: Your correct name as opposed to my incorrect -- and then the benefits.

MR. GRUBER: I still want to be called by Mike. First, I want to thank Michael and Hamilton for having us here, for putting this panel together. I think this is terrific, especially in this era of lack of thought in the budget process to have this type of panel put together. I think it's terrific.

So I think Laura is exactly right. If you look at the history of Medicare reform, Medicare policy discussions, they're almost exclusively on the supply side. There's been enormous change to the supply side of Medicare over the past 30 or 40 years, and there continues to be. But, in fact, the demand side of Medicare is largely fixed where it was when the program was introduced. In fact, the biggest change to the demand side, which is an expansion of Part D, adding Part D in 2003, and it's really a demand side that doesn't make sense. If you think about how the demand side of Medicare works, you have a certain deductible if you go to the hospital, but that deductible is per hospital event. So whether your second stay is called per event or not can determine whether you pay an extra $1,200 or not. You have a payment, which you pay per day you go to a skilled nursing facility. It can add up to $10,000 if you're in a skilled nursing facility for 100 days. You have a coinsurance for doctors, which is 20 percent, which economists will tell you is rational label of organized care, but it's uncapped. So if you spend $100,000 at a doctor in a year, which an elderly person could well do, that's $20,000 out of pocket to you. That makes no sense.

Then you have services like home health care and clinical diagnostics, which are delivered free at no cost to the patient and so, are clearly going to be overused. This system's been in place for a long, long time, and it's time to reform it, and there's been a lot of discussion about this. And really what I propose in mind is really another form of ideas that have already been put out there, which is to do two things: First to reform the cost sharing in Medicare, and the second is to reform the supplemental insurance people use because to deal with this cost sharing, particularly this unlimited risk, people turn to supplemental insurance, most commonly medigap, which is individually purchased supplemental insurance or retiree insurance from their employer. As well we have Medicaid from the public sector and Medicare Advantage HMO plans.

These supplemental plans, particularly medigap and employer insurance, have two flaws. The first is they exert what we call a fiscal externality on Medicare. What that basically -- it's a fancy terminology for the fact that if Laura's on Medicare and doesn't have supplemental insurance and I do and I use one more doctor than she does because I have this extra insurance, Medicare bears 80 percent of the cost of that extra doctor's visit. But my medigap insurance only pays 20 percent and yet I -- so basically they're exerting this externality. This extra cost on Medicare that's very large, that's been estimated to be between 30 and 45 percent of the cost of medigap, is the size of the externality that's exerted on Medicare in terms of higher spending.

The second problem is medigap is really not a very good insurance product. You may know that with the Affordable Care Act after some debate we regulated that insurers should have a medical loss ratio -- that is, the ratio of what they spend on medical care of the premiums they collect -- of 80 to 85 percent after some controversy. For medigap that medical loss ratio is about 65 percent; that is, medigap insurers spend about 35 percent of what they collect on advertising, administration, and profits.

So what do we do? What we do is two things, what I propose to do is two things. First of all is to move to a more rational cost-sharing system for Medicare. This would have three features. First it'd have a small deductible of $500. Then it would have -- well, first it would integrate Parts A and B into one system. You'd then have a small deductible of $500. You'd then have a 20 percent coinsurance payment, but you'd have an out-of-pocket limit. This idea dates back to 1988 with the catastrophic reforms that failed in Medicare, had an out-of-pocket limit. But what's different about my projection is when people have talked about out-of-pocket limits, they've talked about numbers like a $5,000 out-of-pocket limit. We have to appreciate half of seniors live below two times the poverty line. A $5,000 out-of-pocket limit at two times the poverty line is 25 percent of income. That's not feasible to ask seniors who are high spending to year after year spend 25 percent of their income on medical care.

So what I propose is actually an income-related, out-of-pocket limit where seniors as a function of their income would pay lower limits, and it'd go up as their incomes go up. It would parallel actually just on the Affordable Care Act, so an income-related, out-of-pocket limit. My other proposal is to -- and that proposal actually, by the way, doesn't save money. It actually probably costs money. If we take Medicare and put in the system I described plus an income-related, out-of-pocket max, that probably costs money. That's why pair it with a tax on medigap plans as well as employer insurance that compensates Medicare for the externality those plans exert on the Medicare program.

Now I don't propose a rate of the tax. The score up there, the score $125 billion, is based on an estimate from the Office of the Actuary, from MedPAC, which uses a 20 percent tax. We can vary that rate. But the idea is essentially to rationalize the cost sharing under Medicare so you no longer really need the supplemental insurance. And then if you still want it, that's fine, but you should bear the cost it imposes on the Medicare program. Thank you.

MS. TYSON: Can I just say as a quick follow up because the tax part of this, which is the way you save the money, is actually -- think about the -- I guess it's not a fair question -- the feasibility of this after a long, long fight to get a serious reduction in the employer tax deduction for health insurance and all we really got was extreme Cadillac plans with a tax increase. So this is a pretty hefty tax increase to raise revenues. Do you have any thoughts about the feasibility of this?

MR. GRUBER: Sure. So first of all, actually I'm excited because of the Cadillac tax. And with the Cadillac tax, remember that starts at a high level, but it's indexed only overall inflation, not medical inflation. So it becomes lower overtime, and that may be the way to do this, too. It may be to have a long phase-in, something like that. I agree. It's not like this is a heavy lift, but I think that we have to recognize the enormous costs -- if we recognize costs -- if we do three things: If you recognize the costs it is imposing on Medicare, you recognize the enormous inefficiency. If you know that the main provider of medigap pays AARP about $250 million a year to use their name to advertise their medigap program and that's what seniors are paying for. And we recognize that in a rationalized cost-sharing system where people are protected against extreme costs, we don't need to have that supplemental coverage.

MS. TYSON: You don't need it. You don't need it as much.

MR. GRUBER: I'm hoping to put those together and a case can be made.

MS. TYSON: Oh, that's fantastic. And I think the point about the Cadillac and then looking forward to it phasing in overtime is very important.

Let's turn to disability insurance. And I really want to point out something very distinctive about this paper because this paper does not say we know exactly what to do. This paper says we need to have a series of pilots to know what to do. And a very important part of this paper is we have real problems funding pilots because of discretionary spending caps. And we have real problems enforcing the current disability insurance law because we can't even handle the backlog of cases under review for disability insurance because that's discretionary spending. So very important observations about the importance of doing pilot demonstrations and the lack of discretionary spending. Jeff.

MR. LIEBMAN: Great, thank you. The first thing I want to say about disability insurance is it's a leading indicator about what we're going to see with the rest of our social insurance system. The same Baby Boomers who are about to be 65 and 75 and swamping Medicare and Social Security retirement have been swamping the DI system because they've been 50 to 65, which is the peak years of disability incidents. And so the reason that DI spending, primarily the reason it's been going up over the last 20 years, has been the Baby Boomers have suddenly been getting into these peak DI years along with there being an increased number of women in the workforce who are covered by DI.

The second thing I want to say is there are basically three challenges that our current system is facing. The first one is that there's a portion of the disability population, perhaps a third of it, for whom it's really the -- what we're giving people is the wrong type of benefits. What we're saying to people is we will give you lifetime cash benefits as long as you never do significant work again in your life. And there's a portion

-- there are many people on DI, the majority who probably can't do significant work again, but there's a portion for whom would be much better off if we could help them get back to work and offer them a package of support that helped them get back to work. So that's the first thing I want to say about the challenges to the DI system.

The second thing that's a challenge is that there are all sorts of incentives that are messed up in this system. Employers have an incentive if an employee becomes disabled to basically get them on DI so they're not their problem anymore. State governments have incentives to take everyone they can who seems to be eligible for public assistance paid for by the state and get them on SSI or DI so the federal government pays. And as Laura explained very clearly, the Social Security Administration has this incentive because the discretionary spending that funds its administrative expenses is limited, as all discretionary spending is these days. What the Social Security Administration does is they make lots of decisions that save money in the discretionary budget, but cost way more than they save in the mandatory side of the program in program benefits because they don't have an adequate budget basically to develop the evidence as thoroughly as they should and to do the continuing disability reviews of people who are already on DI to see if they're still eligible.

MS. TYSON: Can I just interrupt for one minute? Your number in that respect was really significant. I think you -- it's the $1 spent, saving $9 of --

MR. GRUBER: The actuary's estimate is that for every $1 you spend doing a continuing disability review, you save $9 in benefits. And yet we have several million backlog in disability reviews basically because we'd had -- we don't have enough staff in the DI system to do the front door. And so because we don't want the waitlist to get too long for people applying, we can't do the reviews on the backend.

So one of the things we propose in this paper is in most mandatory programs, the administrative funding is on the mandatory side as well. And we propose to switch the funding for the state disability determination systems over to the mandatory side of the budget so that SSA can actually do their job right, which will, we think, on net actually save money to the federal government because they'll get the benefit decisions more accurate.

But the second think we work on in this proposal is trying to figure out how we can develop a system of support for the people who can go back to work, but today are ending up on DI and typically for the rest of their lives once they start. And as Laura said, that's something where we think there are a number of good ideas out there, but we actually don't know the one best solution that should go nationwide at this point.

We're basically in the same kind of situation we were with welfare reform, let's say, in 1980 before all the states did their experimentation and we did all the pilots. And then eventually by the mid '90s, we thought we knew enough to do welfare reform. We basically need to unleash that kind of experimentation in the disability insurance system.

And so what we called for are three types of pilot programs. And the basic idea behind all of them is the earlier you intervene, the better. If you wait until someone is already receiving benefits, especially given how long it takes to get through the application process, they've been detached from the labor force for a long time and it's too late. And so you want to intervene before people are actually receiving benefits. So the last moment you can intervene and have it be before they get benefits is when they apply for benefits. And so one kind of pilot we proposed would be to target a subset of the DI applicants who look very likely to get benefits, but also like they have some capacity to go back to work. And to offer them, in exchange for dropping their application for DI, instead they would get a package of assistance that would include support for getting back to work and the ITCs like wage subsidy and some other things.

So that's sort of one type of pilot we need to do, but we also think we need to do pilots based around firms, that give firms a better incentive to try to keep their workers employed rather than putting them onto the DI system. And we also have to give states the incentive to package all the different federal streams of money that come to them to deal with the disabled population in more creative ways. And give the states basically shared savings so that they can produce savings for the federal government by doing a better job of keeping people off these federal programs. The states would actually share some of that benefit.

MS. TYSON: Fantastic, thank you very much. All right, now we turn to our last panelist before we move on to our discussant, Edward Thomas, and he's going to be talking about how to limit transfer of costs, federal disaster relief, that's going on to the federal government.

So my question to you in a sense is, is this about shifting the costs from the federal government to some other place -- a state, a person, a citizen whose house has fallen into the water -- or is this a proposal to reduce the cost of disasters or what's the combination?

MR. THOMAS: This is very much a proposal that is extremely difficult to implement and will take a long time, and it's to actually reduce the growing cost of disasters.

MS. TYSON: Okay.

MR. THOMAS: They are wildly out of control. The federal government had been spending roughly $1 billion a week on cleaning up after disasters. Now it's edging up towards $2 billion a week as we have more and more people in hazardous locations like the faults. And what we are proposing is rewarding good conduct and disrewarding risky conduct. We have a situation where state and local governments receive rewards in terms of local tax revenues and do not have a heavy incentive -- actually have very little incentive at all to do the right thing.

And so what we are proposing is that we over a long term reward good conduct at the state and local level, and we do a much better job in terms of the federal agencies doing a better job of conditioning grants and loans and other federal intervention on better quality design, which will gradually reduce our wildly escalating cost of disasters.

MS. TYSON: And so can you give us an example of something where a current practice and how you would change it. What kind of conditioning? For example, I think you talk about tax deductions for property development and standards. Why don't you talk a little bit about examples?

MR. THOMAS: Let me talk about two specific examples. One is a tax deduction for property development. The federal government spends an enormous amount of money -- and we talk about it later in the papers on mortgage interest deduction and other types of deduction, encouraging the development and encouraging home ownership. But to encourage home ownership in risky locations with improperly built and designed buildings and infrastructure is not a very wise choice. And I think we need to look much further than that at how we can reward good conduct.

Massachusetts, for example, where I live -- the fourth member of the panel from Massachusetts --

MS. TYSON: We're surrounded here.

MR. THOMAS: Surrounded, absolutely surrounded -- has any number of standards that they have developed over the years to reduce flood losses: Strong building codes. They reduce earthquake losses, as does California, and yet they receive no particular benefit from the federal government for that good conduct. In fact, other states that do not have those standards perhaps receive a benefit by getting very, very generous disaster payments.

Another specific example is the design and construction of water and sewage treatment plants under the supervision of the Environmental Protection Agency. If the EPA were to comply with the Executive Order from President Carter, Executive Order 11988, and design those plants to a 500-year flood level, which would increase their costs by perhaps 1.5 or 2 percent, we would save a fortune in disaster payments under the Stafford Act. So it's very much along the lines of a stitch in time saving nine, the 9:1 payback, perhaps higher by doing things safely and properly at the beginning rather than cleaning up the mess later.

MS. TYSON: So a lot of your proposals really assume a pretty high degree of regulatory control. So basically you're regulating you cannot locate property on this waterfront. You cannot locate property on this fault. You have to build to a certain standard, whose standard has to be determined in some kind of regulation in order to get a tax credit. How do you see that -- you said it's very long term. Would these regulations come from the state? Would they come from the federal government? Would there be need for another agency to do that because there's a lot of regulation here?

MR. THOMAS: First of all, let me say I'm not saying don't build in certain locations. I'm saying build safely and properly wherever you build. Take into account earthquake, wildfire, flood; take into account tornado safe rooms for life safety in all these locations. And I'm not sure that you need another regulatory agency. We've done this. We know how to do this. We don't need pilots on this. We've done this.

We had one of the worst records in the entire world of dealing with urban fire in this nation 100 years ago. And overtime through zoning, land use, building codes, we turned from being one of the worst nations to one of the better ones. And we did this by individually rating every community in this nation on their ability to deal with urban fire.

So if we were to do this for communities on the basis of them dealing with natural hazards instead of having this fuss right now that we've had where communities have a tendency to try and lower their standards to attract development, we would have communities raising their standards to lower insurance premiums. This is doable. There are suggestions from the American Bar Association about how to do this. There are suggestions from other reputable organizations of trying to involve the insurance industry much more in overall catastrophic casualty losses and rating communities separately so that good conduct is rewarded and bad conduct is certainly not punished, but disrewarded.

MS. TYSON: Disrewarded, right. All right, fantastic, thank you.

I'm going to turn now to our discussant, but before I do I neglected to say one thing about this panel. I'm sure you've all read everything about the biographies of these individuals. But if not, just be assured that each person speaking here is speaking not just from the point of view of outstanding academic research, but real involvement with public service. In every single one of these cases, people have spent dedicated amounts of time to helping to try to come up with solutions for real problems. I just wanted to say that.

And that is true of our discussant, Paul Van de Water, who has been long-time engaged in Washington on issues of health and our general social safety net at the CBO and now at the Center for Budget and Policy Priorities. Paul, do you have some wrap-up observations or questions for our panelists?

MR. VAN de WATER: Well, just a few comments. As a CBO alumnus, I guess my institutional role is to play the skunk at the picnic, if Bob Reischauer will allow me to share that terminology. So I'd like to raise a few concerns.

MS. TYSON: Can you be the optimistic skunk, like Alice, an optimistic skunk?

MR. VAN de WATER: No, I'm the pessimist along with Bob here. I just have to raise a few political and practical questions about some of these proposals.

Now, first of all on Jon, actually I like Jon's proposal quite a bit and particularly on the first part of his recommendation, the change in the Medicare cost sharing. I really welcome his attention to low income protection; that is, having a lower catastrophic cap for people with lower incomes and also, although he didn't mention it as I recall, a lower deductible for low income people as well.

Now, Jon fully recognizes that when you put these things together, that part of the proposal may actually not save any money. And that's actually a very welcomed fact because we have a lot of proposals floating around Washington now that would change Medicare cost sharing whose proponents often argue that they would save money. But I think that if you build in the low income protections, that's not at all clear.

On the surcharge, on the tax on supplemental insurance, again a welcomed idea but you, yourself, Laura, I think raised the key issue about that -- its political feasibility -- so I don't need to go any further.

On Jeff's suggestion for policy demonstrations and disability insurance, I think that idea is extremely welcome, again particularly in comparison to a lot of ideas that are circulating that would implement changes in the program without knowing what they would do. And, indeed, that seems to be the all-too-typical way of proceeding. The fly in the ointment here is that it's not at all clear, quite frankly, that these ideas that Jeff proposes to test actually would work or would, in fact, save money. But at least if we test them, we have a chance to find out.

Another reservation there, too, is I think Jeff and his coauthor Jack Small did a very -- are well aware -- the Social Security Administration where I've also worked like other operating government agencies has, I have to say, a limited ability to conduct demonstrations and experiments, particularly in the context where the agency is under very tight budgetary constraints already. And simply providing additional appropriations and saying well, that won't be sufficient, doesn't do the trick because we're talking about in demonstrations changing the way the agency carries out a lot of its day-to-day activities for subsets of its beneficiaries or potential beneficiaries.

Now on Michael's proposal, he actually moves the other way from Jeff. Instead of wanting to test things and see if it works, he is wading into areas where, in fact, we have tests and pilots underway. And he wants to short circuit some of those and move full speed ahead to implement things like bundled payments and more aggressive Accountable Care Organizations, and there I think there are some real cautions that are in order.

Michael mentioned in passing the major organizational changes that would be required to do that, but I think simply mentioning them hardly does justice to the practical issues that would be involved. Moreover, I think that in talking about moving Accountable Care Organizations to being fully risk-bearing entities, he mentions in passing in his paper the need to perhaps change the structure of ACOs so beneficiaries would be limited to ACOs. That, in fact, is a big change because the whole notion of the Accountable Care Organizations is that they're supposed to be something different from the types of managed care we've had in the past. The organizations would differ in that they would allow beneficiaries to continue to have free choice of health care providers and Michael's approach would seem to backtrack from that.

I have some comments about Edward's suggestions as well, but we can do that in further discussion.

MS. TYSON: I think if you feel -- actually, why don't you make your comments.

MR. VAN de WATER: Well, there I think the issues are essentially political, both at the frontend and the backend. The basic idea is a very good one, more mitigation of disaster effects in advance, imposing more local responsibility, and then at the end of the day requiring the federal government to provide less assistance, but the problems are twofold. First of all, will the federal government, in fact, have to bear a lot of the costs for the disaster mitigation upfront? We see the current suggestions that the federal government should do that. In the case of the New York City area, the federal government has done it and in the case of New Orleans and many other cases.

But even equally or more problematic is whether or not we could make sure that when the disasters do occur, the federal government actually does hold back and not provide assistance to people who suffer despite the mitigation efforts. That, in fact, is why in part we've had things like crop insurance and flood insurance with some degree of subsidization. The thought was when those programs were created that by encouraging people to buy insurance, albeit with some degree of subsidy, it would reduce the need for subsequent disaster assistance outlays. I don't know if we really know the extent to which that's actually worked, but that was the theory.

MS. TYSON: So I'd like to give the authors a chance to respond to anything they've heard from Paul. You might want to start because he ended with you.

MR. THOMAS: Sure, I can start. I think the cost of doing hazard mitigation appropriately belongs with the person that is doing the development -- the homeowner, the developer, the builder. The higher standards would not necessarily be imposed. You've used the word imposed. I like to say encouraged. If you encourage someone to design and build safely to reduce the risk of urban fire, the community's fire insurance premiums go down. When the community is better prepared -- every community in this nation is rated separately by a private market insurance group using a schedule, an insurance schedule, based on their ability to deal with urban fire, including what kind of a building code, what type of zoning in terms of setback they have. And we can do the same thing with respect to other hazards. It's just a matter of doing it.

MS. TYSON: Why isn't that the case? So why isn't, for example, or maybe it is, in a state like California? Is there a private insurance association which determines what safe locations are, what safe building is?

MR. THOMAS: We don't have that with respect to earthquake.

MS. TYSON: We don't.

MR. THOMAS: We have it with respect to floods through the community rating system where a community can lower their insurance premiums by doing the right thing, but that's only for people who buy flood insurance. It's not as universal as what David Conrad and I are suggesting.

So I think we said that the federal government had paid billions for mitigation, as was suggested by Mr. Van de Water, by Paul, down in New Orleans. And I'll have to tell you that the federal government paid a lot of billions. I'm not sure how much of it went to mitigation. There were a lot of gifts, just outright gifts, given to people -- we call them grants, but they're gifts; let's call them what they really are -- with basically no strings attached at all. And folks did what they did with that money. What we're proposing is there would be very stringent requirements on those federal dollars, not so that people didn't rebuild, but they rebuild safely and properly and were strongly encouraged to do that in terms of elevation. And there are wonderful studies by like the Wharton School that talk about the payback to the society when someone when they're building or, in the case of New York and New Orleans, rebuilding a home when they elevate significantly above the current federal minimum base flood level.

MR. VAN de WATER: But I was thinking also of the Corps of Engineers' activities to rebuild the levies and the other flood protection devices around the city. That was extremely expensive and is a cost that's been borne by the federal tax payer, not by the residents of New Orleans.

MS. TYSON: So the distinction is between physical infrastructure for the nation or for a region and I think what you're talking about, which is really private property development within that infrastructure.

MR. VAN de WATER: It is both. The good news about the design -- the new, the novel New Orleans levies, which are actually a system as opposed to the previous set of dirt piles that they had, which is what they were, it was not a system, is that they are designed to be resilient. They're designed to take a licking and not blow. They're designed that when a larger flood than the design flood goes over those levies, as it inevitably will, that the levies will not blow and pumps will keep the water at a modest level. That levy system, the levy system that is known as the Mississippi River and tributaries, which goes back to the 1920s and '30s, are designed to be resilient. They're about the only levy systems I know in the United States that are designed to be resilient. The rest of the levy systems that we have paid for with federal tax dollars are actually designed to blow. They're not deliberately designed to blow, but inevitably when they're overtopped, they do blow. And in turn, they induce more development behind them. We have these levies that meet really no known standard of engineering excellence in the civilized world, at least -- and by the civilized world I mean the Netherlands and Germany and Great Britain -- and the way we used to do things in this nation. And we're inducing tremendous development behind them that, in turn, is going to result in further increases in federal expenditures.

MS. TYSON: So let me turn now to where -- so these are really big long run savings. We have in the next ten years the need to generate really big ten year savings, particularly in health. So Michael and Jonathan, how do you respond to some of Paul's pessimism?

MR. CHERNEW: Well, first let me emphasize that when we're facing these choices, so in evaluating whatever you want to evaluate, you have to compare it to the status quo. So I want to take a second to say the status quo fee-for-service system tries to hit budget targets with a series of fee reductions that I'm not sure anyone believes are really sustainable going forward and does so within a system that has at best case no incentive for particular efficiency and at worst case stunning incentives for inefficiency.

And I will say apart from that, the amount of time and attention one can spend trying to micromanage the nuance of geographic adjustments or how much you should pay for a level 5 physician visit if it's delivered in this site versus that site is stunning. So in that sense the bar for our proposal is low. Maybe that's the best thing you can say for it. The bar is low.

But what I would say is that a lot of the discussions here have to do with the politics and the transitions. And so as I mentioned, I agree. The organizational changes that are necessary to move to a different system of payments is substantial, and I will say in Massachusetts since we all seem to be here the transition has actually been much more successful and phenomenally quicker than I think people would have thought prior -- well, Jon can say --

MS. TYSON: No, you both can say it.

MR. CHERNEW: So I do think there's a lot of opportunity. And I think the experience that CMS has had with organizations applying to become Accountable Care Organizations in various ways has really been quite overwhelming because I think they realize how bad the alternative is.

That said a lot of our proposal would focus on questions about trying to make the regulations in the different parts of the system that we have sensible and synergistic, which they currently are not for a bunch of reasons. We need very important attention to the quality of care. Obviously and no one has said, although I think it's a reasonable critique -- I don't mean to be the other handed economist -- I think it's a reasonable critique that you worry about a provider skimping on care when you change their incentives. We need a good quality measurement.

This issue of benefit design is important and free choice of providers is important. We didn't mean to imply at all that people wouldn't have a free choice of provider; the question is when and under what terms. And I think there's an important role for CMS in trying to figure out exactly what that means, and more importantly if the basic contract in Medicare is you can go to any provider no matter how inefficient and no matter what they do and we will pay in a whole range of ways. Maybe that is the social contract, and I won't argue one way or another, although that is, in fact, not what we proposed.

MS. TYSON: That's the current system.

MR. CHERNEW: Right. And again, as has been pointed out, the demographics of Medicare are working against you with phenomenal force.

MS. TYSON: Right.

MR. CHERNEW: So even if we were to lower per beneficiary spending to historically unprecedentedly slow rates of growth, the amount of money going into Medicare still goes up.

So I was not asked the question about how much money we should tax to funnel into the Medicare system. We were asked the question about how to come up with a proposal that might be more fiscally sustainable and more importantly what would promote efficiency, which is I think what we've done. And my personal opinion is that you can't get there in the current basic structure of how the Medicare program relates to the underlying provider system.

MS. TYSON: Can I ask you -- and maybe it will also segue to Jonathan and may be a little unfair question -- so when I read this first, I saw global cap, you're setting a cap. It's a little bit like saying it's another version but on a provider side of premium support on the consumer side. So basically here's a cap, here's the amount you get, go find your best provider or your best group. How do you compare those two?

MR. CHERNEW: So I don't consider this premium support, although you point out there are similarities to it. I think that this is focused on maintaining the connection between Medicare and the provider system and making that provider system more efficient, giving them the incentive so they can become more efficient, as opposed to a system like --

MS. TYSON: Well, premium support, that's supposed to become more efficient by competing.

MR. CHERNEW: Absolutely, but the point is they still have to interact with a provider system, facing all the competitive issues you raised in your last question.

MS. TYSON: Okay.

MR. CHERNEW: So we're quite agnostic actually. I believe that the insurance industry has a lot to offer in terms of innovative ideas for efficiency, and we're quite agnostic about whether or not we should funnel money to a delivery system that has all sorts of issues or to a set of health plans which have their own issues. But we do in the paper argue that we want some sort of synergy or consistency between them. So, for example, in a Medicare Advantage world we pay organizations based on a county and in an Accountable Care Organization where we pay based on the people who you've enrolled in the past. And so within a given geography, high cost places are getting more money than low cost provider systems. We give the managed care plans a range of tools that they can use in terms of benefit design. They can do much of what Jonathan says, in fact. But outside of that system, we don't give them the same set of levers.

I agree in many ways with Paul, which is it would be folly to allow the system to move in a way that had no consumer protections or regulations about where the restrictions are on benefit copays or fees if you go outside of the network. So I do think a lot of attention needs to be paid to much more sensible regulation of the system we're moving to as opposed to how much attention we pay towards trying to make the system we have work better at the margin. And I just think that if we keep tweaking a system that has these fundamental fragmentations and problems, we will be distracted from a system that has incentives for efficiency.

MS. TYSON: Jonathan, any responses to Paul or anything else here?

MR. GRUBER: Yes, I mean I think that actually your premium support comment is a good segue because fundamentally when it comes down to it, one of three parties has to bear the rising costs of Medicare, either the taxpayer or the provider or the beneficiary. And so far we've been doing it on well, the taxpayer in the future at least and the providers, but not the beneficiaries. And then you have on the other extreme a premium supported proposal, which would put it all on beneficiaries.

MS. TYSON: On the beneficiaries.

MR. GRUBER: So we have to be thinking about a sensible middle ground and a balanced approach. Now, here we have a system, which is an outdated, really broken, system in terms of the cost sharing people face. What you can do is you can shift costs to individuals and have them bear the cost in a sensible way, which would say look, we're going to protect you against major risk, but we're not going to let you essentially impose costs on the rest of the system by having insurance that you don't need anymore. And I agree, Paul, it's a heavy lift and look, the Cadillac tax is a heavy lift, but we did get it and it's a heavy lift. But I think what we have to recognize is as Mike said, there's nothing easy on the table. We have to ask ourselves of Medicare do we want to continue to push and say it all has to happen for providers and the government and beneficiaries get left out of the equation, which I think is just a recipe for eventually saying well, okay fine, let's just move to premium support, but that's all we can do on the beneficiary side. I think there needs to be other good ideas out there on the beneficiary side beside premium support, which brings beneficiary responsibility more into the equation. And I think there's a way to do it, which -- and as I said, it's not unique to me; the idea's been floating around -- but it's a way to do it, which basically rationalizes the way the insurance product works and also gets us out of seniors spending all this money on a product where a third of what they pay goes to advertising and overhead.

MS. TYSON: So -- oh, go ahead.

MR. VAN de WATER: I was going to say, Jon, I hope I indicated that I agree with the --

MR. GRUBER: Oh, yes. You're just worried about the politics of it.

MR. VAN de WATER: I'm just worried about the politics, but substantively I think it makes sense.

MR. GRUBER: No, the politics is -- that's why you have to pair them. I mean you have to pair them. You can't just tax medigap in today's system. You have to pair them, and you have to say that -- I think the way one would sell it is to say look, we have a broken system protection for our seniors that leaves seniors with enormous bills and really the way we sold the Part D program. If you go back to the debate over Part D before it passed, most seniors had insurance for drug expenditures. In fact, only a small minority of seniors did not. But those seniors that did not were being bankrupted by their drug expenditures and that's how we sold Part D.

We have a similar thing here, which is there are substantial seniors that do not have supplemental coverage who are potentially being bankrupted by their out-of-pocket costs. We need to fix that, but to fix that right costs money. And so we need to pair that with the reform to the rest of the system that makes that money up.

MR. VAN de WATER: Now, Laura, on the other hand I do have more serious problems with Michael's proposal. And I think that it's easy to characterize or mischaracterize the way Medicare works, but, in fact, in many ways Medicare is one of the better working parts of our health care system. The rate of growth of spending in Medicare is less than the rate of growth in the private sector. We are, in fact, as Michael said, looking at very, very low projected rates of growth over the next decade and even beyond compared to historical rates. You look at the new *Time Magazine* article. For any of you who actually waded your way through it, that's one of the conclusions that the author reaches, that Medicare is actually doing very well, particularly in terms of holding down prices vis-à-vis other payers.

So I think that we're -- I don't accept what seems to be the basic proposition that Medicare is somehow this awful system that's in desperate need of fundamental reform. I think a lot of the changes that are underway, we need to let those progress and see whether the extent to which bundled payments work or how we can make them work, how we can make Accountable Care Organizations work, rather than just as a marching headlong down these roads without further testing.

MS. TYSON: So let me -- I'm running out of time for questions, but I just want to make sure, Jeff, you didn't have any response to Paul, anything you wanted to add.

MR. LIEBMAN: Well, I think Paul made a very good point, which is that if you look up the history of federal agencies trying to administer demonstration programs, some have worked and some haven't worked very well. Jack and I when we put together our proposals were very cognizant of this, and so we did two things and there's a longer version than what you have that you can read if you'd like.

One thing is the actual delivery of the services that help put people back to work basically isn't done by the government agencies. It's done by either nonprofit providers or employers or private disability insurance companies, and so that reduces the administrative burden on the federal agencies quite a bit.

And the other thing we recommended was that the different demonstrations actually be run by different agencies. So HHS would run the state flexibility one, SSA would do the one about intervening at the time of application, so that would also minimize the burden on any particular federal agency.

MS. TYSON: And you also had the possibility of much more state flexibility so states could do experiments themselves and then employers. You actually, I think -- there are levels of flexibility that are in the system.

All right. I think we have time for a couple of questions. So right there and please make them short and we'll make the answers short because we run into lunch one way or the other.

SPEAKER: I'm Jeff Burnam at Georgetown. I'd like to ask Jonathan how much did we sacrifice by not including a public option in the Affordable Care Act? That seemed to me to be an important incentive to make private insurance cheaper by providing an alternative. Could you comment on that?

MR. GRUBER: That certainly relates to the conversation we're having here. I actually think that it was not as big a deal as made out to be. Here's the example I like to think of. Imagine you're shopping for apples and there were three places to buy apples that were 20 minutes from each other. And the only way to find out what the prices were was you'd have to drive there. And we know in that situation -- in fact, my colleague won the Nobel Prize for proving that situation -- that each apple seller will set a very high, monopoly-like price because of those transaction costs. Now imagine we introduce a fourth apple provider that's 20 minutes away again called Gov Apple. It wouldn't make that big a difference. I mean if you're near Gov Apple, you'd benefit. If you weren't, you wouldn't. But instead of that, imagine we'd introduce an exchange where people could shop on the Internet and know exactly what all the prices were at the private apple providers. Often economists believe that actually that is the bigger difference and that these exchanges introduced in the ACA are really what's going to matter for introducing competition in insurance markets. And we've actually seen it in Massachusetts. Once we introduced our exchange, we had the first major for-profit entry into our insurance markets we'd had in decades, and they drove insurance prices down by introducing a new limited network product that was much more efficient.

So I think -- look, I think the public option would have been fine. Probably on net it would have been a good thing to have, but it was not nearly as big a deal as made out to be. The much bigger deal is not getting enough credit. It's setting up these exchanges, which will introduce real competition in insurance markets for nongroup insurance for the first time.

MS. TYSON: That's great. Yes, on the same side, right there, and then one more.

SPEAKER: Hi. I'm Dr. Caroline Poplin. I'm a primary care physician and attorney, and these days I also work on whistle blower cases for Medicare fraud. I think you dismissed prices very quickly. How would this system -- what would be bad about saying we're not going to pay more than $50,000 for a cancer drug unless it increases life by a year, or a proton beam accelerator if it's more than $50,000 a treatment? Because now there's no limit on these things and prices not only do costs, they send signals into the future and they tell investors that there's no limit on what we will pay for an expensive treatment. So the treatments just become more and more and more expensive.

MS. TYSON: So wouldn't the global payment cap for providers stop that?

MR. CHERNEW: Well, I think this is a question that's more outside of Medicare because on the drug side, Medicare has private plans that are competing one way or another and within Medicare -- what we could discuss -- I am a big believer in the market. I'm not as optimistic in general as Jon is about markets in a number of ways, particularly for certain types of products. But I think the main problem in Medicare is not prices for that reason or for the reasons that Paul said. I think there's other -- right now I think the problem with Medicare is whether the prices would end up being too low. And I might add just to clarify that we didn't propose to get rid of the fee-for-service system. We proposed setting up another system that would operate independently from it. So you'd always have that system under the current law set of prices.

But, that said, we would have to have a longer discussion about price regulation outside of the Medicare market, which is a broader set of questions, which probably has ramifications that are not as salient for the Medicare program now with the new subsidies and the exchanges and stuff. I do think we have to spend a lot of time and attention thinking about pricing in general in the health care sector.

MR. CHERNEW: Can I jump in here on something?

MS. TYSON: Sure.

MR. CHERNEW: Even if in theory someone could make the right benefit-cost decisions about which things were worth paying for and which weren't, the idea that the political system in Washington is going to let that work well I think has been proven to be false. And even if it could do it, it does it too slowly. By the time you do a three-year study and they passed it and Congress overrules half of it, it's not going to work.

The best way to make sure inefficient decisions like that aren't made is actually to do something like a bundled payment or a global payment situation where those decisions will be made by the local doctors, where they will have a fixed amount of resources for their patients, and they will say hey, if we're only getting this flat amount for all our patients, we're going to make some tough decisions about what -- but it will be the medical providers working with the patients to do it. It won't be Washington. I just don't see how we get Washington to do that well.

MS. TYSON: That's right. Now over here?

SPEAKER: Bruce MacLaury, formerly of Brookings. I think it's for Jonathan. A question of the administrative costs and efficiency of income-related caps on copayments, and the same thing is true for premium support. Do we have experiments that show that that's administratively feasible as opposed to absolute payment caps?

MR. GRUBER: Bruce, that's a good question. I mean we're about to run an enormous experiment in ten months, nine months, under the ACA. We're about to run an experiment on a much broader scale of that exact nature. And I think that is an issue. We're quick to run towards mean testing in various ways, and I'm a huge fan in many contexts, but we realize that comes with both potentially economic disincentives and with administrative issues. And we have to balance that tradeoff against the protection. I think the main thing to recognize is that the benefits of that are so enormous because -- you don't appreciate, even before I wrote this paper, I didn't appreciate how low the average elder's income is. And you just can't expect the average elderly person to be bearing $5,000 or $6,000 a year in medical costs. It's just not feasible. So I think it may be administratively difficult, but I think we have to do it. And I think we can. I think the way we set it up in the ACA is going to work with some hitches. It's going to be rough in the beginning. But I think once we get these agencies talking to each other, I think it can work.

MS. TYSON: Any other questions out there? I can't see. All right. Well, I think we've -- I think this is a strong signal of the need for a break for lunch. But let me ask you to join me in thanking the panel for a great presentation today.

(Recess)

MR. GREENSTEIN: Good afternoon, everyone. We're going to start the next panel. And I think you're going to find this a panel of considerable interest.

You know, we have this debate going on right now with sequestration looming: Should deficit reduction be all spending cuts, or should it be a mix of spending cuts and revenue increases?

In an important article in *the Wall Street Journal*, last week, Martin Feldstein wrote -- and I'm quoting -- "Republicans want to reduce the deficit by cutting government spending, while Democrats insist that raising revenue must be part of the solution."

"Yet," Feldstein continued, "the distinction between spending cuts and revenue increases breaks down if one considers tax expenditures.

Here's some examples: If I buy a solar panel, the government pays me. But instead of sending me a check, it gives me a tax credit or a tax deduction.

Congress should review tax expenditures, and eliminate those the country can't afford."

CBO Director Douglas Elmendorf earlier this month, in testimony on the House side, noted that economists generally agree that tax expenditures are really best viewed as a form of government spending.

And maybe it was most summed up some years ago by Alan Greenspan, who referred to tax expenditures as tax entitlements, and urged policymakers to look at deficit reduction from entitlement reform on both the spending and tax side of the ledger.

This panel consists of four really interesting papers, looking at various aspects of tax expenditure reform.

We're going to hear from Joe Aldy, who's an Assistant Professor of Public Policy at the JFK School of Government at Harvard, and former Special Assistant to the President for Energy and Environment, who has written a paper on reforms or elimination of fossil fuel subsidies in the tax code.

We'll hear from Karen Dynan, Vice President and Co-Director of Economics Studies at Brookings, about a proposal for reform of tax expenditures related to retirement saving.

We'll hear from Alan Viard, Resident Scholar at the American Enterprise Institute, with a very interesting paper on reforms related to the tax treatment of mortgage interest and the mortgage interest deduction.

And from Diane Lim -- recently joined Pew Charitable Trusts as their Chief Economist, after a number of years as Chief Economist at the Concord Coalition -- who has written a paper on various approaches to tax expenditure limitations that cover an array of tax expenditures.

One of the things that's interesting about these papers is they don't just look at the revenue or deficit impacts of the proposals that each of the four authors advance, but they really dig into the economics of the proposals, as well.

By and large, these papers are designed to produce reforms that not only yield deficit reduction, but would also increase economic efficiency -- and, in some cases, yield other gains, like reduced fossil fuels emissions, improved progressivity in the tax code, or increases in retirement savings.

At least one of the papers -- and we'll get into this -- also raises another really interesting issue. In the debate we're in in Washington these days, the division seems to be -- when you hear talk about tax reform -- as to whether all savings from broadening the tax base should go into rate reduction, or some should go into rate reduction, and some should go into deficit reduction.

In Karen Dynan's paper, she takes some of the savings that aren't used for deficit reduction, and uses them -- not for rate cuts, but for other tax reforms, designed to improve retirement savings, especially by lower and middle income people -- which, to me, opens up the whole interesting question of, other than deficit reduction, are rate cuts always economically the first place to go with tax expenditure savings, or are there other proposals that also merit consideration?

So, with that, we're going to go to the panel. I'm going to take my seat. We're going to start with a question to each of the authors. And I'm really going to start with Joe Aldy.

Joe, as you know, during the presidential campaign -- and Senate and House campaigns -- members of both parties talked about increasing domestic energy production, and becoming energy self-sufficient.

In your proposal, you call for eliminating a dozen tax expenditures focused on oil, gas, and coal production. And one can already hear the response: You're going to reduce domestic energy production in the United States, and make us more dependent on foreign sources of energy.

How would you respond to that? And, relatedly, how would you think about overcoming those objections in terms of the political debate, and building support for the kinds of proposals you make?

MR. ALDY: Thank you, Bob.

I think it's important, first, to understand, exactly what are the kinds of subsidies that I'm addressing in my proposal? Then I'll discuss a little bit about what we're really getting out of these tax expenditures, and then close with this question about how one thinks about political strategy.

So, the vast majority of the provisions in the tax code that I call for elimination effectively lower the cost of investing in a new oil field, gas field, or a coal mine -- basically, by modifying different kinds of -- effectively, depreciation rules.

And in this way, it actually really distorts how one might make investment decisions in the economy, because it really creates a more favorable place for investment in fossil fuel development than, say, investing in a new factory, or any other kind of big capital project.

Now the question is, if we're actually putting out something on the order of $4 billion a year through these subsidies in the tax code, what are we getting for it?

And when you look at the analysis, we actually get very little. There's some work that my former colleague at Resources for the Future, Steve Brown, who also used to run the oil and gas shop at the Dallas Fed, said, you know, if we -- in his analysis, if we got rid of the oil and gas subsidies, we'd be looking at something like reduction in oil production in the U.S. on the order of 25,000 barrels per day.

Now 25,000 barrels may sound big. When you look at, A, how much we produce in the U.S. now, which has been growing quite rapidly -- if you look at the growth each month, over the last four years, each month we're growing more than that amount. So, it's a really small amount that, when you actually look at the impact on prices, probably means the typical American will be paying something on the order of about $1 more each year.

So, you start to ask yourself, if the production impact is less than what we'd actually see in a month -- in the kind of ramping up we're seeing now -- if you think about the prices, you know, on a per-capita basis, we're putting out more than $10 a person in subsidies, and we might see the total expenditures we face increased by about $1 a year. That doesn't sound like a really good deal for the typical American.

And so what we really see when you assess these subsidies, the vast majority of them are actually just going to the owners of capital in oil, and gas, and coal, and not really substantively changing their production decisions.

So, we've seen a dramatic increase in production in oil and gas, especially in the United States, over the last five years. That's not because of these subsidies. Some of these subsidies have been on the books, dating back to 1970, when we started a period of about four decades where oil production fell in half.

Instead, it's $100 oil, and it's dramatic improvements in technology that have lowered the cost of extracting oil and gas, that have led to the significant ramping up of production in the United States. If we got rid of these subsidies, we would still see significant growth in both oil and gas in the years to come.

The question is sort of the politics on this, of how does one actually craft a strategy to go forward? I think there's one of two ways you could approach this.

One is, think about this in the context of overall corporate tax reform. In the past, when people have tried to push fossil fuel subsidy elimination, it's been sort of a standalone policy debate.

If you actually were to pair it with, say, a reform of the overall corporate tax, in which you might, say, be lowering the marginal tax rates on companies, all of a sudden, some of these companies that benefit from these subsidies may say that, "I'm better off with a lower marginal rate, if I have to give up some of these investment benefits through the tax code."

The other approach one might take -- which I would sort of describe as sort of a fiscal hawk or a deficit hawk approach -- and say, "Let's get rid of subsidies for all energy," whether it's fossil fuels, energy efficiency, renewables, nuclear.

Now if you're to do that, you can say, "Hey, we're going to be able to save even more money in the tax code." If you're to do that, I think it's really important, though, to recognize that the tax provisions that support nuclear, and renewables, and efficiency are also delivering very important social benefits, in terms of reduced air pollution and reduced carbon pollution.

So, if you're going to do something like that, I think it's important to actually pair a reform of all energy subsidies with policies such as a carbon tax that we'll hear about later on this afternoon, or a clean energy standard, or other policies that create, in the private sector, demand for these lower-emitting, socially beneficial technologies, to offset the loss of the support they would get through this reform of the tax code.

MR. GREENSTEIN: We're going to go now to Karen Dynan.

Karen, you know, some years ago, I was fascinated by a paper Brookings put out, coauthored by Lily Batchelder, Fred Goldberg, Peter Orszag. It referred to certain parts of the tax code as having upside-down subsidies, and it included retirement savings as one. It didn't have a specific proposal as to exactly where to go on that.

You have a particular proposal, and you propose to limit savings for retirement subsidies for higher-income households, and to take some of the savings and devoting them to changes in other aspects of the tax code designed to promote more retirement saving by lower and moderate-income households.

Now following a similar pattern as my question to Joe, here, too, you can already hear what the pushback would be. People would say, "National saving is important. Retirement saving is part of national saving. The bulk of saving comes from people at higher income level. You're limiting the tax subsidy for retirement savings at higher income levels. Are you going to end up reducing total retirement savings and total national saving?

MS. DYNAN: Yeah. So, you know, first of all, let me talk about what you shouldn't take away from my paper. So, you shouldn't take away that national saving isn't important; it's very, very important. You know, countries that have higher rates of saving tend to have higher rates of business investment.

And what that means is that businesses have more equipment, and software, and structures, to go about reducing goods and services -- which means that they produce more, and it means that growth will be higher.

So, you know -- in fact, you know, the whole point of the exercise today is to, you know, find ways to trim the budget deficit, and, you know, part of what that's going to do is it's going to increase public saving, which will foster a higher national saving.

So, national saving is very important.

And it's also true, as you said, that higher-income households account for much of aggregate personal saving. So, any kind of reform that caused higher-income households to reduce their savings significantly could be harmful to the economy. So, we wouldn't want that.

But research shows that, in fact, changes like capping the deductibility of contributions to retirement plans 28 percent shouldn't have a big effect on the saving of higher-income individuals.

So, there have been some very good, very comprehensive studies that show that most people actually don't respond much in terms of their saving when you make changes like that. And the people that do respond, they respond by kind of shuffling their portfolios. They take stuff out of retirement accounts. They put it in other sorts of accounts, but there's not, you know, a big impact on their overall saving.

So, one wouldn't expect from my proposal to see lower saving amongst the higher-income people -- and, in fact, you could see an increase in aggregate saving, because I've coupled it with proposals that should encourage lower-income households to save.

MR. GREENSTEIN: Alan Viard has written a paper, calling for converting the mortgage interest deduction into a refundable credit, at a 15 percent rate, with a cap, I think, on $300,000 --

MR. VIARD: Yes.

MR. GREENSTEIN: -- of mortgage. Needless to say, here, one could hear people say, "You're attacking the American dream of home ownership, plus housing is an important part of the economy; weakness in housing has hurt the economy right now. Even if your proposal made sense down the road, aren't you worried about the immediate effect on the economy?"

Again, I'm trying to ask each of you the challenges that would be made to your papers.

Alan?

MR. VIARD: Yes, well, home ownership obviously does have a special political status in the United States, and I think it would be a futile endeavor to really try to undermine the tax breaks for home ownership.

But what my proposal does is it tries to target the preferences for housing in a way that maintains an incentive for home ownership, while curtailing what I think is a very misdirected, very pernicious incentive for investment in large, expensive, owner-occupied homes.

It comes back to the upside-down subsidy point that we've already heard about -- that the current tax system gives the biggest tax breaks to people in the highest brackets, and for the most expensive homes.

And we can certainly make a case, I think, that there are social benefits from having people own homes -- and, obviously, homes of adequate quality. But it's really hard to see how directing resources away from business investment into the construction of mansions and very large homes is really beneficial. The social objectives that we're trying to achieve really occur, I think, lower down the scale.

And the current tax preferences really fall short in that regard. People who don't itemize deductions, people who are in very low tax brackets get little or no assistance in moving into home ownership.

And, in fact, if you think about the fact that the tax breaks are driving up demand for owner-occupied homes by people higher up in the scale, increasing the overall level of housing prices, then the people who are not in a position to take advantage of those tax breaks actually may find it more difficult to buy a home than they would if the government was just pursuing a more neutral policy.

So, what I propose, actually, is not moving towards a completely neutral policy, but keeping, I think, what is a very robust incentive for home ownership -- but just targeting it better; saying that on the first $300,000 of mortgage, you can claim a credit equal to 15 percent of your mortgage interest. The credit is refundable. Even if you don't owe income tax, you can receive the credit in cash. And so you're really giving a much more generous tax break to people at the bottom, people who maybe wouldn't itemize and, today, you can't claim the mortgage interest deduction, or people who are in the 10 percent bracket.

We're saying you'll actually get this 15 percent tax savings, regardless of whether you itemize your deductions or not, but we are going to cap this at the $300,000 level.

Now obviously, there's always a question of transition here. There's the macroeconomic weakness that you asked about. There's also just the (inaudible).

People have purchased homes based on the availability of today's tax breaks, and we can't pull the rug out from under people; that's wouldn't be right. It also wouldn't be politically feasible.

And so I propose, you know, a 10-year transition period -- first of all, waiting a couple years to start the proposal at all, then a transition period of 10 years.

I think that the details of how you handle the transition can be worked out. I think it would be a mistake to let the concern about the transition cause us to either not pursue this reform, or even to scale back the substance of it. It's important that we do move, eventually, to a policy regime where our housing subsidies are much more rational -- where they do continue to support the dream of home ownership, but not the objective of having ever larger, ever more expensive homes.

MR. GREENSTEIN: You know, if I remember correctly -- and maybe I don't -- in the 1986 Tax Reform Act in the Senate Finance Committee, I think they first worked out the broad set of reforms they wanted to do, and then went back and said, "Okay, what are the transition rules we need to support those reforms?"

Now, Diane, your paper takes a different approach. Rather than looking specifically at one deduction or one set of tax preferences, you look at -- and we've heard a lot about this over the past year and in some of the campaigns -- you look at the sort of more global proposals to put a broader limitation on a whole array of tax expenditures.

Could you both describe those proposals a little bit, but also describe a little -- what's the attraction? Why are people interested in the sort of more global limitations?

MS. LIM: Okay. Well, first, I don't want to overpromise my proposal -- or have Bob overpromise my proposal. Mine's not quite as sweeping as I might like to have done in theory, and it's probably the least innovative proposal of this panel, because it's been proposed by President Obama, essentially, in every one of his budgets thus far; it's just that my version is a slightly more ambitious, tighter one that raises more revenue.

So, my proposal is to -- and I should stress it's my proposal, and not the Pew Charitable Trusts's proposal -- is to limit itemized deductions to the 15 percent bracket.

President Obama has repeatedly proposed limiting it to the 28 percent bracket, and that was done largely to preserve the promise to not raise taxes on households under $250,000.

I happen to think that we need to start looking at reducing tax expenditures more broadly across the taxpayer spectrum; otherwise, Republicans are never going to come along to raising revenue, even if it's base-broadening. It has to be more of a shared sacrifice kind of change, and it also has to be very obviously broadening the tax base, and reducing tax expenditures in the scope of government.

So, I propose to limit the rate at which you can take itemized deductions to 15 percent. What that does is it gets rid of a lot of the upside-down subsidies we've been talking about, so it's a progressive revenue increase. It's a revenue increase that broadens the base, however, and therefore can keep marginal rates low.

It's a tax increase that doesn't target particular industries, and I did that because I didn't want anyone to feel like I was picking on them, but a lot of my reviewers in the paper said, "Oh, you're just going to get everyone to hate you, instead of just the Homebuilders Association."

So, then I said, "Well, okay, maybe charitable contributions -- there's an argument to keeping that deduction or the incentive for making that deduction at the high end," and that had nothing to do with me going to Pew Charitable Trusts, by the way, and -- because I wrote it before I went to Pew.

And so I said, "Well, if you're going to let some of those current itemized deductions be exempt from this limit, then we should at least try to save in the cost of those preferences somehow."

So, I suggested putting a floor on charitable contributions deduction, which, of course, complicates the system, and this is full of tradeoffs.

But I think one key to keep in mind is that this is a progressive way of raising revenue. It doesn't raise marginal tax rates. And the alternative is not not raising revenue; the alternative is that we'd have to cut spending.

And it's much harder on the direct spending side, and it is really impossible to cut spending on the direct spending side in a progressive way.

And so I think if people start to view these cuts in tax expenditures as being a different way of cutting spending, rather than a different way of raising revenue -- one of which might be don't raise revenue -- I think that that would be -- I think it would increase the chances of these proposals having appeal, not just to Democrats who want to raise taxes on the rich, not just to Republicans who want to cut spending, but for bipartisan efforts that look at efficient ways of raising revenue and progressive ways.

MR. GREENSTEIN: I want to turn now to our discussant, Adam Looney. Adam is the Policy Director of the Hamilton Project, and he's also a Senior Fellow in Economics Studies at the Brookings Institution.

MR. LOONEY: Thank you very much, Bob, and thank you for four very great papers. I very much enjoyed reading them.

So, I wanted to start off today talking a bit about tax reform. So, obviously, the last time we had a real tax reform was 25 years ago, the Tax Reform Act of '86.

I think everybody looks back fondly on that experience, as a time when we cut loopholes, broadened the base, and used the revenues to lower tax rates.

And what we sometimes forget is that was also a reform that included raising corporate taxes to help finance those lower rates on individuals, that it was a reform that didn't touch any of the largest tax breaks or deductions, including that for mortgage interest, that it occurred in an era before we had really discovered the phenomenon of rising income inequality, and before places like the Joint Committee on Taxation had developed the tools they have today to accurately model how tax changes affect different groups.

And so if you -- just for example, if you go back, and you look at the documentation from that era, the distributional tables, the combination of corporate tax increases, elimination of shelters, and the lower rates on individuals achieves what must be the Holy Grail of tax reform, in the sense that it's a tax reform that was revenue-neutral in the aggregate, but that within each income group, everybody got a tax cut.

And so it -- you know, I'm sure that wasn't the only reason why policymakers were so much more agreeable back then, but it couldn't have hurt.

And so I think when you go back, and when you look at the prospects for tax reform today, I think the job is just much harder. We can't cut the same loopholes twice. The deductions and the tax breaks that have been left on the table, time and again, year after year, have been left there for good reason.

We're probably not going to get any revenues from the corporate side. If we're really serious about deficit reduction, if we do manage to find loopholes, and if we do broaden the tax base, it's likely that those revenues will need to go to deficit reduction, rather than to lower tax rates.

And because of heightened concerns about income inequality, and the effects of taxes on different groups, any of the choices that we do make are just going to be scrutinized in the political process, and that just makes it even more difficult to achieve consensus.

And so the challenge facing these authors, when asked to find revenues within the current system, it's just that much harder than it has been in the past. And as a result, I think that they take a different approach than we've used in the past. They go after what Bob called tax expenditures -- those provisions in the tax system that could just as readily be achieved, in their budgetary and economic effects, through direct spending programs.

And so what the authors do is they go through the tax code, and they say -- with the same scrutiny that might be applied to spending programs, and they say, "Which are the areas that are wasteful or inefficient, and which ones can we improve, both to raise revenue and to improve their functioning?"

Three of the papers, obviously, take on specific areas of spending through the tax code, mortgage interest subsidies for fossil fuel extraction, retirement savings -- things that would just have a hard time as standalone categories, had they been classified under domestic discretionary spending, rather than under the title of revenues. They're expensive. They're often regressive, and they often fail to achieve their basic goals.

Just to give one example, it would feel preposterous today to propose a new entitlement for home ownership that cost $100 billion a year, that was targeted primarily to people who already own homes, whose benefits mostly accrued to people in the upper -- the top half of the income distribution, and whose maximum benefit was reserved for people in the highest income bracket, who had agreed to buy million-dollar homes.

And yet, that's what we do. And we've been doing it for a long time.

You know, one reason is obviously that such breaks are very popular. Another theory is that we tend to do a weaker job in picking and choosing among constituencies, or picking and choosing among specific programs because of political difficulties.

The approach that Diane Lim takes is, of course, not to target any particular group, but to apply a haircut across the board. That raises even more revenues in her proposal. It ameliorates some of the distortions in the current system, and it has that political benefit of not targeting any particular constituency.

So, I was going to also mention Martin Feldstein, and paraphrase his political analysis -- you know, the Republicans want to address the deficit by cutting spending; Democrats want to include revenues in their deficit plans. Shouldn't be there be a million ground?

And so, I think, first of all, it's obviously not that simple, but I have to say that I find that argument compelling, and so I hope, in that spirit, that people are interested in these proposals.

MR. GREENSTEIN: Great. I'd like to ask a couple of questions to the panel as a group. The first one relates to a bit of a tension between Diane's paper and the other papers.

So, as we've discussed, one of the political advantages of Diane's paper is the policymakers don't have to single out the mortgage interest or other popular tax expenditures in the code, and you just do it generally, and there are political observers around town and people on the Hill you can talk to who say, "Well, if we do anything at all, it'll be a tax expenditure."

Having said that, if you look not so much at Diane's proposal, but, as she mentioned, the leading proposals until now on tax expenditure limitations -- the Obama proposal, the Feldstein proposal to limit certain tax expenditures to two percent of adjusted gross income, the idea Governor Romney proposed during the campaign about dollar cap on itemized deductions -- those proposals would not affect the fossil fuel tax expenditures Joe writes about.

What I was a little struck by when I looked -- I hadn't realized until we looked -- is, none of those three proposals put tax expenditures for retirement savings under their limitations. It remains untouched, outside the limitation of all of those proposals.

And while those limitations do cover the mortgage interest deduction, they don't get you because they're just a limitation -- to some of the restructuring Alan proposes, like converting the deduction into a refundable credit.

So, there's a tension here. I would argue that, from a policy standpoint, the best might be a blend of the two, where you have a limitation on some things, and policy changes in the fossil fuels, retirement savings, and the like, and the counter could be, "Bob, you're just doubling the political difficulty by trying to do both."

So, I just wanted to ask the panel to comment on the tension between an across-the-board -- not across-the -- a limitation on certain tax expenditures that has the obvious political advantage, and the policy advantages of being able to go into individual areas, and make certain redesigns, and to touch things -- like, Joe, what you talk about -- that wouldn't be -- or what Karen talks about -- that probably won't be touched under a limitation -- whoever wants to go first.

MS. LIM: So, I actually would characterize my type of approach as almost an across-the-board tax expenditure cut.

And I think of it as -- you know, my -- this proposal is not innovative or particularly elegant, but it's easy. It's an easy proposal, and it raises a lot of revenue.

Do I like all three of the other proposals? Yes, very much, and I think that if we're engaging in tax reform, we should be looking at how the tax system treats energy markets, and retirement savings, and mortgage interest more closely, because maybe there are arguments there to pare back those tax expenditures more significantly than these across-the-board measures would allow.

Honestly, I think that the across-the-board approach has the appeal of being more likely to be thought of as a budget proposal, rather than a tax reform proposal, because I don't think there's any -- there's not much force right now, there's not much pressure to engage in fundamental tax reform, whereas we do have this thing called the sequester coming up.

And I would point out that limiting itemized deductions to 15 percent would raise about a trillion dollars over 10 years, which, coincidentally, is about the value of the sequester.

I would have preferred -- I've always pushed for this sort of limitation on itemized deduction as a good way to pay for extension of any of the Bush tax rate cuts. Now that's gone, of course, which, by the way, makes the revenue estimate an overstatement now, because that was based on the old current law baseline.

But I believe that since we can't use it for pay for tax rate cut extensions, we could at least use it now to pay to avoid spending cuts that are much more regressive in incident.

MR. VIARD: Yeah, I think this is an excellent question, and really gets to, you know, the issue of how -- what's the most politically effective way, and the most economic and beneficial way to try to tackle something as broad as the tax system?

I think it will be somewhere between the two extremes. I mean, on the one hand, you know, we can talk about an across-the-board provision, but nobody is really talking about across-the-board, because, as Diane said, you know, I mean, charity would probably get a -- you know, special treatment, and probably should, and so forth.

So, the issue is not so much being literally across-the-board, doing the same thing to all of the tax expenditures out there, but simply starting from a broad perspective and saying, "Now, from that starting point, let's see which ones maybe should be taken out of this, which ones maybe get somewhat different treatment."

At the other extreme, I don't think it's realistic to believe that, like, a single major provision could be reformed on its own. I mean, economically, I believe it'd be beneficial for something like my mortgage proposal to be adopted, regardless of what was being done with anything else, but, politically, you wouldn't expect to see the mortgage reduction restructured in a major way, while everything else is being left untouched.

So, I think it'll end up being some middle ground, just like the '86 act was, where a whole range of provisions are being modified, where there's probably some similarity in how different provisions are being treated, but not an exactly identical treatment across them.

So, I think you could almost start from either vantage point. Start with something that you might cull across the board, or start with a collection of specific proposals, and you'll end up converging to that type of middle ground.

MR. ALDY: I would just say that, you know, Adam made the right point, which is, some of these provisions have lasted a long time in the tax code.

So, the two most prominent provisions that are in my proposal have been on the books since 1913 and the 1920s.

Now the world of oil and gas drilling's a lot different now than it was then. But it says something about how once we actually get certain provisions in the tax code, and if they're written back in a time when we didn't put sunset provisions on everything that passed in a tax extender's bill, you create the interest, and sort of maintain that kind of subsidy for the tax code.

And I think part of it is trying to think through politically. And I think the way you were framing the opening questions, Bob, is exactly the right way to do this -- which is, "Okay, this makes economic sense. We have a bunch of economists up here that says it makes economic sense. How do we make this into political sense? How do we actually frame this as a way where there's some kind of package?"

And I think that's the way, whether it's a package on the personal income side to get to some of these, and then think about something on the corporate income side. It obviously has to be more than just, let's get a bill -- thumbs up or thumbs down on fossil fuel subsidies.

So, I think the magic has to be in how one crafts a combination of these elements that actually gets broad interest and that kind of reform.

MR. GREENSTEIN: Just sort of -- add a point here, too, is there are certain kind of tax breaks that, as best I know -- and maybe I'm missing something -- I can't see how you could design the limitation (inaudible).

So, the most obvious example would be something like carried interest. But there's a bunch of others. There's like-kind exchanges, which is a pretty egregious way of avoiding tax on certain kinds of real property transactions. There's valuation discounts (inaudible).

There's things that from -- on a policy, not a political -- a policy basis -- are low-hanging fruit, and that they're hard to justify the current treatment. But you would have to be able to win them individually. You couldn't design, as best I can see, the limitations (inaudible).

Let me turn to a different question -- and particularly ask Karen.

And I alluded to this at the end of my opening remarks -- that we kind of have this conversation where there are two candidates on the table for revenue you could raise from tax expenditure and reform, and there are deficit reduction and rate cuts.

And you choose to take a portion of your savings, and you put them back into the tax code, but not as rate cuts, but as a change in a small business -- credit related to running retirement plans for your employees, and changes in the savers credit.

And I'm wondering -- could you briefly describe the proposal, but, more broadly, talk about the economics here? If you got a challenge and said, "Well, anything that goes back into the tax code, the first claim on it should be rate cuts," rather than what you've proposed -- could you kind of talk about that, and how you see the economics of this issue?

MS. DYNAN: Yeah, sure. I mean, it's like any time you save some money, there are choices as to what you're going to do with it. So, you can bank it, or you can spend it in different ways.

In this context, you know, you've talked about the possibility of, you know, cutting rates, which would be one way of spending the money that's conserved by broadening the base -- and that would have economic benefits. But it's a question of priorities, you know, as it always is with these choices.

So, the fact is that many American families have very little financial assets. So, in my paper, I look at families who are in their peak saving years, and I find that if you look at the bottom 20 percent, those folks have financial assets that amount to about a week's worth of their income. And even going up to the next 20 percent, you're finding these families in their peak saving years, again, have financial assets that amount to less than two months' worth of their income.

So, these families don't have much in savings, and they need savings. So, they need savings, in part to secure, you know, a comfortable retirement, but also because savings allows them to pursue opportunities. It allows them to pursue higher education, allows them to pursue home ownership, and, you know, also, families need saving just to be able to weather unexpected disruptions to income or spending needs.

You know, and these -- you know, addressing these needs is not just about the wellbeing of these families; it's about the economy as a whole.

For example, you know, if people have more access to education, that's going to make for a stronger labor force. If people don't find that their spending has to be lurched around by shocks to their income because they have some sort of buffer they can spend out of, well, that's going to make for a more resilient consumer demand.

So, you know, there are good reasons to make promoting saving amongst low and moderate-income households a high priority.

What I suggest in my proposal is a few different things. I mean, what we know kind of works for these families are, you know, simple, easy to use vehicles for saving.

So, one of the most effective things has been found to be employer-sponsored retirement plans, with contributions that are automatically deducted from payrolls, and automatic enrollment at a default rate.

So, those plans are great. They do seem to encourage new savings. The problem is that only 55 percent of private sector workers are covered.

So, that's why, in my proposal, I propose increasing the tax credit for firms that establish and administer these plans, to encourage more of these plans to be formed, and also for firms for whom that doesn't make sense -- you know, it's going to be small firms, you know, that, you know, don't find it's worth the money or the energy to establish one of these plans -- to require those firms to open IRA accounts for their employees, and have, again, contributions automatically deducted from earnings.

You know, you can mitigate the burden on these firms by providing tax breaks for them doing so, and, you know, this would be a, you know, plan where people could opt out if they wanted to. You're not forcing them to participate, but research shows that it does raise the saving of these people.

MR. GREENSTEIN: Others want to jump in on this question, anybody, about rate cuts for -- Alan?

MR. VIARD: Yeah. I mean, I think -- let me say that my proposal, I think, adopts the same general philosophy that Karen's does.

It's not two separate components in the case of my proposal; it's bundled into one. But when I replace the existing mortgage interest deduction with this refundable credit, obviously part of the revenue, you know, that could otherwise have been devoted to deficit reduction or to rate deduction ends up being used instead to provide more generous tax breaks at the bottom.

Anyone who's not -- who doesn't owe income tax today, anyone who doesn't itemize deductions today, anybody in the 10 percent bracket today, you know, would be getting a bigger subsidy for home ownership under my proposal than they would under current law. So, that's why I use part of the revenue to serve those goals.

I think that's a -- in general, an approach that should always be considered. These tax preferences are durable. They're politically popular, and we have to recognize that that's because they do attempt to serve -- or are marketed as serving -- you know, some type of widely-held social objective.

And so a very promising strategy, I think, both politically and economically, is to say, you know, "Let's curb the excesses or the misdirected aspects of these provisions in ways that will raise some revenue. But at the same time, let's actually put something in there that will more directly and more effectively serve the objectives that have always been associated with these things."

So, I think that's an approach that should always be considered in the tax reform debate. Obviously, the way it plays out depends on the exact provision involved, though I think it's a sound general approach.

MR. GREENSTEIN: Come back, Joe, to your paper for a minute.

There are a lot of issues involving trade negotiations with our trading partners that involve energy.

How would your proposal to eliminate a dozen tax expenditures --

MR. ALDY: Mm-hmm.

MR. GREENSTEIN: -- a dozen tax expenditures relating to oil, gas, and coal interact with our trade negotiations with other countries?

MR. ALDY: Well, you go back four years ago at the Pittsburgh G20 Summit. There was actually an agreement among all the major developed and developing countries to eliminate their fossil fuel subsidies. And just a month after that, at the APEC Summit, the leaders of the APEC nations also agreed to eliminate their fossil fuel subsidies.

This effort was spearheaded by the United States and by President Obama, and it's tough to go back to these countries and say, "No, you really need to do more on this front," when he hasn't been able to deliver that here at home.

And I think it's important to recognize what the potential economic implications are in the United States if you could achieve this kind of subsidy reform globally.

So, while the subsidies in the United States focus on production, in most of the developing world and among major energy exporters, their subsidies are almost exclusively on the consumer side -- and it's actually in excess of a half a trillion dollars a year globally. So, we're talking about a lot of money going to subsidize consumption.

If these countries were to eliminate their subsidies, you would actually see efficiency and conservation measures in these countries that actually means, globally, we'll be consuming less oil -- the International Energy Agency estimates on the order of about 4 million barrels a day.

What that means to U.S. consumers -- we actually pay less for gasoline, and diesel, and heating oil, as the world price falls with this lower demand and lower consumption. That also means we'll have lower greenhouse gas emissions.

So, the environmental benefit is really leveraged, and the economic and energy benefit to the United States is really leveraged by not just undertaking this effort, but by the enabling U.S. negotiators to go to these major trade partners, major economic players, and say, "We've now delivered on this agreement, and we want to see you step forward, and deliver on the agreement that your head of state made in 2009, as well."

So, I think there's a lot of potential there to really multiply the energy, economic, environmental benefits of fossil fuel subsidy reform when one looks at what the U.S. government could do engaging these other countries, after the elimination of subsidies in our tax code.

MR. GREENSTEIN: Let me ask one more question to the panel broadly -- and very much including Adam -- and then I think we're going to go to the audience for Q&A.

So, in Alan's paper, he has a specific proposal for transition rule over 10 years.

My question kind of to the rest of you in particular -- whether substantively or politically -- with fossil fuel subsidies, the retirement saving changes, a global limitation, would one need to work out transition rules there, as well?

MS. LIM: Well, I think mine's pretty easy. I don't think you need transition rules for a limit to 15 percent. If, politically, people don't want to go there right away, you can always ratchet down -- you can start at a higher rate, and move it down.

MR. GREENSTEIN: Lower the percentage.

MS. LIM: Right -- lower the percentage limit over time.

So, yeah, I -- and there is an argument to say that if people know that their itemized deductions are going to be limited next tax year, they might have an incentive to do more spending in the tax-preferred areas this year. So, maybe there would be a little stimulus kind of boost from that.

MS. DYNAN: Well, so I would say --

MR. GREENSTEIN: Karen?

MS. DYNAN: -- not in a major way, although I think Diane's last point was an interesting one.

I mean, I think the element of my plan that probably requires, you know, the most transition is this -- the automatic IRA element to the proposal, where you're actually going to be asking firms -- and particularly, it would be small firms, because small firms are the ones that are least likely to already be offering retirement savings plans, to do something new, offer something new. So, to mitigate the burden, you'd want to spread it out over time.

MR. GREENSTEIN: Joe, I don't know this area, so this may be way off. There's kind of a boom in certain areas of fossil fuel --

MR. ALDY: Mm-hmm.

MR. GREENSTEIN: -- production going on now. You -- couldn't you argue that, actually, this is a good time to make the change you're proposing, as distinguished from a period when fossil fuel production is hurting and is down?

MR. ALDY: Yeah. I mean, you know, we're -- we've been in a period of time in which the price of oil has been between $80 and $100 a barrel -- since, really, the middle of 2009.

When you look at the kind of forecasts that are out there, you look at the futures market, no one is expecting us to return to an era of really cheap oil.

So, when you look at that, there are really big returns to be made, and that's, in part, why we've seen a lot of increase in production of oil, especially here in the United States. And we have seen that kind of penetration of the new technologies, that bring new resources into play, that help lower the cost of production.

So, I think you're right. When one looks at it, there's a lot of activity that will continue, because there's a lot of profits to be made, even in the absence of these tax provisions.

So, this could be sort of, you know, a better time to do this than, say, if you were to go back 15 years when oil was trading at $11, $12 a barrel. Then, of course, there'd be a lot of opposition to anything that would actually affect whether or not it makes sense to go forward.

But you look at the activity here in the U.S. now, we have four times as many rigs operating, producing oil, now than we did in 2008. It's a dramatic increase in the activity, and so if we don't take advantage of this, the concern is actually not that my proposal would save $40 billion over 10 years, but potentially a lot more, if you think production is going to really ramp up with the increase in what seems to be a commercially viable U.S. resource.

MR. GREENSTEIN: Okay. I think we would -- Alan, go ahead.

MR. VIARD: Yeah, just a brief comment. I think it is interesting how the politics of transition do seem to vary, depending upon how proposals are framed.

The President, for example, has not proposed any transition relief for his 28 percent proposal. I think that from an economic perspective, of course, the case for transition relief -- or the case against it -- shouldn't be sensitive to whether proposals are being combined with others in an across-the-board approach, or whether they stand alone.

If you think that there should be transition relief for existing home owners, from a change to the mortgage deduction -- and I do think there should be -- then I believe that also still remains valid, even if that's part of an overall 28 percent or overall 15 percent proposal.

And I wonder, in the end, if the politics really are much different. Obviously, the President did not feel impelled to provide -- to propose transition relief upfront, but if that proposal -- or Diane's modification of it -- was to receive more serious consideration, if it was to start moving closer to enactment, I think people would ask whether there should be transition relief for existing home owners on the mortgage side, for municipal bond holders -- since the President's proposal, at least, would apply to that, as well.

So, I think the transition issues, you know, always need to be confronted. And it's also true that sometimes transition relief is implicit, instead of explicit. I mean, Karen, your proposal, I think, would apply your limit to new contributions, right?

MS. DYNAN: Mm-hmm.

MR. VIARD: And so therefore, you automatically -- you've provided transition relief for contributions that have been made in the past.

But yeah, I don't think it's possible to sweep transition concerns under the rug, you know, just based on whether you're doing an across-the-board approach, or something more selective. You always have to think about that.

MR. GREENSTEIN: Great. Okay, we're going to go to the audience now. I -- are there mics that are coming around? Yes, there are.

Gentleman with a blue shirt in the back -- yes, you. Maybe it's not blue; it looks blue to me from here.

SPEAKER: Assuming that I'm a Congressman faced with two bills -- the Lim Bill and the Feldstein Bill. Assuming the CBO cost estimates, they raise the same revenue. Which bill should I vote for, both in terms of the economic merits of the bills, and my electability?

MR. GREENSTEIN: I'm sorry.

MR. VIARD: I'm sorry; I didn't catch it.

MR. GREENSTEIN: I'm sorry. We didn't -- we couldn't quite -- which are the two bills you're referring to?

MS. LIM: My proposal, versus Marty Feldstein's proposal.

SPEAKER: The Lim Bill and the Feldstein Bill.

MR. GREENSTEIN: Oh, your proposal versus --

MS. DYNAN: There you go.

MR. GREENSTEIN: Diane?

MS. LIM: I feel like this is unfair, because Marty's not here, but --

MR. GREENSTEIN: Yeah.

MS. LIM: -- of course you should vote for my bill. But it's because my approach, instead of capping the total amount, is sort of limiting the rate of the subsidy. So, it's trying to preserve the same kind of marginal incentive to give to charity, or to take out a mortgage -- that the same subsidy rate across the full income spectrum -- but it is not sort of arbitrarily putting a cap on whether that subsidy would continue above a certain level. So, it doesn't cap it as much as limits the subsidy.

And so I feel like if there are reasons why we have these itemized deductions in the first place -- presumably, once upon a time, we decided that these activities were worth subsidizing through the tax code -- so instead of questioning that, and instead of picking on any particular subsidy, I'm saying, "Okay, there's an argument to subsidize these activities through the tax code, but let's just limit the cost of these subsidies by treating all taxpayers more uniformly."

MR. GREENSTEIN: And I would just add -- I, too, would vote for Diane's over Marty's.

You just take charitable contributions as an example. Under the Feldstein, once you hit the cap, there is zero incentive --

MS. LIM: Incentive -- right.

MR. GREENSTEIN: -- for additional charitable contributions.

The second issue is Diane's proposal is progressive, and I think, as Marty has acknowledged, given what is and isn't under his limitation --

MS. LIM: Yeah.

MR. GREENSTEIN: -- the net effect of his proposal is actually somewhat regressive.

Question right in front of the gentleman who asked before?

SPEAKER: There's no good model for differentiating --

MS. LIM: Oh, the mic's not on.

SPEAKER: Now it's on.

What we're finding is that there's no good model for evaluating the differences between tax expenditures which have broad social, strategic, environmental, or economic value, and those which are pretty much pork, and were put into the bill because they assisted the Congressman in getting reelected.

And have any of you, in your research, run across any kind of a model that you would suggest, that we might suggest to the Congress, for trying to differentiate between the effectiveness and the real value of different tax expenditures?

Or if not, what would you suggest as some of the criteria that we might be suggesting to the Congress?

MS. DYNAN: Well, the Government Accountability Office has been working on this issue for a long, long time -- you know, pushing for performance-based budgeting, you know, applied to spending that's done through the tax code, right -- that we don't do a great job of performance-based budgeting on the direct spending side, but we do a really bad job of spending on the tax side.

So, it's not for lack of effort in this town that we -- you know, people have been pointing out for many, many, many years that we should be evaluating tax expenditures based on cost versus benefits, and we just don't do it.

And to squeeze in a shameless point about deficit reduction -- I often don't like it when we talk about proposals as being devoted to deficit reduction, versus some other really attractive, good thing, because deficit reduction is this amorphous concept, and I think we have to think more about opportunity cost, which is -- I keep talking about the sequester, but, you know, if it's for deficit reduction, it's instead of some other way of reducing the deficit.

And I think that we have to keep bringing it back to, what are those other ways of reducing the deficit that this would substitute for? Because otherwise, if it's just deficit reduction versus cutting taxes here or spending more there, then that proposal's always going to lose and look bad.

But if it's raising revenue to reduce the deficit, which means we don't have to reduce the deficit this other, worse way, then I think that the proposal has a lot more chance of being palatable to politicians.

MR. GREENSTEIN: You -- yep.

MR. VIARD: I don't know if there is any special framework that you can use to evaluate these, except, of course, just looking at what is the objective -- or the possible set of objectives -- that this provision potentially could serve?

So, in the case of the mortgage reduction, you would say, you know, maybe it's trying to promote home ownership. It may be -- in the case of the provisions Karen is looking at, maybe it's trying to promote national saving, or to promote financial security, and so on.

And then you simply ask, you know, in what areas would you expect this to function effectively, and which not, based on economic theory, based on any statistical studies, and so on?

The one thing I would say is, you draw the distinction between the ones that are -- provisions that are trying to promote social objectives, and ones that are just pure pork, adopted for political reasons.

I think what we need to emphasize is that all the big money is in the first set of provisions. I mean, it's easiest, of course, to say, "Let's get rid of the things that are pure pork in the tax code," just like it's easiest to say that on the spending side: "Let's get rid of waste, fraud, and abuse."

But when we look at the spending side, we actually see that the dollars are in very popular, very widespread government benefit programs, such as Social Security, Medicare, and Medicaid. On the tax side, we see that the dollars are in things like the mortgage reduction --

MS. LIM: Right.

MR. VIARD: -- the retirement saving preferences, and so on.

So, our task is never going to be as easy as saying, "This is a wasteful, ridiculous, irrational provision; let's completely scrap it. That's a really easy call." Instead, it's always going to be something like, "Here's a provision that ostensively is serving some kind of social objective," but let's actually think about whether it's really doing it effectively, whether it's appropriately targeted, and where there is some way that we can restructure it -- that, although it may be painful, although it may require transition relief, it will bring us to a point where we have a smaller revenue loss but are still achieving our essential objectives.

MR. GREENSTEIN: Adam, my memory may be wrong here, but I believe sometime last year, there was a Hamilton Project paper. It isn't a full model -- but that has an interesting discussion in it of some issues and criteria related to tax expenditure.

MR. LOONEY: Well, I have to say, I agree with Alan on this.

I think a lot of the -- it's very difficult to draw black and white distinctions between what's waste, and what's not, and which tax expenditures achieve social benefits, and which ones don't.

We try to enumerate there, but, ultimately, I think it's a very subjective question. And, you know, even within the mortgage interest deduction, one can argue that some of this obviously achieves a social objection. And then some of it's probably pork.

So, I think it is very hard to tell.

MR. GREENSTEIN: You know, on this -- yes?

MR. LAWSON: Mike Lawson, State and Local Government Leadership

Center -- George Mason University.

My question is -- and given my preface there -- I've had -- except for a couple instances -- municipal bonds and earlier local codes -- there's been no discussion of state and local governments, which are also part of the public sector.

So, in light of that, I just open that general area up for just general comments about the impact on state and local governments, and their taxpayers, and their residents.

MR. GREENSTEIN: Great question. Anybody want to jump in?

MS. LIM: Well, with my proposal, the states can still piggyback on the definition of the taxable income and itemized deductions. They could choose whatever rate that they want to apply to itemized deductions, still.

So, they might have to keep track of itemized deductions, separate from adjusted gross income, and then apply their own rate limitations -- or not -- to the itemized deduction, to calculate state taxable income. But I think that's doable.

And I also feel like this is a better approach for deficit reduction, for state and local governments, because I think that if we raise -- if we reduce the deficit on the federal side more through the revenue side, there's less likely to be an adverse impact on state and local government.

MR. VIARD: I mean, I think state and local governments probably, you know, would feel some impact, because you would imagine that a reform effort that's comprehensive probably would make some modifications to either the municipal bond exclusion, or the state and local tax deduction -- or both.

I think Diane makes an important point, though, that you have to look at, you know, the comparison. Other ways of reducing the deficit would also impact state and local governments. They're not going to, I think, escape completely unscathed under any real deficit reduction plan.

And so, again, you just have to decide which provisions are effective, and which are not. I mean, the municipal bond exclusion, I think, is pretty hard to defend as being an effective, or efficient, or desirable way to assist state and local governments.

And so that, for example, as we go about setting priorities, I think, is something we would want to try to either end or restructure.

MR. GREENSTEIN: You know, I think there's some interesting questions here, and part of it relates to whether some things that are beyond the four papers -- certain kinds of other exclusions for income are closed.

So, if one looked at the 1986 Tax Reform Act, it provided increased revenue to states, because since states piggyback in many cases, their definition of taxable income to the federal, by broadening the base in the way the '86 act did, it broadened state income tax bases -- and, in fact, a number of states then went and cut rates, to give back some or all of the increased revenue they got from broadening the base.

In this case, on the other hand, there are issues on the state and local deduction -- municipal bonds -- that could go in the other direction. So, I think one would want to look at a mix.

I was always fascinated by what happened at the end of the 2003 tax bill, when a dividend cut was going to go through. And in its initial form, the cut in taxes on dividends in 2003 was a 50 percent exclusion, which would have cost states a bunch of money.

And precisely because of the impact on states, at the very last moment, four Governors -- two Republican, two Democrat -- in the Senate got it switched from a 50 percent exclusion to a 50 percent rate cut -- in which case it no longer narrowed the state base.

So, these are all important questions, I think, for policymakers to look at, and the underlying theme of your question, I think, is right, which is, there is risk that decisions will be made without much attention to the impact on state and local finance.

The person right behind you, I think, had a question.

SPEAKER: Thank you. This is the question for Mr. Viard. In reading your paper, I have a two-part question -- and the second part, you can decide if you want to answer it.

The first part would be, from what I can see, what you're trying to do is sort of level the playing field, but on the same token, you're somewhat willing to have everyone penalized -- the Clintons, the McLanes, and, God love her, the Sarah Palins of the world -- who all own more than one home.

And so my question is, are you assuming that those who own more than one home do not take their tax refunds and invest it back into the community? Are you worrying that they send it overseas?

And the other question -- this is up to you if you want to answer it -- does your proposal -- would your proposal affect you personally?

MR. VIARD: Okay, well, I'm not a home owner. So, I guess perhaps that -- all of us are always -- I guess it was Oliver Wendell Holmes who said that, "Try as we might, none of us can ever look at any policy issue through any eyes except our own," and that's an inevitable limitation that everyone faces.

No, the thing on the second homes is -- has nothing to do with any animus towards the people who own two homes -- or more than two homes -- but simply asking, what is the justification for a special government subsidy that treats that kind of expenditure more favorably than normal, run-of-the-mill expenditures?

And I think the only real coherent goal of the mortgage deduction is to try to promote home ownership. If somebody already owns one home, then, obviously, that goal has been satisfied, and I don't think there's any legitimate governmental objective served by subsidizing the second home, as well.

So, I think that is -- in policy terms -- you know, a relatively easy call.

MR. GREENSTEIN: I'm going to go, because there are more questions. Did you have a -- you had your hand up? Okay, go ahead.

MS. NGUYEN: Thank you. I'm Genie with Voice of Vietnamese Americans. I'm also with the Asian Real Estate Association of America, the D.C. chapter.

And I'd like to bring up the focus on home ownership, because both -- I think you, and, also, Diane -- Alan and Diane -- and even Karen -- kind of propose not promoting home ownership with your tax proposal -- however, look at the whole big picture -- the way that we are in the crisis today, partially is because of the crisis, of the bubbles, in the housing bubbles.

And homebuilding and construction has always been the core of our economy. So, right now, we still have a high number of unemployment, and almost, like, 40, 50 percent of those came from home construction business.

So, I do feel that, regardless of how much deduction --

MR. GREENSTEIN: I'm sorry. The -- we're almost out of time for the panel, so could you go to the question, please?

MS. NGUYEN: Okay. So, then, my question actually have a little bit with Alan, and Karen, and Diane -- because without -- with you taking away the mortgage deductions, would you then, not promoting home ownerships -- and people who can spend time buying a house -- like, even for Diane -- is that putting them into tax saving?

If they put that in their house, they can stay in there, and they can get tax deduction, and they can put that back into the market -- because with the home, they buy a lot of things. It's somehow -- it's (inaudible). When people have a house, they will come out, and they --

MR. GREENSTEIN: Okay, I'm sorry. I'm going to -- let's go to Alan.

MR. VIARD: Okay, yeah, so let me say that --

MS. NGUYEN: I'm not quite done yet, though -- because --

MR. GREENSTEIN: I'm sorry you're not quite done, but the panel is out of time, and we're looking for questions, not statements. I'm going to cut you off --

MS. NGUYEN: I --

MR. GREENSTEIN: -- and go to Alan.

MS. NGUYEN: I do have a problem with the interest rates, because you're saying that the $300,000 --

MR. GREENSTEIN: I'm sorry. Can someone cut the mic? Thank you.

MR. VIARD: I mean, I think you've stated --

MR. GREENSTEIN: I apologize, but there's another panel after ours, and they need enough time, too.

MR. VIARD: Well, let me try to be brief -- and I think you've stated your points.

First of all, let me say that long-run tax policy should never be set based on the idea of trying to maintain aggregate demand by promoting a particular product. Yes, of course, people who go out and build mansions are going to be contributing to aggregate demand. So would people who buy groceries, so would people who buy TV sets, so would people who buy furniture.

There's no reason why aggregate demand says favor one sector over another. Yes, there is a timing issue. There is a transitional concern, but, you know, this point about the bubble -- to me, that would suggest that we actually want to move away from a situation where we have an artificially overexpanded housing sector.

And then let me just say -- I mean, your question repeatedly referred, you know, to not promoting home ownership. But, I mean, I would submit -- and I think it would stand up under any reasonable analysis -- that my proposal maintains and expands the incentive for home ownership, but not for the expensive, large houses.

MS. LIM: And you steer the benefit more to lower-income households, so if you're worried about the contractionary effect, Alan's actually made that a more stimulative proposal for the short-term.

MR. GREENSTEIN: Okay, I think we are now out of time for the panel, and ready to go to the next.

I want to thank Adam, Alan, Karen, Joe, and Diane.

(Recess)

MR. GREENSTONE: If you were going to debut 13 ideas in one day, although the Hamilton Project loves all 13 ideas almost equally, wouldn't you say (laughter) the ones that were a little dearer to your heart were numbers 9, 10, 11, that's you, Tyler, 12 and 13? And so, this panel is supposed to talk about alternative or new sources of revenue, and I don't want to take time for the (inaudible).

I'm just going to very quickly make three observations. I think even after the end-of-the-year deal, the United States government is not on track to generate revenues that approach the expected levels of spending. You can see that when we're back at full employment. You can see that out many years, more than a decade. It's probably also true that marginal tax rates seem frozen for, I think, an extended period of time as part of that deal, and we just heard about tax expenditures and what might be feasible there. And there are a lot of excellent ideas on that panel. I would have voted for your idea, Diane, but they all seemed a little politically challenging.

And so, what we were going to try to do in this panel with this fabulous set of authors is say, hey, maybe there are new and alternative sources of revenue. And to start that off I was going to turn to Tyler Duvall who's an Associate Principal at McKinsey & Company, and was a former Acting Undersecretary at the Department of Transportation, and Tyler's going to talk a little bit about user fees and some other ideas in transportation. But I'm just going to start by asking if Tyler could provide a little context for -- I thought we paid for all of our infrastructure out of the gas tax. Tyler, what happened to that?

MR. DUVALL: Forget it.

MR. GREENSTONE: Yeah. And also, it's every month the Society of American Civil Engineers gives us grades on our infrastructure, and they seem to -- somehow we've hit F, but it keeps going lower, and maybe you could help us explain how your proposal's going to solve both of those problems.

MR. DUVALL: So, yeah. Basically the gas tax at the federal level is the predominant mechanism on cars and diesel tax on trucks. That mechanism, for many, many years was bringing in more revenues than we outlaid, and we had a huge surplus account in the Federal Highway Trust Fund which funds about 40 percent of the highway investments and about 40 to 50 percent of the transit capital investments in the U.S.

There was a deal cut by the Congress basically to spend down that balance. The President and the Congress agreed we had a big balance; let's spend it down. Unfortunately, when they did that, they didn't propose any alternative long-term, so we're now stuck with a situation where the projected outlays far exceed revenues coming into the Trust Fund at the federal level.

At the state and local level you've already seen, basically, a big move away from the gas tax. In fact, the gas tax is a (inaudible) minority tax to fund transportation infrastructure in the U.S., even though everyone at the federal level here in Washington thinks it's the only tax in town. So, what we've talked about in many policy circles around the country for many years now is the shift toward the direct user-pay system, which frankly was envisioned by Win Vicory in the mid-1950s. It was not a new idea. This is an idea that's been around for many, many years and now is being implemented around the world and starting to be implemented here in the United States, and it basically uses technology to charge drivers the true cost of driving on roads during peak periods, during off-peak periods, to charge trucks the true prices, and the basic problem is that the prices today do not bear any relationship to the cost being imposed. So some rough math, we're looking at about a 2 to 3 cent charge per mile to get on the Capital Beltway here in Washington, D.C., with the true cost being composed of about 35 to 40 cents a mile. Obviously at Econ 101, we're going to have a problem with that equation, and we do.

So, what's great about this idea is that basically it's one of the few win-win revenue policy ideas out there in which you see basically better performance outcomes from the system. You see more revenue come in. You see speeds, reliability, and flow conditions improve. You see environmental conditions improve so from our perspective, from Jack and my perspective is that the country needs to start to transition to this approach more aggressively.

MR. GREENSTONE: Now, bear it in your proposal there is something -- they're going to put a GPS on my car, and the government's going to know where I am all the time? Was that your idea?

MR. DUVALL: No, that's definitely not my idea.

MR. GREENSTONE: Okay.

MR. DUVALL: No, there's lot of different technology solutions. The great thing about where we are as a technological matter is that there are probably 50 different ways you can design the technology to do this. Obviously, the Germans, for instance, that are tolling every truck on the Autobahn today using a GPS transponder that generate about $5 billion a year in revenues for reinvestment in various asset classes in transportation, but for those of you who have lived in the Washington, D.C. area, they just opened up the first high-speed private toll road in the D.C. area along the Capital Beltway. That's just an overhead gantry. You buy your Easy Pass from the state of Virginia or from any state in the system. You blow through the thing at 65 miles an hour. The only record they keep is when you did it; send you a bill if you obviously go through it without the transponder. So, the technology's not an issue.

To the extent that we want to move towards more futuristic technologies like a GPS-based system, as you said, there are obviously major privacy concerns. Many groups concerned about that. I think the reality is if the country, as a policy matter, was willing and able to do that, you could design privacy protections into those systems.

MR. GREENSTONE: And would we stop getting Fs from the American Society -- or is that just a thing because they want to build more bridges?

MR. DUVALL: Yeah -- so I think, actually, the civil engineers obviously put out a rating I think every 2 years around the quality of the nation's infrastructure. The reality is what's really suffered in the last 15 to 20 years is the performance, the operating conditions. The physical quality actually of the bridges and the pavement are, believe it or not, better today than it was 15 years ago. I know that sound to be true, but what's happened is we have a serious decline in the operating performance. Now, that doesn't mean the quality's where it should be. Obviously, we need to re-capitalize and the great thing about this idea of pricing directly is that it's not just a demand-side policy. It's also a supply-side policy.

So, the reason we have bridges to nowhere, the reason why we have this miss-allocation of resources is because the pricing being sent on the supply side don't bear any relationship to balancing supply and demand, so I think you'll see a big --

MR. GREENSTONE: I think that's a very important part of the proposal. Can you say that in English again?

MR. DUVALL: Yeah, so -- (Laughter)

MR. GREENSTONE: So, what's going to happen?

MR. DUVALL: So, right now the mechanisms to make capital --

MR. GREENSTONE: There's a lot of highway miles in West Virginia and Montana. Right?

MR. DUVALL: Yes, exactly. We have the largest highway system in the world by double any other country. So, the reality is right now the signals sent to suppliers are unfortunately too driven by political forces, so we're not using cost-benefit to a large extent. There are only a handful of states that use it systematically to allocate investment dollars, so the reality is we've got this huge pool of capital going into the system every year and generating declining returns on investment. And the pricing that we're talking about would not only balance supply and demand, it would also send a signal where the scarcity is most obvious in the system. Today we use congestion, delays, or other, obviously political forces to come up with that answer, and I think it would be a clear guide as we see with railroads, with the electricity grid. All of the network utilities use price signals to allocate resources, and we just don't have that on the highway side.

MR. GREENSTONE: Thanks. So, next we have Ben Harris who wrote a paper with Bill Gale on the value-added tax, and so I hesitate to do this, but I can't resist the temptation just for a little personal history. So, I was an assistant professor at the University of Chicago. Now, at the University of Chicago, Milton Freidman, he's not a deity but he's a semi-deity. And the reason relates to your proposal actually, that he's not a full-fledged deity. They still hold him responsible for the payroll withholding tax, which was originally his idea and the reason is that it's like a money machine for government. So, are you proposing that there be another money machine for government?

MR. HARRIS: So, let me just first give you the 30-second overview of a value-added tax. A value-added tax is a tax on consumption. It's levied incrementally along the production chain, which sounds like it doesn't matter but actually matters quite a bit for the administration of the tax. It's taxed in every OECD country except for the United States. It raises about 20 percent of revenue in OECD, so it's a major part of taxation in every major industrialized country in the world.

But, Michael, to your point, so the VAT has wrecked a lot of careers. In Canada the Prime Minister proposed it in 1991. He was out several years later. The same thing happened in Japan. There's sort of a warning to Congressmen who support the VAT. In the late '70s, the Chairman of the Ways and Means Committee proposed the VAT, and he lost the next election. Byron Dorgan famously said the last person who proposed the VAT in Congress doesn't work here anymore. So, the VAT has wrecked a lot of careers. Fortunately Milton Freidman's was not wrecked by the payroll tax.

The question about the money machine. A lot of people oppose the VAT on the grounds that it's a money machine, and it's not always clear what they mean. I interpret this one of two ways. One, it could mean that the VAT raises revenue, in which case, yes, you're exactly right. That's what it's designed to do. The numbers up there, that's exactly what this tax, which most taxes are designed to do, to raise revenue. I cannot quarrel with that, guilty. The second thing people mean about a money machine is that the VAT can lead to larger government, and the fear is, particularly among conservatives, is that if you institute a VAT that that will lead to more spending on the other side of the ledger, and that's a fair concern particularly for those of us who are concerned about deficits.

If we go back and look at the historical experience for all of these OECD countries that have instituted a VAT, the IMF has done good research on this and they found that no, the VAT does not lead to more spending. But more fundamentally, this is a value-added tax for deficit reduction. It's not a value-added tax for more entitlements. It's not a value-added tax for more discretionary spending. It's not even a value-added tax to help deal with the sequester. This is a value-added tax for deficit reduction.

One of the pillars of our proposal asks that Congress couple the value-added tax with spending restraints, so it's really a two-part proposal, so I don't think it would be a money machine in the second way that people refer to it.

MR. GREENSTONE: Can you contrast it with alternative sources of raising revenue? What's so good about taxing consumption?

MR. HARRIS: So --

MR. GREENSTONE: Aren't prices high enough?

MR. HARRIS: I teach a few policy classes at policy schools, and I always talk about the value-added tax and how great it is. I start off by talking about problems with deficits and then go talk about the administrative benefits of a value-added tax, and usually the students are on my side.

And then I sort of hit them with this is just a rise in prices. Bill and I are proposing a 5 percent increase in prices on everything. And that's how the optimal consumption tax should work. It shouldn't distort your decisions about what you choose to buy. You shouldn't choose to buy a Halloween costume because its tax is entertainment, but to not buy clothes because it's clothing and it's given a discount over favor of a Halloween costume, you want the decision to be neutral of different types of goods. So, the value-added tax is an increase in prices, undoubtedly. We propose a 5 percent value-added tax which would raise prices by 5 percent. This would be the lowest in the OECD, tied with Japan and Canada. And the reason why it's such a favorable way of raising revenue is that it taxes consumption and not savings. So, for the economists in the room, you know that income is divided between consumption and saving, and one thing that the value-added tax does that the income tax does not is provide neutrality with respect to decisions about saving and consumption.

If you're a saver, you'll be penalized under the income tax, but you won't be penalized under a consumption tax like the VAT, and that's the primary advantage over income taxation.

MR. GREENSTONE: And I think we'd be remiss to move on without talking a little bit about the distributional concerns that people have about value-added taxes.

MR. HARRIS: One of the primary critiques other than the money-machine argument about a value-added tax is that it's regressive. That means that it's a higher burden on lower-income households. Pretty much everyone involved in tax policy agrees that progressivity should be one of our primary goals of any tax system, so when I stand up here and I propose something like a value-added tax, people reasonably make the point that it falls higher on lower-income households. Why? Because lower-income households don't have the opportunity to save very much. They tend to consume most of their income. The higher-income household that does save is not going to be taxes as much under the value-added tax.

My response to that is two-fold. One, it is regressive, but it's not as regressive as you might think. It's mostly a proportional tax. The first 95 percent of the income distribution or so, the benefit comes from the top 5 percent. This is not the optimum way to tax anything, to give people at the top the best. So, what we propose is to help deal with this regressivity concern with a demagrant (?) which is a $450 cash transfer to everyone, for adults, and $200 transfers for each child. This would effectively exempt the first $26,000 of consumption. If you spend $26,000, your net tax burden will be exactly zero. Thank you.

MR. GREENSTONE: On the last panel, I thought Diane made a really good point when we were talking about raising revenue, that there's all these different suggestions were on the previous panel, and then we compare them to this panel. No one really likes more revenue by itself, but you have to think about what would it be instead? And so, I think Adele was going to talk a little bit about her ideas on the carbon tax, and I note in your paper you said that it's arguably the most efficient form of revenue raising, so you must have a mind that's better than some.

MS. MORRIS: Yes, and I'm so glad, Michael, to have this opportunity to sit on the more politically-feasible panel (inaudible). (Laughter). So, you want to compare carbon tax to alternative ways to raise revenue, and we use a couple different dimensions. There's efficiency and equity which we've heard about. On efficiency grounds, a carbon tax stacks up very favorably and here's why. As we've heard, income taxes reduce the net returns to working and saving and investing and these productive economic activities. For example, by putting that wedge between what an employer pays and what a worker gets to keep, right? And that creates incentives. That creates genuine economic burden of raising that dollar of government revenue. A carbon tax, on the other hand, shrinks the wedge. Now what wedge is that? That's the difference between what I pay for fossil fuels, like what I put gasoline in my car, it includes the private cost to produce and market that fuel and a little bit to fund road maintenance, but it doesn't include the environmental damages that come from the combustion gases of that fuel. Right? So, by internalizing those external costs, I'm actually providing more efficient incentives in the energy markets and thereby creating more efficient incentives across a whole host of activities. That's which fuels you use in electricity, fuel economy, energy efficiency, deployment of renewables. And very important over long periods of time, the development of new technologies, because the price on carbon's going to give a market to lower emissions technology, so you don't have to have an inefficient hodge-podge of subsidies for those other technologies.

MR. GREENSTONE: One thing I notice about your proposal, it covers a lot of space, and somehow you snuck in there a discussion of regulations.

MS. MORRIS: Yeah.

MR. GREENSTONE: So, I didn't quite see what that had to with carbon tax.

MS. MORRIS: This package is - I've very carefully structured it to illustrate the kind of deal I think can be made. Right? So, I've got a carbon tax, but it's in the context of a pro-growth tax reform.

MR. GREENSTONE: Is it like a spoiler alert where this is the politically feasible version?

MS. MORRIS: Yeah, yeah. Well, I mean, really. We've heard this a number of times. Anything in isolation can be picked off as, oh, that will never happen. But really, compared to the alternative and put it in a context where there's something for everybody, okay? So, in my proposal I've got a pro-growth tax reform where I'm adding a carbon tax creating efficiency in that market, and I'm using most of that revenue for a permanent reduction in the corporate income tax rate from 35 percent to 28 percent. I've got 15 percent of the revenue reserved to protect the poor, and that's the equity side which I failed to mention earlier. And I'm also combining that with the suspension of the Clean Air Act authority over greenhouse gases, so I'm eliminating that regulatory uncertainty that's clouding investment in the energy sector. And then, if you're worried about trade, I've got a careful collection of policies to address any competiveness issues including carefully tailored border carbon adjustments that protect our industries who are energy intensive and trade exposed. And a diplomatic initiative to make sure that our policy's not unilateral, and in addition, we have that corporate income tax reform that's going to make the American economy more competitive across the entire corporate sector.

MR. GREENSTONE: Thank you. I think there's a lot to unpack there and we're going to come back in a couple minutes. So, next we have Pia Orrenius. Now, Pia, when I was going through the list here, I had to remind myself this is about the budget, and you're writing about immigration. (Laughter)

MS. ORRENIUS: Like when you were able to come up with something, Michael. So, in our plan we confront -- you might, as well. We don't confront the entire immigration policy or immigration system, but we sort of carve away at the temporary-employment base visas, which you might say, well, why are you dealing with that small subcategory of immigration policy? But actually, if you're looking at what impacts economic growth and productivity, the competiveness of U.S. firms, I think that would be one of the first places to start with regard to immigration policy.

Namely, over the last 15 years, let's say, about a third of the growth in the high-skilled labor force has been through the influx of high-skilled foreign workers, so it's a very important system, and more and more over time those workers have been coming in under temporary-employment based visas like H1Bs and not under the Green

Card Program.

So, why do we think that there's room for reform in this particular program? Well, what we start with is we think that the program would benefit from more market forces, so our idea is to create more of a market for foreign workers, and the way we would do this is we would introduce auctions where we would auction off permits to employers to hire foreign workers. And we would have auctions for high-skilled workers which would accommodate the H1B-type workers which are computer programmers and doctors and that type of thing. And then we'd have another auction for low-skilled workers which would accommodate farm workers and other workers coming in at the H2A program or the H2B program, which are seasonal programs.

The benefit would be that these permits would be tradable, so we would say to employers you can come and bid for permits. You can then hire your worker, but then if you change your mind or that worker leaves you, you can sell your permit to another employer. And the important change here also is that these visas for workers that would be brought in under this program would be completely portable, portable between employers that have permits that they've gotten either from the auction or from other employers which have sold them the permits.

There's a lot of benefits. Obviously, aside from generating more revenue, basically this creates a market in the sense that it takes the best and the brightest among the foreign workers and funnels them to the employers that value them the most. This would be natural outcome of the auction, and so it's an important change from the system we have now, which is basically first-come-first-serve, and so it really doesn't take advantage of the fact that when you have more supply, more people willing to come, that you can you can actually pick the best, and that's simply the one that's first in line.

So, we get a more flexible system as well, which will then be more efficient and more selective, which will -- the third thing we thought about too. It would be more transparent, but that may very well doom it, of course. (Laughter) Sometimes I wonder the reason that we have the system we have is because non-transparency actually helps it survive. But that's basically our idea in a nutshell.

MR. GREENSTONE: Can I ask one follow-up question now? There's a lot of talk right now about immigration and an immigration bill. Could this fit into a larger immigration bill?

MS. ORRENIUS: Oh, absolutely. I think it fits in very naturally. The way we are talking about it now is not even to increase the number of employment-based visas, but just to take the existing programs and funnel them into this option system, which has so many benefits except for immigration lawyers, of course. (Laughter) But aside from the immigration lawyers, everyone else benefits, the way we see it. So, we're not even advocating for controversial things like increasing H1B visas or increasing H2A visas, but rather just accommodating what's going on now in a more efficient and flexible system.

MR. GREENSTONE: Thank you. Next we have Phil Swagel. So, Phil, I was trying to think of a way to introduce your proposal, and so it struck me there are at least two views about the housing market. The first is that the federal government has got to get out of the way, and the whole problem is that the federal government is involved. And the second view is that there's nothing more important or central to identity in America than the ability to own a home. And so, the federal government's got to be right in the center of those two. And I think what you've done is you've found some space between those two views. So, is that going to make everyone hate you or (laughter) how's that going to work?

MR. SWAGEL: No, I think that's a good way of doing this is I'm trying to balance both sides; that housing's important and there's a government role for it, but we don't want taxpayers at risk from too much of a government involvement in housing.

So, in substance, I look at the problem with housing finance system that the government is dominating it, and private capital is not active in allocating capital. So, that's one problem. Another problem, and this is where the panel comes in, is there's about $20 billion with a "B" of profits every year being generated by Fannie Mae and Freddie Mac, the two firms under government control. And sometimes there's a paradox that those funds haven't been noticed and spent. Right? I mean this is kind of old fashioned, but when I was in the government, the administration would do an annual budget and it explained, well, here's the revenue and here's the spending. No, we don't do that anymore, I guess. But one could imagine if there were an annual budget from the administration, that that could say, look, here's $20 billion in revenue, and we want to use it for this and this and this. And you might worry that we're going to build high-speed rail and, you know, things that might not be super-effective, which is why I like Tyler's proposal because it seems much more effective.

MR. GREENSTONE: It might be worth noting that both Phil and Tyler worked in the Bush administration.

MR. SWAGEL: So, he's just more polite. So, this is what I would like to do is get the government to back away from allocating capital, have the private sector come in and allocate capital. It will better protect tax payers, but I think importantly also, it will open up access to mortgage financing. Right now, it seems that we have unelected official, not even a political appointee, deciding basically who gets a mortgage. I think Edgemark has done a great job, that's not the roll. He doesn't want that role.

If we have private capital come in and decide which potential homebuyers to take risks on, I think it's better for everyone. And if there's some provider of private capital who wants to take a risk and put up their own capital, we should find a way in the housing finance system to let that take place. So, that's really to try to balance stability from the government role against the better incentives from private capital and the better access, I would say, from having private capital make the decisions on housing.

MR. GREENSTONE: So, where does the $130 billion come from?

MR. SWAGEL: So, the $130 billion is the potential revenue for the government from selling off Fannie Mae and Freddie Mac. There is a huge number of issues, but the paper goes through a calculation, a very simplified calculation, of what the cash flows in and how that translates into the $130 billion odd revenue for the government. And one point I make is that sometimes the tension between maximizing the government revenue and good housing policy. Right? That you might say, well, the government should just be a monopolist. Right? And we know monopolists make good profits. That's probably not what we want for housing policy because we want competition in housing origination. We want lenders to be competing with each other to make loans to people. We see the effects now where originators have backed out of housing, and some borrowers face very high interest rates who don't have access. So, that's one of the tensions that I explore in the paper is between revenue and the market structure.

MR. GREENSTONE: Thanks. So, I thought we'd play a little game for the next part of this, and one thing I love about each of these proposals is that the government really is going to need more revenue, I think, going forward, and we have to be serious about finding new ways for that revenue. But I wanted to hear who is willing to make the case that theirs, among all these worthy ideas, was the most politically feasible?

MR. SWAGEL: I could. I mean, I think housing finance is one of these issues where both sides are in the way. Right? This is how the housing finance system works for many people, and so from the administration's point of view, well look, it works, don't fix it. It's not broken. Of course, we all know that many people don't have access to housing finance.

On the other hand, if you read my paper you'll see that I'm proposing a new government backstop. Rises in yet another bailout, now I would say let's formalize the government role in order to shrink it, but obviously from the right, the idea of formalizing a government role is not attractive, so it's really both sides, I think, are in the way.

MR. GREENSTONE: And I should add, if you think someone else's proposal is more feasible, (laughter) you can advocate for that one.

MS. MORRIS: I want to make one case for a carbon tax and that is when people express concern about the political feasibility in a carbon tax, the implicit assumption is that the alternative is no-climate policy. Well, that's not the alternative. The default is the regulation of greenhouse gases under the Clean Air Act, which was never designed for the kind of pollutant that we have with greenhouse gases, and that's going to be a protracted, messy, long promulgation of regulations and state-implementation plans and litigation, and it'll be 10 years before we actually see something take effect. And all that time, we've got investment uncertainty and really a dangerous delay in serious action on climate policy.

So, I think even if you don't even care about the climate, you don't even think it's a problem, you've got the Supreme Court supporting the President's authority to regulate under the Clean Air Act, and he says he's going to do it. So, that's a very credible threat, so get your market-based environmental policy while you can, and do it in the context of fiscal reform where you can have a program with tax reform at the same time.

MR. GREENSTONE: That was passionate. (Laughter)

MR. HARRIS: Let me just add that that is perfectly politically feasible, and how do I know? Because it's been done 150 times before in other countries. The only countries that don't have VATS are a few countries in the Middle East and a few island nations. Everyone else has seen the benefits of the VAT and put it in place, and that's not a reason to have a VAT. It's okay to be different. The reason to have a VAT is because we need revenue. We're in a fiscal crisis and from where I sit, there are really only three options for getting out of this fiscal mess if you think that revenues need to be part of the solution.

One is the VAT, another is the carbon tax. Another is the one that Diane proposed when she was up here before is limiting tax expenditures in some broad way.

Beyond that, these are some good ideas but they don't really get to the magnitude of the problem with our fiscal shortcomings. So, is it politically feasible? I think so. We've seen it happen in other countries, and it's one of the only solutions to the fiscal mess we've gotten ourselves into.

MR. GREENSTONE: So, you're giving up on American exceptionalism?

MR. HARRIS: (Laughter)

MR. GREENSTONE: Pia, do you want to take a stab?

MS. ORRENIUS: I can give lots of examples of why the current system is wrong, I guess. I don't know if that's going to convince the lawmakers or not, but for example, we had a joint conference with the Bush Institute and the (inaudible) said in December and there was a woman from Oracle there, and she was saying just how many unfilled vacancies they have at Oracle every month. It was something like 3,000 positions go unfilled month after month because of the lack of H1B visas, which obviously, there's not enough to go around. And then she also said that even when they're allocated, even when they put in for H1B visas, and say they put in for five, and they maybe just get one or two approved of those. Then they don't get to pick, of the five workers they wanted to sponsor, they don't get to pick the best ones, the ones they truly most wanted out of those five, but just whoever the government decided to process first is the one that they get. What a terrible outcome, and how easy to fix?

MR. GREENSTONE: Do you think there's any lawyers who are able to get their clients in the front of the line?

MS. ORRENIUS: I suspect so. If you look at what they charge (laughter), but yeah, so we have to sock it to the -- no. (Laughter) But there's definitely lots of middle men in this area, so I think one benefit of a more transparent system that we're proposing with the auctions, I just think one really good outcome is that you eliminate a lot of middle men.

MR. DUVALL: Can I put a plug in for mine?

MR. GREENSTONE: Yeah, please.

MR. DUVALL: So, mine is the only one that is actually happening, so we've got, in the last 5 years, six states in the United States have opened up these facilities, and so the real question is can we go faster and more comprehensive? And can the federal government basically drive that more aggressively than it is? And the other thing we've got, in addition to successful experiments with the technology, is we've got really popular experiments, so the public opinion polling on all of the experiments that have been done to date are 75 to 90 percent public support.

Now, before you do this, it's very hard to explain what it is because people can't experience it. And the Swedes, they're one of the more fascinating public policy experiments of all time when they, basically, around Stockholm, drew a cordon, effectively, to charge people to go into downtown Stockholm, and they basically said, all right, let's do it. Literally cleared up the congestion overnight in Stockholm. We're going to do it for 7 months. We're going to take it down. We'll let you experience life as it was before, and then we're going to have you vote on what you want. (Laughter) Public support at the time the rolled it out was 10 percent. The time they voted on it, 61 percent, and they kept it, and they threw out the government that put it in at the same time. (Laughter)

MR. GREENSTONE: You said it started to sprout up in the U.S. Is that just on existing roads or has it effected the placement of infrastructure?

MR. DUVALL: Yeah, so one of the big --

MR. GREENSTONE: I think it seems to me a big part of --

MR. DUVALL: A big part of the political challenge is touching existing facilities, so the experiments to date have been squeezing out capacity in existing corridors, shifting HOV lanes. On I-95 in Miami, for instance, they restriped it. The most congested stretch of I-95 -- if you've been down there, you can now go free-flow for about 20 miles on that road, when before you were literally dead stopped. Now, they took existing capacity only to the extent of the HOV lane.

The first ever, though, conversion of an un-priced road took place in Seattle about a year and half ago, the 520 bridge, which basically connects Microsoft's headquarters to downtown Seattle, and Microsoft was a big proponent of this, and basically converted. Now you can go free-flow from Redmond to downtown Seattle every day. And what's great about these experiments is they are being sold to the public correctly as performance experiments, not simply revenue generators.

MR. GREENSTONE: Thank you, Tyler. One thing, I just want to return to Adele's proposal. Now, the thing is that it is global climate change, and so one criticism people often have of these kinds of policies are that if we just do something, but if China and India don't do anything, who cares? We're still going to have climate change. And one of my favorite climate change facts: they have now had to introduce new colors on the weather map in Australia after this summer to get to the high level. So, my question is, is this really going to help with global climate change? And why might it or why wouldn't it?

MS. MORRIS: Well, certainly as the largest historical emitter, the U.S. has a responsibility here. Even though we're not currently the largest single emitter, we happen to still be second-largest emitter. And really, everybody's eyes are on the United States.

It is a necessary condition for countries around the world to take serious action on climate change that could eventually lead to the stabilization of these gases in the atmosphere. It's not a sufficient condition, so my proposal includes a vigorous diplomatic aspect. We need to leverage our action into action by other countries. I've got a separate paper where I elaborate how we could instigate a carbon-pricing dialogue with other countries to try to encourage action that analogous to ours, and mutually ramp up our ambition over time in a way that really will lead to global containment of this serious risk. But you're absolutely right. The U.S. can't do it by ourselves, but look, if we don't do it, nobody's going to do it.

MR. GREENSTONE: Do any of you have questions for each other, or I'd be happy to open discussions to the floor?

SPEAKER: I have a question for you, Adele.

MS. MORRIS: Sure.

SPEAKER: So, being in Texas, I hear a lot about energy although I'm not an energy economist, so I guess the premise of the question is not all carbon is created equal, I guess. So, why am I saying that? Well, I'm alluding to, for example, now that the oil prices are so high and natural gas prices are so low, natural gas rigs are being shut down and drilling is going down in terms of natural gas production, and oil production is rising. And the interesting thing is when I saw these carbon emissions were the lowest I think they've been in 20 years, looking at the first quarter data or the data that just came out for last year, and the explanation that was given was that this is really because natural gas is so cheap, and it's used in electricity production, so now less coal is used. So, natural gas has actually contributed to declining carbon emissions. So, can you comment?

MS. MORRIS: Sure. The good news is actually carbon is all created equal, so if you price carbon, you're going to give everyone the incentive to switch from coal to natural gas because more of the BTUs of natural gas come from hydrogen than in coal. Right? So, what you're doing is creating all the right incentives across all the potential energy sources to back out of the most polluting ones and move into the less polluting ones, just according to their cost effectiveness at reducing those emissions.

Now, what you point out is a great lesson for us. That demand slopes downward. Right? So, when natural gas became cheaper, we started using more of it. That means that when carbon becomes more expensive, we're going to emit less of it, and we've seen that time and again across the energy economy. Prices matter, and they particularly matter over long periods of time because one of the drivers of the new technologies that have brought natural gas prices down were high natural gas prices. Right? So, that tells us that when carbon's more expensive, those technologies that reduce carbon are going to become a lot more attractive to investors and consumers, and that's exactly what we want for the cost-effective addressing of this environmental problem.

MR. GREENSTONE: Phil, did you have a question?

MR. SWAGEL: No.

MR. GREENSTONE: I just want to come back to your proposal before we open the floor. So, you think with the reform you're suggesting, it's going to increase access to the housing market for people? Can you just explain that a little bit more?

MR. SWAGEL: Sure, sure. That's a good question. There's going to be two effects. So, one is having more private capital will likely raise mortgage interest rates. Right? That's a consequence of protecting tax payers is to raise mortgage interest rates, so that will reduce access in a sense, but right now there's a hard cutoff. There's some people who just cannot get a mortgage so the channels by which private investors can take risks on certain borrowers are just cut off. And that's what I would open up by having both the government backed mortgage sector and then one in which there's no government role. And to have those side by side, the so-called private label securitization and in that channel, private investors could take risks, and that would increase the access for mortgage financing.

MR. GREENSTONE: Okay. I think we should open the floor to questions. There's a question there in the back.

MS. YALADI: Hi, my name's Yolanda Yaladi and I'm a recent graduate from Swarthmore College, but I currently work in D.C. And my question is directed towards Benjamin Harris and it's about the VAT. And even though you said that across-the-board VAT shouldn't change anything on the consumer side in terms of savings and purchasing, some people have expressed a concern that it may cause undue burden in terms of compliance and production, so I was hoping you could speak to that.

MR. HARRIS: That's an excellent question. In the last panel, someone also stood up and asked what about state and local governments. These are kind of related and let me explain how. Forty-five out of 50 states, plus 9,000 local governments, currently use a retail sales tax, and the tax system is a mess. Raises revenue but it's a mess. States have to comply with different tax bases, different tax rates. There's a fair amount of evasion, and most importantly, one of the worst things about it is that there are business-to-business taxes which shouldn't happen. So, when a business purchases an input from another business, it shouldn't be taxed in the retail sales tax but it is. In fact, about 40 percent of the retail sales tax revenue comes from business-to-business transactions, and this is not -- I mean it sounds like it's sort of an esoteric concern. It's not. It raises the cost of business investment. It raises the cost of doing business, and it makes businesses less competitive.

So, your question about compliance and administration, I see the VAT as an opportunity. It's an opportunity to harmonize all of these various state and local taxes into a single unified value-added tax. And this is an enormous task. States don't want to do this, but it might be good for them.

When Canada went ahead and put the value-added tax in place in 1991, over several years it gave states the opportunity to harmonize under the existing value-added tax and -- not states, provinces -- and many provinces did. Some did, some didn't, and for those that did, it ended up being a pretty good experience. It wasn't without its growing pains, but basically what happened was that these provinces that chose to harmonize went ahead and had the exact same tax base as the federal system. The federal government collected taxes on behalf of the provinces, allowed them to choose their own rates in a way that would suit their own needs, and then distributed it back to them. So, this is a real opportunity to take away, not just the administrative burden from states, but also the compliance burden for American businesses that are forced to comply with this incredibly complex web of retail sales taxes.

MR. GREENSTONE: There's a question here.

MR. VANDENBERG: Hi, I'm David Vandenberg from Tax Analysts. This question is for Adele. Can you talk about how the case for a carbon tax is different, stronger, or weaker on tax policy grounds versus energy policy grounds?

MS. MORRIS: One of the great things about a carbon tax is that it is a two-for. You get more efficient tax policy, and you get more efficient environment and energy policy. And really, there's no shortage of distortionary tax instruments, and there's no shortage of inefficient environment policies. What we have right now is the prospect, like I said, of Clean Air Act regulation. We also have assorted dogs and cats and various subsidies and tax credits and loan guarantees and grants and federal procurement of this and that. On the environmental side, and frankly, economically, it's not very rational as a way to promote clean energy. So, the chances here are to kind of rationalize both sides of the coin, and have an efficient revenue instrument that also allows you a more efficient way to address your environmental goals.

MR. SWAGEL: I would just add the same thing. Adele and I were colleagues at the Treasury and worked on these issues together before she moved to Brookings. In some instances, I think the policy will go forward when it can be sold on both sides. Like this side says, okay, we're saving the planet, and this side says we're lowering taxes and boosting growth. And somehow, we need a double-sided paper. (Laughter)

MS. MORRIS: That's right.

MR. WALKER: Barrett Walker with the Walker Foundation. I just read that China has proposed a carbon tax. Will that change anything in this country?

MR. GREENSTONE: Isn't there the famous quote that, "I don't remember any Chinese official having a vote in U.S. Senate?" (Laughter)

MS. MORRIS: I'm glad you asked that question because one of the continual arguments we've heard against serious climate policy in the United States is the lack of analogous policy in our major trading partners and major developing economies, in particular. So, I strongly believe the U.S. should say, all right, you want to talk about a carbon tax? Let's discuss. And we're in the middle of a very important fiscal discussion. You guys have your own issues with air pollution and things you need to deal with on the revenue side. Let's have a multilateral conversation about how we can all move together, and I would love to see the U.S. welcome the signals by the Chinese that they're interested in pricing carbon. And I've been, frankly, disappointed that we haven't heard more from the U.S. and other parties to the Major Economies Forum welcoming those kinds of statements and saying let's get together and let's talk about this because there are more and more countries now that are pricing carbon at the federal level and at the sub-federal level. And I strongly believe that's an opportunity for us to get together to discuss this issue and move forward together because it does, as you said, Michael, it is a global effort and it is important that we all move together. And as we've said, we need that moving together for our own domestic reasons, to give people comfort that we're not unilaterally disarming our economy.

MR. GREENSTONE: There's a question right there.

MS. SPINNIS: Hi, Nancy Spinnis with Executive Intelligence Review. I'd like to go back to the big picture for a minute, and the crisis that we're dealing with, and here on the fact that we had a financial blow-out in 2007, and the crisis is worse now because we're subsidizing massively the very banks that brought that crisis about in the first place. The solution that's been put on the table by many economists including the former Kansas City Fed head, Thomas Homey, including now Sandy Weill, including my organization, and (inaudible) and including many others, is glass starts with cutting that obligation, cutting the bail-out. It will really help our finances.

MR. GREENSTONE: You know what I think? I remember you asked a question earlier today. I think we had a chance to discuss that that excellent question.

MS. SPINNIS: Only one person answered Glass-Steagall and I would appreciate if they would.

MR. GREENSTONE: I think given all the other people in the room, it's probably unfair to them to ask the same question twice, so why don't we find a second person we can ask a question of. Over here.

SPEAKER: Hi. I'm (inaudible) with the National Small Business Network. Adele, you've talked about using the money from the tax on carbons to reduce the corporate tax rate. Most small businesses are passed through entities, and they pay their taxes at the individual tax rate. Would you be willing to adjust your recommendation to include special tax rates for these individuals who are paying their taxes at their individual rates?

MS. MORRIS: Well, you bring up a good question about double taxation of capital income, and right now we have capital taxes on the corporate side. We also tax a second time dividends and capital gains on the personal income side, so there could be a case to be made to make some of the adjustments on the corporate income tax rates and some of the adjustments on the capital income side of the personal income tax, and I think that would get at the kind of folks you're talking about. I think there's a good case to be made to making this tax what on the capital income side, whether you do it just on corporate or you do it on capital income in the personal income tax because those tend to be the most distortionary taxes, and I think you're getting your most pro-growth tax swap with that capital income tax reduction. But yeah, there could be a variety of formulas one could use of how exactly you structure that capital income tax reform.

MR. GREENSTONE: Okay. I think there's a question here, and maybe we'll have time for one more after that.

SPEAKER: Mine's very quick. It's for Pia. On these H1B visas, they are randomly distributed which I see is a big disadvantage. But a lot of them are distributed to companies in the creative industries that are much lower paid. So, one consequence of what you put in place is that all of them will go to people in technology and higher paying fields. And people like chefs, designers, artists, who now get randomly distributed some, they'll no longer be access and it will sort of change the flavor of some of those industries.

MS. ORRENIUS: Well, you raise an excellent point, and that's been a criticism of our idea is that small businesses, non-profits, and lower-paying industries are the ones that would really come up short in this system, and I think some of that criticism probably rings true in the sense that we expect it was going to buy us toward the big paying firms like Microsoft and so forth, Oracle, high-tech industries that pay more are going to bring in also more productive workers. And, of course, we do propose a solution for non-profits because we say have them bid, you know, because they bring in obviously important stem workers that work in research and development and so forth, so have them participate in the auction, and then the government can rebate some of the fee to them so they're not paying the full price. And I don't know, maybe you could come up for a scheme like that for small business. I don't know.

I mean, you could probably divide -- the good thing about the auction is it's very flexible. Really, you can change the number of people that you're bringing in, change what the prices firms pay. It's very flexible and it's transparent. It would really -- it can accommodate many different schemes.

MR. GREENSTONE: Pia, wouldn't you be able to hold separate -- if people thought that there was not enough chefs, or not enough of NBA players or something (laughter), couldn't you hold separate auctions in each of those categories and meet whatever political objective people have?

MS. ORRENIUS: I guess. I mean, we also argue that this would be a more simple system, so (laughter). I think Madeline wants to take this question. She's going like this. Cut off Michael's head. Oh, bad question. Bad suggestion. Bad suggestion.

MR. GREENSTONE: Okay. I think we have the final question here.

SPEAKER: This question relates to the last question and extends it to the VAT and the carbon tax. The real problem that often seems with any tax system is the human desire to decide that certain activities are more desirable than other activities. In England you have a VAT with some several thousand different rates, depending on what it is you're buying. In the carbon tax, why a carbon tax rather than an energy tax? Because you value carbon emissions more than you value the reduction of energy, and we just heard why you don't even want to discuss having multiple auctions for multiple skill sets. But what really can you do about that in terms of rational tax reform that will stop making unwise choices since the power to choose is also the power to have unwise choices?

MS. MORRIS: Let me go directly to that because this is why I proposed a carbon tax. Because it goes straight to the market failure. What is it that's creating the damage? It's the buildup of CO^2 and other greenhouse gases in the atmosphere. There's no reason, from a climate perspective, to care whether you use solar or wind or electric cars or what have you.

SPEAKER: (off mic)

MS. MORRIS: Well, exactly. So, my proposal would create an environmentally neutral playing field. Say, if you can reduce carbon, whether it's nuclear or solar, duke it out and let the market decide what the most cost effective way to reduce emissions is. In my view, the government doesn't need to take a position on it, and in fact shouldn't. You fund basic research but then let the market determine which of those technologies are going to be most cost effective. That's not a comparative advantage of government, frankly, is determining these winners and losers. Let the market do what it's good at and fix the market failure with the tax.

SPEAKER: You've already started with the determination that energy sources that use carbon are not as good as energy sources that don't emit carbon, and that's a decision. And it might even turn out to be an unwise decision (inaudible) a hundred years to figure it out.

MS. MORRIS: It's a well-documented scientific result. It's not my opinion.

MR. GREENSTONE: This is an economic spin. I think your question is well suited for a scientific panel, where I think that there seems to be some consensus in (inaudible) so I think we've probably run out of time at this point.

MR. DUVALL: Can I ask Pia one real quick question?

MR. GREENSTONE: Tyler's got one question.

MR. DUVALL: In a scenario where the government controls the supply, like in some regulatory mechanism, is there concern that, obviously, that supply constraint will produce more revenues that they will then realize what's actually continued to constrain the supply even though the market would dictate further? I mean, do we create a perverse incentive on the supply side?

MS. ORRENIUS: Yeah, I think it -- right. I mean, but you also have a responsibility vis-à-vis employers, I think, and I think we also talk about you really don't want these permit prices to fluctuate too wildly because you really want employers to be able to count on being able to bring in the workers that they're accustomed to or that they need and so forth. So, I think the government is going to have the incentive vis-à-vis employers and voters and stuff like that to be, you know, take advantage of that to set prices too high.

I have a question for Ben. So, VAT, when I go home to Sweden, my -- well, when I visit my family in Sweden, they have a VAT, of course. I think it's 25 percent on almost everything. I guess one criticism is I always thought was that one nice thing about the sales tax here is that you see it everywhere. So, I tell my kids, look this is the tax you're paying. So, when you -- the VAT is sort of an invisible tax. How do you --

MR. HARRIS: That's a concern that's often raised. The VAT can be an invisible tax or it can be a transparent tax. Some countries do print the VAT paid on every receipt. And, in fact, in these cases there's no more transparent tax than having a tax that's literally handed to you every single time you pay it. In our proposal we said, yes; make it a transparent tax like some countries do. Not like Sweden, if Sweden doesn't. Make it like the countries that tell you every time you pay it, and I'm happy to argue that there's no more transparent tax than a value-added tax properly designed.

MR. GREENSTONE: Okay, let's just step back for one moment; appreciate everyone who's been here through all 13 proposals. I had the idea that everyone should be awarded an ice-cream sandwich at the end. I was outvoted on that idea. (Laughter) Karen Anderson will be fielding questions about that at the end of this.

So, I thought we should close just by highlighting kind of what these five authors did which is kind of amazing. These five authors all have policies that are, in principal, if implemented in the way they've outlined can contribute to budget consolidation, which is absolutely necessary. And at the same time, increase savings, get rid of carbon, build the right roads, get the right workers here, and allow people who can't get mortgages currently, although they are capable of paying their mortgage, to be able to take out home loans, so I think you can join me in congratulating these authors.

(Applause)

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