

THE BROOKINGS INSTITUTION

A Joint Brookings Institution Hamilton Project – New Republic Briefing

ECONOMIC SECURITY IN A CHANGING WORLD

Friday, September 15, 2006
4:00 p.m. - 5:30 p.m.

The Brookings Institution
Falk Auditorium
1775 Massachusetts Avenue, N.W.
Washington, D.C.

C O N T E N T S

Panel 1: Hamilton Project Forum on Economic Security and Economic Growth

Moderator: Peter R. Orszag, The Hamilton Project at the Brookings Institution

Panel Presentation:

Jeffrey Kling, The Brookings Institution
Howard Rosen, Trade Adjustment Assistance
Coalition; The Institute for International Economics
Jacob Hacker, Yale University

Panel 2: Can We Increase Economic Security Without Harming Economic Growth?

Moderator: Franklin Foer, The New Republic

Panel Presentation:

Jacob Hacker, Yale University
Brink Lindsey, Cato Institute
Peter R. Orszag, The Hamilton Project at the Brookings Institution

Panel 3: What Single Policy Change Would Best Promote Broad-Based Economic Growth?

Moderator: Glenn H. Hutchins, Silver Lake Partners

Panel Presentation:

Kevin Hassett, American Enterprise Institute for Public Policy Research
Robert Kuttner, The American Prospect
Gene B. Sperling, Center for American Progress

Panel 4: Economic Security in a Changing World: A Discussion

Moderator: Jonathan Chait, The New Republic

Panel Presentation:

Roger C. Altman, Evercore Partners
Peter R. Orszag, The Hamilton Project at the
Brookings Institution
Robert E. Rubin, Citigroup Inc.
Laura D'Andrea Tyson, London Business School

* * * * *

PROCEEDINGS

MR. ORSZAG: Good afternoon. My name is Peter Orszag. I am a Senior Fellow here at the Brookings Institution and I direct The Hamilton Project.

We are here today to discuss a crucial topic, why and how to provide more economic security to American families in a growth-enhancing way. As you are going to hear later on today, the probability of a 50 percent or greater decline in family income has more than doubled since the early-1970s, rising from 7 percent then, to 17 percent now. So it is not at all surprising that in combination with stagnant real incomes and much more volatile incomes, that American families are not feeling so great about their economic well-being.

The problem is not just that economic insecurity harms American families' well-being, but also that it impairs growth. In particular, providing a core level of economic security makes it more likely that American workers can cope productively with the temporary setbacks that are an inevitable part of a dynamic economy. Most importantly, it diminishes political demands for growth-reducing policies like protectionism or other steps that would stop the process of ongoing growth.

How do we go about providing that additional economic security? We are releasing today a strategy document from The Hamilton Project that I co-authored with Jason Bordoff and Michael Deich which lays out a vision for how to provide economic security in a growth-enhancing way, and it focuses on two major components. The first is better preparation before adverse events happen, and the second is more pro-work and market-friendly assistance after bad events occur.

In that first category of better preparation ahead of time, the two major

components are education and saving. Education is not only an investment in a more productive future, but also a form of insurance, because better-educated workers are able to adjust more flexibly to the exigencies of life. And saving provides a buffer against which one can draw upon should bad things happen. The Hamilton Project has already released discussion papers on both of those topics, and it will be releasing more proposals in those areas in the future.

Today we are also going to be releasing some new discussion papers on the second component, ways of providing assistance after bad events occur. The United States has long relied on unemployment insurance as its one primary form of such assistance, and other forms of social insurance including the disability insurance program and others also exist. In evaluating that kind of ex post or after-the-fact assistance, one needs to carefully balance the benefits of additional security, the ones I also described, and the potential incentive effects from reduced work effort or other things that could occur if you provide too much assistance or provide it in the wrong way.

So the proposals that you are going to be hearing about later today try to reach that balance between providing an adequate level of security to promote growth, and avoiding significant disincentives that could impair it. Too much of the debate in Washington and elsewhere has just been about the disincentive effects, not enough has been about the benefits of providing some degree of economic security from the perspective of promoting economic growth.

What we are going to do today is first have a panel releasing three new discussion papers, and I will introduce those folks in a moment. Then we are going to turn to a joint symposium with The New Republic to discuss those proposals and the broader topic of economic

security and what we can do about it. What we are trying to do here is very much in the spirit of The Hamilton Project, both releasing specific discussion papers for debate, and I want to emphasize that those discussion papers are intended for debate and to spur discussion, they do not imply a full embrace necessarily by all the people associated with The Hamilton Project.

The second is to sponsor important discussions about the topics of the day, and that is where this symposium with The New Republic comes in. We are particularly pleased to be co-hosting that with The New Republic, and I think Frank Foer, the editor, has a few remarks.

MR. FOER: Thanks so much, Peter. When we talk about economic anxiety, I think we also have to concede that we are at a moment of some creeping intellectual anxiety, at least for those of us who reside in that narrow sliver that identifies itself as the center-left, that we are at this moment when a lot of fundamental assumptions that once seemed bedrock to us now appear at least a little bit less certain. There is no doubt that the contours of this last recovery are unsettling and that the data should at least lead us to take a hard look at some of our theoretical assumptions about economic security and about economic growth.

At The New Republic, we have begun to engage in this reconsideration. Over the course of the last few months, we officially recanted the piece we published by Betsy McCaughey Ross against Hillarycare, and we have endorsed a form of universal health care. We have been publishing essays by Jacob Hacker, who you will hear from on several of the panels, and we will be co-publishing with The Hamilton Project some of the papers that Peter just described.

I am so pleased that the magazine could be associated with The Hamilton Project

which is doing the hard analytical work of rethinking assumptions and rethinking actual policy, and they are doing it in a spirit of what seems to me to be complete intellectual open-mindedness. And I am so pleased to be associated with them and very privileged that we can share the stage with so many people that I admire. Thanks.

MR. ORSZAG: We are now going to turn to our first panel which will discuss three specific proposals that, again, have to do with ways of providing more assistance to workers when bad things happen. I want to just for a moment contrast the kinds of things that you are going to hear now with an alternative approach that involves direct market interventions—basically trying to stop the bad things from happening in the first place, which the evidence, for example, from Peter Lindert at U.C. Davis and elsewhere suggests really does have a direct and adverse consequence on economic growth—with a more market-friendly kind of approach to deal with the events. That is what you are really going to hear about in a moment.

We are releasing two different discussions on the same topic, unemployment insurance, and that is intentional. It is supposed to signal that we are really trying to spur debate on important topics, and certainly, reform of the unemployment insurance system—which was designed in the 1930s when the labor market was a lot different than it is today—would be justified as one of those important topics.

You are going to hear two different visions, first from Jeff Kling, who is at Brookings, and the second from Howard Rosen, who is at the Institute for International Economics, about how we should move from the system that we have now, which I think is widely seen as having flaws, to different visions of where we should be moving toward.

Then you will hear from Jacob Hacker, who is at Yale University and is the

author of a new book, *The Great Risk Shift*, who has done a lot of work documenting the increase in family income volatility, who is proposing a new program of catastrophic income insurance called universal insurance. He will describe that in more detail, both the concept behind it and some of the details associated with it.

MR. KLING: Thanks, Peter. As I think everybody in this room probably knows, the dynamic forces of innovation and competition not only fuel the growth of the American economy, but they also cause turbulence. Over 57 million new jobs began in 2005, and 54 million ended, and there were 20 million involuntary job losses. You will be hearing much more from my fellow panelists about how public policy has not really kept up with changes in the labor market over time, but I will just highlight two key facts here.

One is that about one-quarter of permanent job losers had wages that were at least 25 percent lower than on their previous job, and about a third of involuntarily displaced workers had lower wages over the subsequent 10 years. So these are the kinds of subsequent economic shocks from which families would like to have protection.

We have a public policy in place, as Peter described, we have unemployment insurance where individuals typically receive up to half of their previous weekly earnings for up to six months after a layoff. However, the system encourages layoffs because employers do not bear the true costs. The receipt of U.I. benefits encourages longer unemployment spells, and U.I. provides payments to many people with short unemployment spells who will be reemployed at higher wages and does not target the resources of the system to those who were hit the hardest by job loss.

The proposal that I am going to discuss today is explicitly designed to be

budget-neutral, and I project that it would have several important benefits. Currently, only one-third of the system's resources go to those who have long-term wage losses, so the resources are not really going to the places where people need them the most. The proposal that I am going to describe would increase the share to 61 percent.

For those with wage losses, it would cut in half the share with very large drops in hourly wages. The increased incentives for finding new jobs would reduce unemployment durations 5 to 10 percent, and the allocation of benefits could be made more progressive by increasing the share of benefits going to the lower half of the income distribution from 43 to 54 percent.

How do you get these kinds of benefits that I am describing? As part of this reform, the government would create a program of wage loss insurance for reemployed workers that would be available after any permanent job loss. To give a concrete example, if you had someone who lost a \$14 an hour job and they took a new job at \$10 an hour, then the wage loss insurance would cover one-quarter of the loss, or a dollar an hour in this case. To target to those most in need, the benefits would be focused on those who have new jobs earning less than \$15 an hour, and the duration of payments would depend on work history of the individual, the persistence of the job loss, and they could be made for up to six years for somebody who had been working full-time.

As a complement to wage loss insurance, traditionally U.I. payments would be replaced by withdrawals from temporary replacement accounts, or TRAs. Eligibility for and withdrawal amounts from TRAs would be structured to provide the same ability to maintain living standards as does the current U.I. system. TRAs would provide a mechanism through

which workers could voluntarily accumulate savings prior to unemployment and to borrow against future earnings if they exhaust those savings. Loans from the accounts could be paid back through withholding from future paychecks.

The payments from firms would be tied more closely to the firm's layoff history, reducing incentives for temporary layoffs, and tax rates would be lowered and collected from a broader tax base.

This reform built around wage loss insurance and TRAs would be a fundamental shift towards insurance for persistent, long-term effects of job loss, and the core principle is smaller short-term needs can be met with savings, borrowing, and repayment, so that funds for insurance can be targeted to assist those facing larger, longer-term losses. The proposal would continue to provide access to funds needed to maintain living standards after job loss for those experiencing short bouts of unemployment, and provide a greater share of benefits to lower-income workers. The new system would also incentives to reduce unemployment, both discouraging temporary layoffs and creating stronger rewards for finding another job quickly, ultimately enhancing economic growth.

I will stop there and go to Howard.

MR. ROSEN: Good morning. First of all, I want to thank The Hamilton Project for including our paper in their project.

I was thinking about this this morning, the last time there was any kind of significant discussion of unemployment insurance was actually 10 years ago, when Janet Norwood released the Commission Report. No one followed-up on that report, and there has virtually been no discussion of this issue over the 10 years. I think it is very necessary to have

this discussion, and so I commend The Hamilton Project for including this topic in the issues that they are addressing.

At this point in the economic recovery, I think there is a very interesting question, and I would say that I also had this question 10 years ago during the 1990s recovery, which is, if we are doing so well, why are workers so anxious? People may say how are you coming up with that question? What is your evidence of that?

The one piece of evidence, and there are a lot of others, but the one piece of evidence actually harkens back to what Peter said, which is that we are finding it very difficult right now to move ahead on a liberal trade agenda during a period of economic growth. If we cannot do it now, imagine how difficult it is to do it when the economy is not cooperating with an agenda for liberal trade. So this really should make us kind of humble and make us kind of humble and suggest that there is something going on.

What helps us explain this dichotomy that we are doing so well, but yet workers feel so anxious? The first is what Jeff has just said, which is there is a considerable amount of turnover in this economy, and it is looking like it is a lot more than we imagined. The story that we get every month on the net increase in employment and the unemployment number is basically irrelevant these days in telling us about what is going on in the labor market. It is these data on establishment behavior that are really what is important. To bring it very much at home, on average 1 out of 5 people in this room today will either change a job next year, begin a new job, or lose their job, or all of those things, so it is very encompassing around the entire economy.

The other thing is, as has been mentioned, there has been major changes in the

labor force, probably the most important changes in the labor force in the last 100 years, which may help explain this dichotomy between why the economy can be doing so well and workers continue to be so anxious. What are some of those changes? I am only going to focus on three of them.

The first is we are inundated with the news that the unemployment rate has been falling, but yet no one has been talking about the fact that the duration of unemployment has been increasing. That is the number-one piece of evidence. The second is that we see that there has been a delinking between the incidence of unemployment and the business cycle, and we are seeing, therefore, that unemployment has been much due to structural factors than the cyclical factors. And again, this is a major change in the labor market over the last couple of years. And the last thing is that we find a convergence of state unemployment rates, which means that this is a national phenomenon. This is no longer the Northeast versus the Southwest; this is a national phenomenon that is going on.

To put it in very clear terms, a lower percentage of the labor force may be getting unemployed, but the costs to those people are higher now than ever before, and the probability of any one of us becoming one of those unemployed is also much greater.

This graph shows the duration of unemployment across business cycles, and you see two things. One is the duration continues to rise after the business cycle peaks; and number two, that over time it has been increasing.

This is the convergence of state unemployment rates, as I mentioned before, this is the standard deviation between the states, and there is a really very clear trend that it is declining, and although there are fragmented labor markets in terms of job creation, in terms of

unemployment, it looks like it is a much more national labor market.

All of this reveals some problems with the current unemployment system. The first is, only about a third of unemployed people actually get unemployment insurance in this country. Large groups of people—like voluntary job-leavers, the self-employed, people looking for part-time jobs, which we know is an important thing these days—all of these people are cut out of the program. If you are going to have a system, you want to make sure that you provide assistance to all people, and we are failing to do that.

If you are lucky enough to get assistance, the assistance is very low. We are talking about something like \$260 a week; it is below the poverty rate for a family of four. It goes nowhere near the initial objective which is to replace one-half of lost wages.

There is a weak link between this assistance and reemployment. In some sense, I do not mean this in a pejorative sense, but our unemployment insurance program is kind of like compensation for losing a job. We pay people off, but there is no kind of constructive movement towards reemployment. We have an extended program that is supposed to help workers during periods of prolonged unemployment and economic slowdowns. This program is basically obsolete because the triggers are broken. In fact, in the last two recessions, this program was inoperable and Congress had to enact its own kind of temporary unemployment insurance programs.

Finally, and this is what I find the most egregious, the federal tax that we use to finance unemployment insurance which is relatively small, the taxable wage base has not been keeping pace with inflation and has not been changed in 22 years. The tax is incredibly regressive.

This graph shows the decline in the reciprocity rate, which means the share of unemployed people getting unemployment insurance, you see that it is falling. Currently we are above trend, but the overall trend has been declining. This graph shows the taxable wage base. As you can see the blue line is the base, the red dotted line is what it would be had it been adjusted for inflation. It is currently \$7,000, and we estimate that if it had been corrected for inflation from the beginning, it would be closer to \$45,000. So you can see the regressivity of this tax.

So the proposals that Lori and I come up with derive directly from the changes that we see in the labor market. The first is that we believe that there needs to be an increase or a strengthening in the federal role of unemployment insurance. We have a cacophony right now of 53 programs around the country. We need to harmonize those state programs, we need to expand eligibility criteria to cover new forms of nontraditional workers, contingent workers, part-time workers, and we need to bring more people under the tent.

We also need to raise the assistance level and link that level to experience and local labor market conditions—the more difficult it is for you to find a job, you might need some more assistance. We need to fix those extended benefit triggers so that program works automatically. I have to say this is not too hard to do, and it is really curious why it has not been done over the last 20 years.

We need to create something that, as Jeff has suggested, links unemployment to reemployment, and what Lori and I suggest is taking a lesson from the recent introduction of wage loss insurance under the Trade Adjustment Assistance program and bring that over to the unemployment insurance program. I do not want to go into all the details right now, but you

could limit it for a certain group of workers, be it older workers or whatever, you could replace a certain amount. Jeff's amount is I think a quarter, ours would be maybe 50 percent. These are all things that would be discussed in terms of how much you wanted to. Our proposal would require that you would have to take a job within the first 26 weeks in order to get the wage loss insurance. But, again, we have a program in place and we would now like to bring it over to the unemployment program.

We suggest the creation of private unemployment accounts. I will tell you very honestly where this comes from. A significant share of the unemployed are the self-employed, and we feel that we need to do something for that group of people. It is very difficult to bring them under the traditional unemployment insurance system. So we have come up with a scheme which is basically an IRA for the employed person so that they could use it during their period of unemployment because we do not want them taking it away from their retirement funds. We propose a separate fund, and, again, you could debate what would be the individual parameters.

The last thing is we drastically need to fix this wage base in the FUTA tax. Let me say that doing so would really generate a significant amount of money. Some of that money or all of that money could be used to finance the reforms that we are suggesting today. But, again, this is a regressive tax falling on the wrong people at the wrong time and needs to be fixed. Thank you very much.

MR. HACKER: Thanks very much, Peter, and I have exactly the same sentiments that Howard does about the project. I think it has been a really important venture with a diverse range of voices and diverse range of proposals, and I feel privileged to be part of it.

I am told that I have five minutes, and I was once told that the definition of an academic is someone who could speak for five minutes and five hours and say exactly the same thing, so I want to give you the five-minute version. John Dilulio gave me another version of this joke . He says if you are a politician you can speak for five minutes or five hours and say nothing.

(Laughter)

MR. HACKER: So I am going to do something unusual for a policy wonk. I actually want to start by very briefly telling a story about real people, the Dorsetts. They were profiled in The New York Times a few years ago. They are a family of five. Arnold Dorsett is an air conditioner repairman. He is making more than his father ever did, \$70,000 a year. He works 90-hour weeks, so it takes a heavy toll on his time. Luckily, his wife, who is training to be a nurse, is staying home with their three kids.

Unfortunately, however, their young boy, Zachary – sort of slightly in the background there – has not been healthy since his birth, and a few years before this story was written, he was diagnosed with a rare immune system disorder. That disorder wrecked the family's finances. They had insurance, but within a year or two they had already run up \$30,000 in unpaid medical bills, and they eventually were forced to declare bankruptcy.

In fact, the Dorsetts are not alone in this plight. Depending on your reading of the statistics, somewhere between 400,000 and 700,000 Americans file for bankruptcy each year in part because of medical costs. Most, like the Dorsetts, had insurance before they filed, most, like the Dorsetts were working – most full-time – but as we know, private insurance and work often are not enough. And of course, when it comes to insurance, the Dorsetts were lucky in the sense

that they had it. Not all Americans do. We just learned that 47 million Americans lacked health insurance last year, and we know from other statistics that 1 in 3 Americans will go without health insurance over a two-year period.

This proposal is not about health insurance alone. In fact, catastrophic health costs for the insured as well as the uninsured are just the tip of the iceberg. We have heard about job insecurity, and Lori, Howard, and Jeff have really laid out the dimensions of the problem, so I do not want to belabor it here. But I do want to point out that one of the features of our system of social insurance is that it is heavily job-based: most Americans receive a good deal of their retirement benefits and all of their health benefits through the workplace.

Universal insurance is meant to deal with the serious and growing problem of economic insecurity in the United States. The evidence of this economic insecurity is abundant. It ranges from rising rates of bankruptcy, to skyrocketing consumer debt, and perhaps most telling of all, to increased income instability of American families. I have a figure that Peter cited earlier, it is from a logistic progression looking at individuals with average characteristics, and what it shows is that there has been a really dramatic increase in the probability that families will see a very large income drop. And I have other data that is contained in my recent book *The Great Risk Shift*, and feel free to pick it up and read it and decide for yourself whether you find it convincing.

These kinds of income drops cause real hardship. One of the reasons they cause such hardship, of course, is that families and individuals are highly loss-averse. They fear income losses, and they experience pain because of income losses far more than they happily anticipate comparable income gains or take pleasure in such gains.

But I think there is another reason to be concerned about these trends. It really highlights the degree to which in an era in which work and family have changed dramatically, our existing policies simply do not provide good protection against many of the sources of economic insecurity that families face today.

So the goal of universal insurance—which is actually very simple in its broad conception, though the details are another matter—is to fill some of the gaps in existing policies by offering a flexible, short-term catastrophic stop-loss insurance program to virtually all Americans. Unlike most existing social insurance programs, universal insurance would both protect families against large income drops, and provide some relief when they are faced with the most serious expense that most families face, namely, unexpected catastrophic health costs.

Why do I call it universal insurance? There are two reasons. One, it covers basically all citizens. It will cover everyone with ties to the labor force, and almost all Americans have some tie to the labor force for most of their lives. It is available to anyone whose income, after a catastrophic event of the sort that it covers, falls below the 95th percentile in the income distribution, although the coverage is much more generous for lower-income workers. I like to think of this as targeted universalism. It is universal and universally available, but it provides the most generous coverage for those who need help most.

The second sense in which this is universal is that it covers a wide range of risk to family income: unemployment, disability, temporary unemployment due to illness, loss of a breadwinner, and catastrophic health costs. I include these because I think they are the most serious risks. They also have the virtue of being in the panel study of income dynamics so I can model the cost. But the idea is really to articulate a concept here, that we should have a flexible

foundation, not just the highly categorical programs that we have now, to deal with the rapidly changing world of risks.

I want to stress one thing and then say just a few words about the effects of the proposal. What I want to stress is that this proposal is a stop-loss form of protection, that is, it is inclusive of all other public benefits that individuals receive. In fact, I estimate that about a third of the income losses associated with the events that universal insurance covers are already covered by existing programs. Universal insurance would simply fill the gaps that were left behind to provide Americans with a basic level of financial security, and in doing so, it would really make tangible some of the gaps that exist because, for example, we could save money by improving unemployment insurance once we know how many people fall through its cracks, as Howard discussed.

What are some of the effects? Let me just describe the very basic management of the proposal first. It would essentially provide a sliding-scale replacement of income to families who experience income drops or catastrophic health expenses that equal or exceed 20 percent of income. Here is the basic schedule of the coverage. You do not need to memorize the specifics. They are in the proposal. The basic idea, though, is that for those who after an income loss or catastrophic event have income that is below the twenty-fifth percentile, you would provide the most generous coverage of replacing 50 percent of income. As you move up the income ladder, the coverage would get less generous. I would also exclude people with very large asset holdings since they are able to insure against these events with their own wealth.

What are the effects? I guesstimate using the panel study of income dynamics that about 3 million Americans each year would not fall into poverty because of the proposal, so

there are 3 million Americans who would not be on the poverty rolls because of universal insurance, which really confirms that many of the poor are poor for very short periods of time because of specific catastrophic events.

Universal insurance also cuts the chance of large income drops in half. Using the panel study of income dynamics again, I simply plugged in the income after universal insurance was in effect, showing the increase in income that results.

The total cost according to the panel's study of income dynamics and the medical expenditure panel survey would be roughly in the range of \$35 billion, which is a lot of money. But I want to be clear that this is really a proposal for discussion, the costs could actually adjusted down or, if you wished, up by changing the parameters of the coverage.

I also want to emphasize in closing that we should not underestimate the gains of this kind of spending, because these costs are simply not new costs for society or our economy. They are now borne by families and workers individually, in many cases in ways that create great hardship. They are often a burden on privately financed institutions of social protection; our bankruptcy system, our system of private relief, our networks of communal care, our system of uncompensated charity care, and so on.

But more important, and this is something Peter emphasized up front, these are costs to our society and economy because Americans lack basic financial security. Just as entrepreneurs and corporations have bankruptcy protections and limited liability so that they can look to the future and take risks, so families need a basic form of economic security so they can look to the future and invest in their futures. In short, universal insurance would provide security to enhance opportunity, and in that way it would help Americans – Americans like the Dorsetts –

to have the basic security that they need to reach for and hold onto the American dream.

MR. ORSZAG: We are now going to open up the floor to questions that you may have. I think there are microphones coming around. If you would just identify yourself and ask your question, we will try to get you an answer. Who would like to start? Bob Kuttner.

MR. KUTTNER: There is a really interesting conceptual or philosophical difference within these proposals, if I am understanding them right, and I want to see if that is right. Some of them, like Jacob's, are funding a new kind of social insurance more via general revenue. Others are asking people who are already either economically stressed because of declining median incomes or at risk of greater economic volatility to in effect advance fund their own personal social insurance. Is that a correct framing of some of the differences?

MR. ORSZAG: Let me answer that, and Jeff may come into this. I do not really think so because in each case, Jacob is obviously proposing some new form of social insurance, Howard and Lori are proposing an expansion of an existing form of social insurance, and what Jeff is proposing is a change in what social insurance provides, away from providing short-term cash assistance to workers who then get reemployed at higher wages and toward workers who are reemployed at lower wages.

And I think his argument—and, again, I think this is why the conceptual point is important, and you can debate whether or not it is true—is that that is a more important source of risk and a more pressing problem facing most families than financing the short-term gaps.

MR. KUTTNER: Fair point, but I am asking a different question.

(Laughter)

MR. ORSZAG: Then I guess I have to give a different answer.

MR. KUTTNER: Right. I hope so. I take the point that all three of these are significant improvements on what we have. You can redesign social insurance for the 21st century economy, and I take my hat off to all three of these writers. I am asking a different question, namely, who pays the freight. There was a British Labor MP who used to say famously, it is the poor that pays for the poor. By the way, the financing of these is structured at a time when we are already worried about worsening income distribution and worsening income volatility, are we increasing the payment structure in a direction where the very likely victims are advanced paying out of their own pockets the cost of social insurance to a greater degree than at present?

MR. ORSZAG: Again, I do not think so, but let us go through the different proposals. Howard's would involve a significant expansion in the tax base, making the existing U.I. tax less regressive than it currently is. I will let Jeff comment on this, but the overall effect of his proposal would also I believe even on the revenue side make the system more progressive, and certainly as a whole it makes it a lot more progressive. And Jacob's proposal clearly is very progressive on the benefits side, and has put forward a couple ideas about how it could be financed, but that is obviously up for debate.

I would say that one of the big topics that we, I am now saying we The Hamilton Project, will be exploring next year involves the tax system and what can be done. I will just point for example that, in terms of making financing both more efficient and more progressive, I co-authored a policy brief, this was not a Hamilton thing, although maybe it will turn into one, that suggests that the \$500 billion a year that we spend subsidizing retirement, health, and other socially beneficial activities, most of that is done in a very inefficient and unfair way through

deductions and exclusions. That is a lot of money. It is 4 percent of GDP. A universal credit kind of approach would be more efficient and more fair.

There are lots of things that we could possibly explore as part of the tax system to make that side of things, again, both more efficient and more fair, but I do not think in terms of the immediate proposals that any of them are making the system less fair or less efficient.

MR. HACKER: Do you want me to speak to that very briefly since I am the one who Bob holds up as having added to the system? Of course, we are going to pay for these benefits one way or the other, and as I suggested, we are already paying in hidden ways for many of the things that I would like to do out in the open.

One thing that I would want to emphasize is that how you would finance this benefit would obviously be important in determining its ultimate incidence. I suggest several different ways, but the easiest way to finance it would be with a very small tax on wages with no wage base, so no cap on the total amount paid. I know that that is a proportional tax and not highly progressive, but the benefits are extremely progressive.

But what I want to say is that even when you have working-class people paying a small tax to fund their benefits, social insurance actually has a magic property to it through risk pooling. For a very small tax you can receive very generous benefits in the event that you are one of the unfortunate people who is hit with the risks that are covered. There is no way that an individual can do that on their own through an individual account. They have to save that full amount on their own with whatever tax benefits are provided.

So I think that one of the things that this whole initiative expresses is the need for a combination of a social insurance approach and some kinds of savings measures, that you need

to increase savings particularly to help people get through short-term periods of unemployment as Jeff suggests, but we also need to have social insurance for wage loss and for other catastrophic risks that simply cannot be insured against by individuals on their own.

MR. ORSZAG: Jeff?

MR. KLING: I think that in the spirit of fundamentally restructuring and shifting towards having insurance for the larger, long-term losses that individuals cannot really insure on their own, there is a set tradeoffs, so people who have temporary layoffs or people who have unemployment followed by wage gains, they are going to have less under my proposal, and people who have long-term wage losses are going to have more. So that is essentially a shift towards the group that I think we want to have more social insurance for.

In terms of the financing, the financing that I propose is set up in two parts. One is to fund the parts of the temporary earnings replacement accounts where people never go back to work or their wages are very low and so there is some tax revenue that goes into that, and that is funded by a tax at however much lower weight, but a much broader base and being more progressive.

The wage loss insurance would be set up in order to incentivize firms to act in the right way of having the firm who is laying off people be responsible for then contributing to the wage loss insurance payment that goes to their former employees, so those firms are going to be the primary payers and that is set up in order to try to have them internalize the costs of the layoffs.

So if you had two workers who were fairly similar but one of them, their outside opportunities were much worse, that you as the firm would take that into account when thinking

about who to lay off, and so that is another part of the financing. So in terms of who pays the freight, a lot of it comes through this firm side, either through the broader-based payroll tax, or through the experience-rated payments that firms would make in wage-loss insurance.

MR. ROSEN: I just want to say something briefly. I live here in Washington and I spend a lot of time here, but somehow I missed the day when there was a law passed that said every new public policy had to be revenue-neutral. Lori and I are suggesting that that just does not hold for us. If you start with the premise that the challenges confronting the U.S. economy are greater today than ever before, that there have been major changes in our labor market, not just movement from manufacturing to services, we are talking about gigantic structural changes in who gets unemployed and for how long they get unemployed, what are the costs of unemployment, and then you have a number like 47 million people who do not have health insurance, and then to suggest that dealing with all these problems has to be revenue-neutral, I think is politically naïve.

So at some point the question is not what is revenue-neutral, but does revenue-neutral mean that the total budget has to be the same. Maybe we spend more in this area and less in other areas, or maybe we do increase government spending a little bit in order to deal with these things. So I do not buy this constraint. I will say it very openly, I do not buy this constraint of revenue-neutrality in order to deal with problems that we have never had before. I think that that is an important message that needs to get out, and Lori and I are not embarrassed to say that.

MR. ORSZAG: I told you we were going to spur debate, so there you have it.

MR. ROSEN: Yes. We give a menu of proposals, and we purposely say in our

paper when we talk about increasing the reciprocity rate of unemployment from a third, which is outrageous, to maybe closer to 50 percent, we say that is not going to happen overnight, maybe go to 40, maybe go to 45, and we give different costs for those things. So we are not suggesting that we want to spend an additional \$8 or \$9 billion immediately. What we are saying is if we have to, this is how you would do it.

MR. ORSZAG: I want to make just one more point and then I know we want to move on. Behind your question is the real concern about the real degree of progressivity in the overall tax system. There is very interesting research by Tom Piketty and Emmanuel Saez suggesting that we have over the past three to four decades experienced a very sharp decline in progressivity of that overall system both because of the rise of the payroll tax, but also importantly the corporate income tax has declined sharply as a share of GDP even though profits have increased.

I would say that it seems to me like some serious intellectual effort could be devoted to thinking through how corporate income tax systems could work in a world in which capital is increasingly mobile across national boundaries, and that at least to me would seem like a worthwhile endeavor for someone to undertake.

QUESTION: I come at it from the other end from Mr. Kuttner, and that is if the people who pay the taxes are going to end up financing any kind of program, what evidence can you point to that the people who vote are actually going to be in favor of addressing this problem that is a problem that is most severe at the end, and, incidentally, those people do not vote?

MR. ROSEN: May I start that? I think personally that this is a selling problem. We talk about unemployment insurance as a program, and we have the bean counters who talk

about how you run these programs, and that is all done by certain committees and they get into the technical details of it. The piece that is missing is that our politicians have to get the big picture. They have to acknowledge that there are all these problems going on in the economy and what we are going to do is strengthen the safety net that we have in order to deal with these.

Let's use an example to make it very real. We separate trade policy, and we have different people talking about trade policy, and all those wonderful people say that we need to do more for workers who get hurt because of trade policy, and they are in a totally different community from the community of people who deal with the intricacies of these programs. What we need to do is bring those communities together, I would imagine that is called leadership, and that we would have political leadership that would say that we have to make one contingent on the other, and we have not done that yet.

My final point is, we do not need to sell this as U.I reform, we need to sell this as what is going on in the economy, we need to have more economic liberalization and openness going on, and in order to do that we have to strengthen our system, our safety nets, and here is one way to do that.

QUESTION: Again, these are all wonderful ideas, but I am trying to connect it to some signal that the electorate is interesting in doing this or that this is an issue that might move people to vote a particular way. The President gave another press conference today and he said the thing he always says which is if you elect Democrats, they are going to raise your taxes. Here we are sitting here listening to reasonable proposals that are going to cost money, and he is accusing that Democrats raising taxes is a good selling line with voters, and I wonder citing the data about insecurity and public opinion, can you point to anything that the public is going to

suddenly get behind these ideas that have not been generating that much enthusiasm?

MR. ORSZAG: I do not think anyone on this panel is, as Bob Rubin likes to put it, licensed to practice politics.

MR. HACKER: I am a political scientist. I am not licensed to practice politics, but I do study it.

MR. ORSZAG: Let me say two things. One is, I want to remind you that not all the proposals cost additional money. Jeff Kling's, for example, is revenue-neutral, and I think that is important to keep in mind.

The second thing is, the evidence at least that I have seen suggests that when people talk about revenue that is tied to a specific program that they can see is beneficial—for example, Social Security—the picture changes dramatically relative to some free-floating, disconnected discussion. In a context in which you are talking about whether there are specific risks that families face and whether they would be willing to pay for protection from them, I think that is a much different context than a more amorphous one. But now for the professional.

MR. HACKER: I would say that what Peter said is absolutely right. There is this old saying that Americans are philosophical conservatives and operational liberals, that they are against government in the abstract, and they love it when they see it in the case of Social Security, Medicare and other programs.

So what evidence is there that Americans would be receptive to some of these ideas? I agree with Howard that there is a real gap of leadership in trying to get these issues on the agenda and in front of Americans, but there certainly is a huge level of discontent with the economic direction of the country, higher than we have seen since the early-1990s, and that level

of discontent extends across all racial groups and major demographic groups.

Howard mentioned how trade liberalization is a barometer of this. There are surveys that have been done recently by the Pew Centers and the private firm ISR that have both shown record levels of concern about the economy and about the security of people's benefits.

With regard to the President talking about cuts in taxes, the President's approval ratings right now are really low, let's put it that way. He was completely unable to achieve the core elements of his Ownership Society agenda, and I think part of the reason is that people do not think that that is the right direction, and I think the real opportunity and challenge is to convince them that there is another direction that involves not just helping people who are left behind, but helping middle-class Americans who feel at risk by providing security to expand opportunity.

MR. ORSZAG: Thank you. One last question and then we will move on.

MR. KLUFNER: Jim Klufner (?), Senate Budget Committee. I am one of those bean counters who cares about the operational details. I have a question for Jacob. You have this income insurance program, but it all assumes that you know when somebody has had such an income loss. How exactly are you going to do this? Are you going to let people experience the loss and then get it back on their tax refund? How does it work?

MR. HACKER: I talked about the details in the proposal, but suffice it to say that there are some pretty substantial administrative and technical challenges in terms of thinking through how this would work in practice, and I have only made part of the necessary progress in doing that.

Essentially, the way this proposal would work is it would piggyback in many

cases on existing verification and eligibility systems. It would work through the Tax Code. Yes, you would have to experience the unemployment to get the benefits, but the moment that happened, you could apply for advanced protection, and employers would be required to advertise this coverage. In the case of catastrophic health costs, there would be outreach efforts through hospitals. At the moment that you start to have large costs, you can apply to receive an ATM-like card that would apply coverage. There would be a reconciliation process in those cases where it ended up at the end of the year that your income did not drop as much as you expected or your expenses were not as great.

In practice, I think that the way the benefit is structured is that this is going to be less of a problem than you might think. It is not something that people are just going to run out and try to get whenever they lose a job because it is going to take a fairly substantial drop in income on the one hand, and on the other hand, the benefits that are provided are going to be fairly modest for people who are comfortable, so that it is really going to be those who really need the benefits of protection, who are already going to have some interaction with other programs, who are going to really benefit. I think it is a great question, and I welcome the challenge.

I think one thing I would say is that we have very low levels of take-up with many benefits, and part of the reason is that we run each take-up effort separately. We have Medicaid eligibility rules that are often cumbersome and difficult, we have unemployment insurance eligibility rules as Howard has said that are completely Byzantine. Universal insurance would be available for Americans hit with a wide range of risks, it would be widely publicized, and lots of Americans would receive benefit from it in the case of catastrophic events. And the hope is that

that would also facilitate an outreach effort as well as decrease any stigma that might be associated with the receipt of insurance benefits.

MR. ORSZAG: Thank you. With that, I think we need to wrap this up. I want to thank the panelists. We are running a little bit late, so what I am going to propose is we have refreshments and drinks and obviously rest rooms, as this is a long afternoon, and rather than taking a formal break, we are going to switch over the panels and obviously we will have a much more fluid situation throughout the rest of the afternoon with people leaving as need be.

Thank you very much to Howard, Jeff, and to Jacob, and if the next panel could come up, that would be terrific. Thank you.

(Pause)

MR. FOER: In the spirit of Peter's call for efficiency and his ruthless attitudes towards refreshments and the restroom, we are going to push ahead and force Jacob Hacker and Peter to stay up here without leaving their chairs.

One of the first questions we need to ask is why is a journalist moderating this panel in the midst of this wonk fest? I think if you look around, we have three panelists who had championed slightly different proposals to address economic security, and in Brink's case, probably more than slightly different. But in answering this question, does economic security come at the cost of growth, we are inevitably moving beyond the data and we are entering the realm of philosophy and politics, and I think that is probably the reason why a journalist could moderate this panel.

But in working through this, we are going to end up I think coming back to, first, questions about economic insecurity, to the extent that economic insecurity is the problem, I

think we are going to hear very different analyses of the situation from the different panelists.

Fortunately, we have three nonbomb-throwers up here, so despite our ideological differences, I think that we have some chance of finding common ground. Before we start, I would just like to recommend Jacob's books *The Great Risk Shift* and *Off Center* which are excellent, and Brink's book *Against the Dead Hand*, which is a very shrewd analysis of why globalization has not taken around the world like we necessarily thought it would. The only reason I cannot recommend Peter's book is that he has not written it, to my knowledge, but I am sure it will be exquisite. Jacob?

MR. HACKER: The title of this panel is something like "Is economic security at odds with economic growth or in tension with economic growth?" I would like to rephrase the question to "Is economic security *inherently* at odds with economic growth?" – and say emphatically that it is not. Of course, measures that provide economic security could be growth-reducing, could impair the proper functions of our economy, could create distortions that we would not want. But economic security properly done is at the cornerstone in many ways of a well-functioning, dynamic capitalist economy.

Indeed, the key innovations of American capitalism – according to David Moss's fine book *When All Else Fails* – were really about providing protection against risk, not to everyday workers, but to entrepreneurs and financial actors including, of course, corporations. The U.S. was a pioneer in the provision of such broad-based risk protection to the financial community including as a secure money supply, bankruptcy relief, limited liability for corporations, and in the Great Depression, one of the great innovations, deposit insurance for smaller holders of capital.

And we know that today on the landscape there is a whole host of quasi-public institutions, quasi-private and public institutions like Fannie Mae and Freddie Mac that for all of the debate around them, do I think fulfill an essential purpose and fulfill a basic idea that government should be a risk manager and has a special role and capacity as one.

I think though, that today while we have still limited liability for corporate America, increasingly we have full liability for American families. And the real question for the next generation of risk protection is how we can update the economic security measures for workers that now are over 60 or 70 years old.

The evidence of insecurity we have already talked about, but I want to highlight a few things that have not been mentioned. Rates of bankruptcy are at record levels. In 1980, there were 300,000 personal bankruptcy filings. Last year in part because of the Bankruptcy Reform Act and the rush to file before it took effect, there were 2 million personal bankruptcy filings. Foreclosure rates are about five times as high as they were in early-1970s. A stunning statistic is that in the last few years about 1 in 60 mortgage holders have entered the foreclosure process that can end with their home being auctioned to the highest bidder in a local courthouse.

I have already mentioned the uninsured, but I want to mention another change that I think has had many salutary effects for our economy but have nonetheless increased the risks that families are facing and the responsibilities they have for managing those risks.

In 1980, about 80 percent of medium and large-sized firms offered guaranteed defined benefit pension plans; today the number is less than a third and falling. We know that the only place that defined benefit pensions have any future today is in the public sector. I think that there is no turning back the clock on these changes, but we cannot deny that these changes

have increased the degree to which families are responsible for managing risk, and they are taking on these responsibilities in a context in which many of the traditional protections that they enjoyed from their employers and from government are eroding.

In this context, I think the argument that economic security would be at odds with economic growth and opportunity gets the story backwards. Peter put an emphasis rightfully on the need for people to get back on their feet, on the degree to which economic security policies can alleviate hardship. But I think we should also recognize that these policies have a very forward-looking goal as well to try to encourage people *ex ante* to invest in their futures, to make choices without fear of the downside risks that could accompany them.

Three quick examples. Job lock. There is a huge debate in the economic literature about the extent to which people feel locked into their job by the quality of the benefits they receive, but let us just specify, regardless of what the exact estimates are, that the fact that people's benefits are tied so closely to work today—tied to corporate ships that are increasingly unstable in a context in which people are less likely to receive benefits or secure benefits than in the past—does introduce distortions into our labor market, that the fixing of which would improve the flexibility and performance of our labor market. Rebecca Blank has done excellent work on this subject.

The second area I want to emphasize is family and individual investment. It is true that a certain degree of insecurity is necessary for people to feel that they should work hard and get ahead, but levels of insecurity that are too high can depress the degree to which people invest in their jobs, make commitment and effort, or invest in specific skills that would put them at risk. Indeed, human capital is the most important investment that families can make, but it is

also an investment, as Howard discussed earlier today, that can put us a grave risk if the skills that we have invested our life and our life savings in in turn out not to be needed by an ever-changing market.

Finally, I think we should not discount the story that Peter told about the political economy of risk protection. If Americans do not feel they are economically secure, they may well demand policies that would clamp down on the dynamic processes of change and adjustment that are at the heart of America's flexible and high-performing economy. If risky people demand growth-reducing policies or worse, then economic insecurity will indeed be very much at odds with economic growth, and economic security could very well promote growth.

MR. FOER: And now for something entirely different.

MR. LINDSEY: Not entirely. First let me just say I am delighted to be here on this panel. I am very much of the opinion that libertarians and liberals need to talk to each other more because I think they will discover they have a great deal in common and that discovery may put their treatment of their differences in a new light.

In particular, I think the past several years have made clear that liberals and libertarians stand on the same side of a whole host of vital issues, from civil liberties to stem cell research, to defense of scientific rationality against things like the intelligent design movement, to equal rights for gays, to immigration, to support for a less-bellucose foreign policy, so, indeed I think there is a great deal of common ground, and, indeed, although nobody understands it when I say it, I do think of myself as a liberal and so I think there is need for classical liberals and modern liberals to talk more to each other.

Of course, liberals and libertarians have important disagreements on economic

policy, but I do believe that it is possible to treat these differences as technical rather than ideological, to treat them as differences that are amenable to rational empirical debate and susceptible to resolution through enlightened compromise. I do not want to shrink from clarifying my differences with supporters of what I will call the economic security agenda, but I do hope to identify ground on which some possible compromises may be struck.

At the very outset let me say that when you are talking about economic security, there is a real fork in the road that you have to deal with at the outset, which way you are going to go. One way is to seek economic security through stopping disruptive economic change, the other way is to seek economic security by helping people to cope with and adapt to economic change. I am very much sympathetic with the latter course. I am delighted that The Hamilton Project is devoted to exploring that latter course, so in fundamental sympathy with the big-picture strategy of The Hamilton Project, let me make three points about reconciling economic growth and economic security.

First, I do not think that reconciling a concern for economic security with a concern for economic growth is going to make a lot of progress if we get stuck in some kind of ideological grudge match with the capitalism bad, government good team on one side, and the government bad, capitalism good guys on the other side.

I am afraid that not in the rhetoric here today, but out of doors from the calm and sweetly reasonable Brookings Institution, that much of the rhetoric from supporters of the economic security agenda succumbs to the temptation of ideological posturing over dispassionate analysis, and here I am talking about this deep-seeded need it appears to me on the part of many people on the left to bemoan the state of economic development in this country

over the past 30 years and to poor-mouth the enormous accomplishments in material well-being that have occurred over these decades.

It is absolutely the case that the changing structure of the American economy does heighten certain risks that are legitimate objects of public concern, but by the bottom-line metric of economic security which is security not from potentially disruptive change but security from material privation, the overwhelming majority of Americans have never had it so good. There has been great progress in material welfare in this country even accounting for heightened volatility and heightened risk.

When you look at risk, you have to look at the other side. There is a risk/reward relationship. We have heightened risks today for some people, but we have higher rewards for all, and I think that the conception of the economic security problem needs to always be firmly placed in that larger context.

My second point is the number-one priority for people who care about either economic security or economic growth, and certainly for people who care about both, ought to be dealing sooner rather than later with the fiscal unsustainability of our current entitlement programs. Unless Medicare, Medicaid, and Social Security are restructured sooner rather than later, future generations are going to face the grim choice between precipitous benefit cuts or huge growth-crippling tax increases, or both, and.

I am afraid that this Sword of Damocles which is hanging over our heads does not get that much attention amongst the supporters of the economic security agenda when, in fact, I think it is the number-one threat to both economic security and economic growth amongst all the public policy issues with which we wrestle.

The third is, and finally, I think that a concern for economic security and a concern for healthy economic growth can be best reconciled by taking seriously the idea of social insurance. That sounds weird for a libertarian to raise the banner of social insurance, so why am I doing that? Because I think the concept of social insurance properly understood places real limits, certainly not libertarian limits, on what tax and transfer programs can do.

For a tax and transfer program to qualify as social insurance, it has to consist of risk flowing to cover insurable events, specific risky contingencies that are outside of a universal's control. So what kind of line does that draw? The kinds of economic security proposals we have heard about today, revamped unemployment insurance, wage insurance, universal insurance, catastrophic health care cost insurance, those all I think qualify as types of legitimate social insurance. Everybody pays taxes, some people suffer defined losses, and they are covered.

But what is excluded, and here is where I wander off the reservation as far as this podium is concerned, the Social Security and Medicare pay as you go status quo is excluded because retirement and large health care costs during old age are not risky contingencies, they are 100- percent predictable contingencies that most people have to prepare for on their own. Also excluded by a legitimate concept of social insurance would be any kind of move towards a single payer since routine medical expenses are likewise totally predictable and within the capacity of most people to provide for for themselves.

So that is the common ground I see, on the one hand, to make libertarians happy, moving away from sloshing huge amounts of money from one cohort of the middle-class to another, and thereby freeing up resources to upgrade and modernize true social insurance to be in

accord with the realities of the 21st century economy.

MR. FOER: Thesis, antithesis, Peter Orszag with synthesis.

MR. ORZAG: I already commented earlier this afternoon on why economic security can be growth enhancing, but I think it would be useful to break down the three different ways of trying to provide economic security and this comes back to comments that both Jacob and Brink have made.

You can, again, try to provide better preparation ahead of time through education and saving, for example. You can try to provide forms of social insurance and other market-friendly ways of providing assistance after the fact. Or you can try it through direct market interventions. So, for example, rigid hiring and firing restrictions, trade protectionism, trying to protect particular sectors or firms, you can somehow try to stop the world—stop the world, I want to get off, you try to shut the process that is generating the insecurity in the first place, or parts of the insecurity.

What I want to emphasize is that the first two components can absolutely be made to be growth enhancing, but that final one, at least my read of the evidence suggests, cannot. So in the first two components, the easy one obviously is preparation ahead of time, education and saving. They are both clearly growth enhancing.

Education improves productivity in addition to providing insurance, saving improves national economic performance and economic growth, in addition to providing a buffer for households. And there are a lot of good ideas out there about how we can make significant progress on both fronts, both on education and saving, and I would be happy to get into those if anyone is interested. We have had other symposia and forums on those topics, and will continue

to have more in the future.

That, however, is not enough, and I think it was very interesting to hear from Brink. You often hear the response, and this has been the focus of some recent columns in major newspapers, that all we need to do in the face of these changes is provide more education or perhaps encourage more savings, this kind of what Jerry Bernstein has called you're-on-your-own economics, all you need to do is provide those kinds of universalized approaches ahead of time and we are done, and I think the evidence is very clear that that is insufficient to addressing the real need.

So that brings us into this second category of social insurance—things like unemployment insurance, perhaps things like universal insurance, where what you are trying to do is provide things that again can be growth enhancing. Both Howard and Jeff have spent a lot of time mapping out the work incentives that are entailed in his proposal. His proposal would involve both a more progressive or fair approach, and one that strongly encourages work, and I think that Howard and Lori would also argue that their proposal is growth enhancing rather than diminishing.

The final approach though is the sort of sand-in-the-wheels approach, and, again, that is just where we do face a division or a part in the road, and I am glad that Brink is with us and not on the other side of that fork in the road. But I think there is a real significant debate that the nation faces about which direction we should head from that fork in the road, and, again, I think that we can clearly go down the road of embracing economic growth but then enabling households and workers to better address it and to lots of things that not only make families better off but also increase economic performance overall, and that is why we are here today.

So I think there may not be quite as much difference precisely because Brink embraced that second component. Obviously, there are differences of opinion with regard to exactly what programs should be included in that, and I think we may part ways on Social Security in particular, but the conceptual approach of wanting to provide additional risk protections to families in areas that they would not adequately address on their own is a very important philosophical or guidance to policy makers, and so I am just very pleased to see that we are aligned on that.

One final point is with regard to the long-term fiscal problems facing the nation, I want to make it very clear that The Hamilton Project believes that we are not only failing to invest in adequate security in investing in our people, but we are not paying our way either. We obviously need to address both problems, and they reinforce each other in negative ways, so it is particularly challenging to address both, but we hope through various efforts including perhaps likely in very small part due to ours, but that through various efforts that we can start the process of addressing both problems at the same time.

MR. FOER: That was a very genteel discussion. Jacob, would you like to respond to anything?

(Laughter)

MR. HACKER: Of course. No one ever passes up a chance to engage with people who differ from them, and I am pleased to report that there are a lot of areas of agreement. There was at one time a libertarian view that all forms of social insurance were inherently illegitimate. Nozick, one of the great philosophers of the 20th century, famously argued that the only form of shared security that was legitimate was personal security provided

through police and army protection. Brink's very different argument may be pragmatic and realistic and based on political considerations as well as philosophical ones, but I think it is the right argument.

Social insurance of almost all the activities that government engages in the domestic sphere is one of those that is most efficiency producing when done right and most valuable to individuals who cannot insure against these large risks on their own, and it can be supportive of a vibrant, dynamic capitalist economy.

I totally agree, I should say before I get to disagreements, also that the argument should not be that capitalism is bad and government is good. Peter Gosselin, who is sitting in the fifth row here, likes to quote one of the political scientists—he was an economist but he worked a lot with Robert Dahl—that I most admire, Charles Lindbloom, who said that the market is all fingers and government is all thumbs, and sometimes you need fingers and you need delicate information flows and the ability to respond rapidly to changing conditions, and sometimes you need thumbs. Today I think you need thumbs to put the finger back on the scale to balance the needs and demands of working Americans that are being drowned out by the cries and claims of those who have wealth and influence.

Now I am getting to the differences, as you can see. First of all, this risk/reward tradeoff. In my work I have shown there is a fairly substantial increase in instability, I am sure there will be much debate over the dimensions and degree of that change, but I think it is fair to say that there is enough evidence to suggest that families are facing substantially more instability of income than they were a generation ago.

If that is the case, what is the reward that median-income families have received?

If you look at the income distribution statistics, it is about 15 percent. Since 1979, according to Congressional Budget Office figures, median-income households have experienced a real increase of about 15 percent in income, those at the top 1 percent have experienced about a 200 percent increase in real income. I am not in any way going to belittle the massive gains in material wealth that we have seen in this nation, but the distribution of those gains has been highly uneven.

And during the same period, we have seen a decrease in the degree to which people can protect themselves against economic risk with the decline of insurance, the declining generosity of health insurance in many cases, the shift from defined benefit to defined contribution pension plans, the reform of our bankruptcy system, and the substantial erosion of unemployment insurance.

So I think that it is fair to say that although Americans are a little richer, they are really scared. They are scared about the possibility that a single step or bad event will send them over the financial cliff, and that is what we see in many of the public opinion polls that have been done in recent years.

When we talk about fiscal unsustainability of public programs, I am not going to be original in suggesting that I think we really do need to distinguish between the problems of Social Security and those in Medicare. Peter is the guru on Social Security. He has a proposal out there that is not painless, but seems pretty reasonable to me, and I am going to defer to him on what the question of what should be done and when on Social Security.

But I do know a bit on health care, and so I will just say a word about health care, I will say a word about Medicare. Medicare's problem is not an entitlement problem so much as

a health care problem. Health care costs have been rising far faster than inflation for many years. Medicare has actually done a better job than the private insurance sector in controlling those costs. To say that Medicare is unsustainable because it is too generous flies in the face of all of the evidence. Medicare's benefit package is less generous than most private-sector plans. It is so much less generous that elderly Americans are actually paying more out of pocket today than they were at the time of Medicare's passage, because at the same time that costs have risen, Medicare has been caught largely in a holding pattern.

Medicare is a vital form of social insurance. People are not insuring against the risk of retiring, which is for most people roughly 100 percent, nor the risk that they will need health care in old age which we all hope that we will face. They are insuring against the risk of not having adequate income at those times or adequate insurance to deal with catastrophic costs. Do we really think if Medicare were not here that elderly Americans would be able to buy adequate insurance in the private market? Do we really believe that we have eliminated the problems of myopia, procrastination, low income, and risk of premature retirement that leave people in old age often dependent on Social Security as their only source of income?

The recent surveys are very telling on this. Though the 401(k) revolution has had great effects on our capital markets, it has not necessarily had great effects on the savings of middle- and lower-income Americans who often enter retirement unprepared, who also—because 401(k)s and other defined contribution plans do not provide effective ability to manage your retirement risk—often exhaust their savings before retirement. If we did not have Social Security and Medicare, and I will end here, I think we would have a much more risky world, and I think that we have seen in recent debates that Americans both value these programs and are

willing to pay for them.

MR. FOER: I am going to throw it back to Brink just to rebut before opening it up to the floor, and I would especially be interested to hear you kind of push back a little bit on the way that both Jacob and Peter have been talking about the relationship between their economic security programs and growth. Are you willing to concede that the programs that they are pushing are indeed growth-enhancing and do not come at any sort of expense?

MR. LINDSEY: I am in a strange position of feeling much more sympathy for the actual proposals that are being put forward especially by Jacob than the reasons he puts forward for why they are a good idea.

(Laughter)

MR. LINDSEY: So I apparently have some kind of genius for self-marginalization. First, I consign myself to outer darkness of the political spectrum by calling myself a libertarian, and then I marginalize myself within the libertarian movement by being a squish who says nice things about Social Security.

But I do think that the interrelation between economic security and economic growth in the real world runs both ways. First, most obviously from my perspective, you cannot have economic security without economic growth, and that the foundation for economic security however you are going to define it is a vibrant market-based process of economic development.

But by the same token, I think that at least in political economy terms, programs of economic security can enhance the overall prospects for economic growth. You see this around the world a lot in countries struggling to liberalize and move from a state-dominated model of economic development to a more market-oriented model, that because those countries

often lack safety nets for people, they doggedly cling to safety nets for companies and industries to the great detriment of economic dynamism in those countries. That is the kind of big picture.

On poor-mouthing, just some risks that do not feature prominently in Jacob's book which I just had the pleasure of reading, the risk of dying. Life expectancy at birth has gone from 70.8 in 1970, to 77 in 2000. The death rate has gone from 9.5 per thousand in 1970, to 8.5. Infant mortality has gone from 20 per thousand to 6.8 between 1970 and 2001. Workers killed on the job has gone from 18 out of 100,000 in 1970, to 4 in 2002. Occupational injuries and illnesses have gone from 11.6 cases per 100 full-time employees, to 5.3 between 1973 and 2002. Homeownership rates have gone from 62.9 percent in 1970, to 68.3 percent in 2003. People with college degrees or higher have gone from 10.7 percent of people 25 years or older in 1970, to 27.2 percent in 2003.

If you go through a whole list of the consumer products and household appliances that were available in 1970, and I will not bore you with the statistics, but for many of them, the percentage of Americans below the poverty line is higher today than the percentage of all Americans in the early-1870s. And, of course, there is a whole host of gadgets and gizmos and life-saving technologies that were not even around a generation ago. So in terms of material welfare and in terms of a risk/reward relationship, I challenge you to do the thought experiment, do you want to take the mix of risks and rewards for the median worker in 1970 and the command over goods and services that you have, or do you want to take it today, and I guarantee you that I would take today's.

As to the issue of entitlements, that is a gigantic kettle of fish.

MR. FOER: As moderator, I think I have to prohibit us from doing there.

MR. LINDSEY: And Cato is batting 0 for 1 on that of late, but let me just say that without a doubt, the Medicare problem is to a significant extent health care cost problem, I grant that, but it is also a demographic problem because it is a pay-as-you-go system. So as the dependency ratio gets worse and worse, the burden for the current taxpayers are asked to fund the system gets worse and worse when there is the possibility of private savings being marshaled in anticipation of the near certainty of high health care costs in old age.

Furthermore, in addition to the demographic problem, pay-as-you-go systems suffer from the leaky budget of distribution from current workers to current retirees. The dead weight loss of associated with raising a dollar of tax revenue is somewhere between 20 and 60 cents depending on what specifically you are talking about, and that is money lost to the economy, so that is a big tradeoff between economic security and economic growth.

When you have gigantic amounts of percentage of GDP being sloshed from one bucket to another and a lot is leaking out, that means a lot of resources that could have been going to economic growth that are not, or that could be funding the kinds of reimagined social insurance programs. So my guess in bottom-line political terms, unless we can free up significant resources through an overhaul of our current entitlement systems, you are not going to find the money to do some of these neat ideas.

MR. FOER: That should be enough to generate some questions.

MR. KUTTNER: This is a line making the rounds in the libertarian blogosphere about would you rather have the technology and the gadgets and the statistics of 1970 versus 2006, how about if we had the science and the life expectancy of 2006 and the income distribution of 1970. Think about that for a minute.

Second question, doesn't every single study show that the dead weight loss of administering private insurance is several multiples of the dead weight loss of administering Medicare?

MR. LINDSEY: I'm sorry. Say that last question again.

MR. KUTTNER: You were talking about the leaky bucket. Isn't the private health insurance a much leakier budget in terms of dead weight administrative costs, marketing, risk selection, all that stuff, isn't it much less efficient to do that through a whole plethora of private insurance companies than it is through Medicare?

MR. LINDSEY: First, on your counter thought experiment, mine was between two real- world things, living in 1970 and living today with all the ups and downs of living back then with all the ups and downs of living today. Yours is between reality today and a fantasy world of the fruits of the kind of economy we have today but without the structure of the economy that has produced those fruits. So, it would be great, too, if all the — were eliminated and every kid had a puppy, but you are just not going to get the kind of economic dynamism today with the economic structure of the first couple of postwar decades.

MR. ORSZAG: Just for a second on that, do you think it is impossible to have achieved the economic performance and scientific advances we achieved without, for example, the top .01 percent accruing the share of income that they have now accrued?

MR. LINDSEY: Of course, the .1 percent of this group of people we can go and point fingers at or soak or whatever. It is a different group of people every year, right?

(Laughter)

MR. LINDSEY: The world we are living today, would any change in economic

policy have knee-capped the great bulk of economic growth over the past 30 years? Of course not. As Adam Smith said long ago, there is a lot of ruin in a nation. You could have all kinds of policies that compromise economic growth, yet the fundamental enormous dynamism of market competition chugs on. I would say that we would be unlikely to have seen anything like the kind of growth that we have experienced and increases in material wealth that we have experienced if we were still with a 70 percent top rate, if we still lived in a world in which it was normal for people to in good conformist organization man fashion stay with the same large organization and dutifully follow orders to climb the corporate ladder.

I think we are living in a culturally different world and in an economically different world. The kinds of organizations and structures that were good for spreading mass production and corporation organization techniques throughout the economy in the first couple of decades after World War II clearly were not continuing to produce robust economic growth into the 1970s. The reason the 1980s happened is because the 1970s happened.

Of course we can talk about margins about this, that, and the other thing, but generally I think we have made significant economic progress and the more entrepreneurial, more competitive, more market-oriented, more universalistic economy that we live in today is a major part of the reason.

MR. FOER: So you are saying that the insecurity that Jacob is describing is a phenomenon of people being big babies who are complaining about material issues?

MR. LINDSEY: Not at all. I think statistics seem to show that job displacement rates are higher today than they were in yesteryear. In white collar jobs in particular, the layoff rates through the 1990s boom were higher than they were during the 1982 recession, and so we

see at the top of the economic pyramid much greater turnover in the Fortune 500 than we did in previous decades, and I presume that kind of robust dynamism and creative destruction are occurring throughout the economy that makes people if competitive pressures are ramped up, then anxieties are ramped up, too.

We see the exact same thing happening in our cultural lives. We have traded in stability and security of staying with the same spouse your entire life for a world with perhaps more opportunities, but also greater risks, right? The right and the left share this strange nostalgia for the 1950s. The left wants to go to work there, and the right wants to go home there.

(Laughter)

MR. LINDSEY: But the 1960s happened and the 1980s happened, and both of them brought a lot of good and both sides need to sort of deal with that and move on.

MR. ORSZAG: May I comment on this for a second? I am obviously going to leave the domestic side alone, but with regard to whether there are things we can do to continue the great growth engine that we have enjoyed while also lifting the middle at least to some degree, I think there are a whole variety of things, and in some sense that is a lot of what we are trying to explore through The Hamilton Project that could be done. Nobody is talking about moving back to 70 percent marginal tax rates. My own read of the evidence was that the Clinton level marginal tax rates did not have any adverse consequences for growth. If anything, that was a period of very robust growth.

Again, I think even in the tax code you can explore different areas. In the tax code I think there is a lot that we can do, and I will come back to why we are spending \$500 billion a year in a very inefficient way, that would both promote efficiency and help middle-class

families, and when they both go together there is not a leaky bucket and it does not make any sense why we continue to do things just because of inertia that are neither good for growth nor good for middle-class families, and I think that is a very good starting place to make progress on this issue.

MR. ROSEN: I have a quick political question. Your comments on social insurance are refreshing. Are you saying you and your colleagues are willing to tolerate this, or would you be actually willing to go out and aggressively advocate these things?

MR. LINDSEY: I cannot speak for my colleagues or for my ideologies generally. Let's put it this way. I'd be willing to go out and sell and advocate a package deal that includes entitlement reform on the one hand and social Medicare modernization on the other. That is a package deal that I think most libertarian-minded people, and that is people within the liberal tradition are most focused on curtailing centralized power and most are enthusiastic about voluntary and private activity, I think that is a package that would sell and I would be willing to sign on the dotted line.

MR. ROSEN: I think some people are so impressed that you find so many areas to agree that they are focusing on that, and I just want to go back to the issue that Bob Kuttner raised a minute ago. Just to be clear again, do you believe that the growth that we have enjoyed since the 1970s, since the products of your good news, are the result of, for example, the rise in unemployment duration that Howard talked about? The issue almost gets joined and then it kind of veers off, so I just want to be clear. Is the rise in life expectancy, the increase in GDP, the product of rising economic insecurity or no?

MR. LINDSEY: I cannot think of it that way. That is, are all the good things

only possible because of all of the bad things? No. And causation does not work that way in this abstraction called an economy which just consists of billions upon billions of activities and decisions all summing together over time. The fact is that our economic growth and development have occurred because of a fundamental shift away from manufacturing towards services, because productivity growth has been occurring faster in manufacturing than it has been in services, it has occurred because of better monetary policy, it has occurred because of better tax policy, it has occurred because of a whole host of factors which have had then a whole host of consequences, some of them positive, some of them negative.

What I would not want to do is say that every single negative thing that has happened you just have to live with because it is the price we have to pay. But I would also caution against assuming that you can wipe out all the negatives and not have any costs on the positive side. Beyond that, I do not think I can specify.

MR. ORSZAG: If I can just come in, I want to stay joined on that issue, but I think it is very important to emphasize yet again, it strikes me that we are at a point in our nation's history where the risk that we will take steps that actually do impair future economic performance are very significant and that some of the reaction to the failure to respond appropriately over the past 20 to 30 years to growing economic insecurity will manifest themselves in ways that, in answer to your question, do actually kill the golden goose kind of thing.

We are at a point where I think the insecurities that Jacob has documented but that most Americans seem to just sense are potentially manifesting themselves in very counterproductive ways, and that is why I think it is particularly urgent that we not only address

the fiscal problems that the nation faces, that is very important, but also tackle head on this sense of insecurity that too many Americans feel and that in my opinion is not a necessary part of economic growth.

MR. LINDSEY: May I just say one more thing in response to Howard's question? First, the proof is in the pudding, I think. Libertarian free-market types supported fast-track or TPA, trade promotion authority legislation. But what I am saying is that free-market types were very much in favor of an overall legislative package that included trade promotion authority and expanded trade adjustment assistance. They recognized that they were not going to get the one without the other, and they thought that on the whole that it was a win for the free-market side and so they supported it.

And it does not really matter I think when you are talking about package deals whether in the coalition that supports a package deal who likes what part of the package. The point is assembling some compromise that everybody considers a win for them, and I think a package of pro-economic growth changes along with pro-security changes can be appealing and produce a win.

MR. ROSEN: I have to respond because that community did not support a package from the beginning. They supported trade promotion authority. It was only when the liberal community said that legislation is not going to go forward unless — then it became a reality. What I was asking you before is why don't you in the beginning say you needed trade policy that also takes care of the workers, but you didn't. Your community did not say that, and only accepted it once it was imposed upon them. That's what I meant by is it taxing or are you

MR. LINDSEY: I would have supported that package to begin with, and there are a lot of complicated politics for how legislative deals get cobbled together. But let me also just issue a caveat. I am not an uncritical admirer of social insurance. There is social insurance, and there is social insurance. I think as someone who comes from the free-market side, I am concerned about incentive effects; I am concerned about mission creep.

Disability insurance is a perfectly vanilla form of social insurance, but I would not like to have our policy environment like that of many Western European countries where startling fractions of able-bodied men declare themselves permanently disabled because the benefits are so generous. So I think an appropriately tailored program that does not undermine work incentives is one that I could get behind as a part of an overall package of improving our economic policies. Is that the thing that I would start out with? No.

MR. HACKER: I just want to say that I think this exchange really raises the fundamental issue, that the free-market enthusiast's line has been for many, many years that an open dynamic, competitive market creates more winners than losers, and that helping those losers get back on their feet is much more preferable than clamping down on the dynamism that produces the losses in the first place. But I think what Howard is saying is right, it is high time that Americans and political leaders demanded that those who make that claim put their money where their mouth is.

MR. LINDSEY: And it is high time for the supporters of social insurance to stop bashing Wal-Mart.

QUESTION: When you speak about the high income earners and how you have to want to save the future and with social insurance we are not also taking care of the other side

by making sure that those at the bottom have the ability to save for the future, and we hear these things about disincentives and you look at 30 years of data and it shows even those states who have higher unemployment insurance benefit rates and benefit amounts, there is no data to support that those have longer durations, in fact, they have shorter durations. So where is that other side going to make sure that you can enable the person to actually save for the future?

MR. ORSZAG: Let me comment on that in a couple of ways. First, the overwhelming body of evidence on unemployment insurance suggests that it does have some albeit quite modest effect on unemployment durations, that is to say, it does extend unemployment durations, albeit quite modestly.

With regard to where the money could come from, in other words, how can people afford to save anything, and now I am going to move away from unemployment insurance because that is obviously a broader question and there are obviously two parts of that. The first is that we need to increase take-home pay, or there needs to be more take-home pay and that comes back to both education, but also some of the tax changes that we were at least hinting at earlier on.

And then I think it is very important to us, and I have not commented on this earlier, but there is a very powerful way of getting Americans to save, and it is a topic of a variety of other work that I have done and others have done, is to use inertia. Inertia is incredibly powerful; through well-known psychological forces, money that you touch is very much harder to put aside than money that you never touch in the first place.

Things that flow directly through payroll deduction into a savings account is a much more effective way of trying to encourage people to save than getting money in your hand

and then saying, oh yeah, I have to put a little bit into an IRA. The evidence, for example, is that new employees at a firm with \$15,000 or less in earnings, if they have to wade through a book like this and sign up for a 401(k) plan, 15 percent do. If they are in the 401(k) plan automatically and then they have the opportunity to opt out, 80 percent participate. It is very clear that American families that are busy with other things and have other pressing needs will save if we give them the right structure to do so.

Just to pause on that for a second, I think we should have a system where you go to work for a new employer and you have some automatic form of saving that you can opt out of if you want, but that you are automatically having some saving going on without having to wade through this kind of binder; we need an EZ Pass kind of approach to savings so that you are automatically in unless you opt out, your contribution rate is automatically increasing over time, you are automatically invested in a diversified low-cost fund, and all of that has very strong evidence behind it that it really works. There is so much more that we can be doing to make 401(k)s and IRAs work better.

MR. HACKER: And just to continue that point, because I think the point about leaky buckets in the public sector, in the private sector particularly in regard to 401(k)s there is a huge amount of leakage that occurs as people change jobs and they get lump-sum payments or they need to borrow against their plan which is less of a problem but can sometimes create shortfalls. So I think another aspect of this really is thinking about not only getting people to put aside money up front, but also about making sure that they have continuous access to savings vehicles over the course of their working lives.

I actually think here is an area where there really should be a lot of agreement,

that whatever form the benefits take, however exactly they are structured, there really is not a reason why employers should be the ones who are deciding whether you have access to them. That is the way the system is structured now, the tax benefits push in that direction. It is regressive and it impairs economic security in a more dynamic economy.

QUESTION: I want to go back to something Peter mentioned on the first panel, and that is at the time of rising insecurity and record corporate profits, what should we expect from the corporate side in this security picture?

MR. ORSZAG: I think that obviously is a very big topic with a lot of controversy surrounding the role of corporations in, for example, providing health and pension benefits. It strikes me that at the very least one can imagine a world in which corporations at least have to play the role of facilitators, that is, provide access to, for example, in the 401(k) and IRA setting, some automatic form of saving. You can draw analogies actually in health care and other areas, too.

So there is a lot of pressure in corporations in an international environment and in an international economy that might curtail their ability to function as fiduciary agents or even as the pooling mechanism, but they can clearly continue to serve as a facilitator or a mechanism for providing important benefits and I think we sort of need to flesh that out and develop that more, but that is consistent I think with what Jacob was saying.

The second thing is, and I am going to return to another topic, our corporate income tax revenue as a share of GDP has plummeted over the past 40 years. There are a lot of holes in the existing system involving transfer pricing, how one adjudicates where profits are arising. There was a major tax case that was just settled earlier this week or late last week

involving Glaxo and the allocation of pharmaceutical profits between the United States and the United Kingdom.

That is a very important topic in my mind, that corporate income tax can finance a lot of the core social insurance benefits that we are talking about, or the other operations of the government. So at least in my mind I am thinking that corporations can play an important financing role in terms of the corporate income tax, and then an important facilitator role in terms of providing access to benefits in terms of retirement, health, and elsewhere that would rest on top of a bottom layer provided by the government.

MR. HACKER: I want to add to that because I both agree with it and also think we could push this point a little further. Where I agree with Frank—and I think this is important to understand—is that these risks are not faced by individual workers only. Corporations are obviously under severe economic pressure because of these benefits. We have just seen GM, for example, laying off thousands of workers in part because of the very difficult time it has had in dealing with its retiree benefit costs.

So I do not think we could help corporations substantially by providing a more level playing field and a better system of economic security that relieved them of some of these burdens. Historically speaking, if you go back to the Great Depression and also the period after World War II, leading corporations have been pioneers in pressing for government programs at times when they realize that they are no longer able to maintain these benefits on their own. I think there is really a high-road and low-road route by which corporations will get out of being mini welfare states.

The high road will be a partnership with government that will allow them to be

facilitators, allow them to contribute in some way, but will ensure that Americans have secure benefits. The low road I think is the abandonment of these benefits or the movement to insecure guarantees, defined contribution accounts, not just with pensions, but with health care, and the movement away from providing any kind of risk pooling. And I think that will leave people even more insecure than they are today.

MR. LINDSEY: I was just going to make a quick point just to remind everyone that corporations are not real. They are just legal structures. Taxes on corporations are just taxes on their workers and their shareholders, and so they are not some magic sugar daddy you can tap into costlessly.

MR. FOER: We'll end on that note.

(Applause)

MR. ORSZAG: Our next panel is going to focus on continuing the discussion and will be moderated by Glenn Hutchins, who I should say is not only a member of our Advisory Panel, but also really the force behind this joint symposium. He is the person who originally suggested that we get together with The New Republic to hold a joint event. Glenn, do you want me to introduce everyone else, or are you going to do that?

MR. HUTCHINS: I am all set. Thank you, Peter, and I am glad we waited for that.

My name is Glenn Hutchins, and one of the ironies is that, me, who no one knows is going to introduce these three people who everyone here knows, but I will go ahead with it. I will introduce these folks in the reverse order of their speaking. Gene Sperling, to my right. We worked together in politics. I think one of the few key people on the Clinton economic policy

team who was there from the campaign through January 2001, from the beginning to the end, and he was of course National Economic Adviser to the President. His fingerprints were all over the many economic accomplishments of those years, and it is no surprise as a result of that he is currently a go-to guy for any Democrat thinking about running or actually running for President.

Since then he has brought his characteristic energy to his activities, and I will just note two very quickly. First, he has a new book out, called *The Pro-Growth Progressive*. Gene, do you have a copy you can show us?

MR. SPERLING: (Off mike.)

MR. HUTCHINS: I highly recommend you buy it at full price at a bookstore in your neighborhood. Secondly, while we are all worried about future generations in the theoretical sense, Gene has been doing something about it in a practical sense. He is the daughter of a five-month-old daughter, I believe. So congratulations, and we thank you for your contribution to future generations.

Kevin Hassett, over here to my right, probably a person who does naturally reside there, is the Director of Economic Policy Studies at the American Enterprise Institute. He has been an economic adviser to George Bush and John McCain, among other. He has had a distinguished career in academics and public service. He has produced a broad range of thoughtful books and articles on economic policy which I have personally enjoyed, and Kevin we are very pleased to have you with us.

To my left is Bob Kuttner, who will speak first. I first became familiar with Bob, a little plug for The New Republic, I am an avid reader of The New Republic, and he has had a series of thoughtful and provocative articles there, especially when he was Economics Editor for

the magazine. And as all of you I am sure know, Bob is co-founder and co-editor of The American Prospect which is an important and influential journal which has made real contributions to the debate over the last three years. He is a prolific author and was recently named Senior Fellow at Demos. Congratulations, Bob.

The first question which Peter has instructed me to ask is, let's see if I get this right, Peter, What single policy change would best promote broad-based economic growth? I live in New York, but I realize that this is a town in which people are renowned for taking pride in not answering the question they are asked. But I gather, Bob, you would actually like to answer the question. Is that right?

MR. KUTTNER: I would, and thank you. My first reaction was, of course, there are no silver bullets, but then I realized this was a rare opportunity.

(Begin Tape 2-A.)

MR. KUTTNER: The single policy change that would best promote broad-based economic growth if of course restoration of progressive taxation. Why? The Hamilton Project is dedicated to a high-growth economy with more opportunity and security for ordinary people, and The Hamilton Project also seems to believe that this enterprise requires a degree of social investment, not the kind of social investment that fits the economy of the 1930s or the 1950s, but the kind of social investment that enables the dynamism of the 21st century, but also recognizes that if people are protected against unavoidable risks beyond their control, they are more likely to take the kinds of risks that produce a dynamic entrepreneurial economy.

The Hamilton Project of course is also devoted to restoring fiscal balance. Obviously, you can have fiscal balance with the government spending 12 percent of GDP or

20 percent of GDP or 22 percent of GDP, and I think all of my economic work has been devoted to arguing that within a reasonably broad range, the effect on economic growth of having a society that is more or less facilitative of opportunity and security for ordinary people is indeterminate.

You can gum it up by the wrong kinds of programs like AFDC, but there are all kinds of social investments that are facilitative of growth, and we have heard about some of them this afternoon, education, I would add early childhood development, a more dynamic use of money spent on unemployment compensation, something I have been writing about since the 1980s, health insurance is not requiring you to get locked in to your present employer and causing your employer to bear an uncompetitive burden, so that well-designed social insurance facilitates dynamism and also increases opportunity and security. Jacob Hacker is very much in this tradition, as you have heard.

I also would say is this delusional to think that we can put progressive taxation back on the agenda? Aren't politicians going to slit their throats if they support restoration of progressive taxation? Bob Rubin who wrote a very brave op-ed in The Times last year saying in so many words that we need fiscal balance, but one way we need to do it is by getting rid of the Bush tax cuts on people earning over \$200,000.

I do not think the Democrats lost the mid-term election in Clinton's first term because they raised taxes on the top 2 percent, and they did not raise taxes on the bottom 98 percent. I do not think saving the death tax is a political death knell. There is a group called Responsible Wealth which is made up of multimillionaires in favor of preserving the estate tax led by Gates Senior and Warren Buffett.

The other day, the papers carried a very interesting story, Medicare taxes on people earning in the six figures are going to go up slightly next year. A person earning \$200,000 a year is going to pay about \$900 more. This was a provision that was tucked into the 2003 legislation creating Medicare Part D, a la Bush, primarily a subsidy for the insurance industry and the drug industry, but the Democrats, I gather, I did not know about this until I read it in the paper, managed to put in a little provision that made the donut hole a little bit smaller and the hit on the deficit a little milder, saying let's raise Medicare taxes slightly on very affluent people. Seeing this in the paper was like sighting a rare endangered species that one thought was almost extinct. Oh my God, a little bit of a harbinger of progressive taxation, and even better, progressive taxation in the context of paying for social insurance which is ordinarily paid for by regressive taxation.

I think if we do not do this, if we do not get progressive taxation on the agenda, after all, in the ear of that Bolshevik Dwight Eisenhower, the top rate, as you know, was 91 percent and that was the era of the postwar boom. The 1990s were a very good decade, we did very well, and I am not just saying this because Bob is here, we did very well with the Clinton tax rate. It would be quite salutary I think to go back to the Clinton tax rate.

Here is the little bit of vinegar. I think if we do not do that, I detect — maybe I am reading too much into this — that there are two phases of The Hamilton Project that are in very creative tension with each other. One is the Jacob Hacker/Peter Orszag face that says let's update social insurance for the 21st century and use social investment not to retard economic dynamism, but to enhance it. The other face is oh-my-God entitlements, and I think if we end up with a grand compromise at Andrews Air Force Base that includes our good friends from Cato,

the only common denominator in this grand compromise is to really sandbag Social Security and Medicare.

A lot of good people at Brookings have come up with plans that keep Social Security essentially intact as a defined benefit plan. It is the last one practically that we've got. There were some very bad plans in the late Clinton Administration, less the work of the Clintonistas and more the work of Breaux and Thomas and so forth, it came that close to switching Medicare to a kind of defined contribution plan where you would get a voucher and you would go out in the free market and buy some minimal free-market health insurance plan that you were free to choose to supplement with your own resources or not, and if you did not have your own resources to supplement it, too bad for you.

Yes, these programs need reform, but I think the wrong kind of entitlement reform, rather than building on the social insurance we have, would shift more risk onto individuals at a time when individuals, as Jacob has so eloquently demonstrated, have had too much risk shift.

Before I conclude, the idea of a grand bargain with the Republicans on fiscal reform, as I am sure Bob Rubin knows better than I do, is the sound of one hand clapping. We are talking about putting taxes on the table. You cannot find a Republican in this town willing to put the Bush tax cuts on the table. What they want on the table is permanent repeal of the estate tax, more and deeper tax cuts that would produce more of a revenue hole. So if we do not put progressive taxes back on the table, this path leads inexorably to undercutting what is left of social insurance, and I hope that does not happen. Thank you.

MR. HUTCHINS: Thank you, Bob. Kevin? Without fear of contradiction, I

might hazard a guess that you are not going to agree.

MR. HASSETT: Yes. You can always tell if there is an AEI person at Brookings because they close the shades.

(Laughter)

MR. HASSETT: But apparently that was not enough for me, because Peter and the organizers decided that hence forth, apparently, when I appear on a panel that I am only allowed to discuss a single proposal. I talked to Bill Gale (?), my regular adviser on such things, about the constraint restraint, and he suggested the proper solution, which is that I use my time to discuss the one thing that we need to do to make the economy greater than it is, and that is to adopt the Hasset Agenda.

(Laughter)

MR. HASSETT: But I will not actually cheat and do that, but, rather, I will take Peter's task seriously. I could add that I have really been impressed at how many people have done that and how quickly The Hamilton Project, at least as I see it on the Web, has produced a whole bunch of interesting and productive things.

The question I ask myself is what is the one thing that is kind of doable that we really ought to do right now to ensure that the economy does not derail? Again, you could get very ambitious and say, well, we should have a broad- scale fundamental tax reform, but that does not seem to ever get anywhere.

So rather than focus on that, what I would like to do is talk about the one thing that I think is most out of whack in our tax code, and I think that it is out of whack enough that it is already causing a lot of damage to the economy, especially to blue collar workers and the

middle-class, and it is something that is relatively easy and not that costly to fix. So that is a simple proposal that I would like to focus on. I will base my remarks on some interesting work that has been done both in the academic literature by university economists, by people in Brookings papers, and by people over at AEI.

The thing that strikes me as strange, and there are a number of things that we observe that suggest there is truly something bizarre going on, is that it seems like U.S. companies do not really want to be in the U.S. quite as much as we would like, and I think if I say that statement, then pretty much everybody ought to say, yes, I have that sense, too. There are a number of ways that companies can express that preference to us or that we can observe it in their behavior.

One of them is a propensity of a company to locate operations offshore and overseas, and I can say that if you look at the things that they try to move offshore and overseas, it is really quite striking how broad the technological context is within which they operate. Or to put it another way, it is not just the folks who have lots of labor as a percentage of the value added in their product that locate overseas, we have firms locating semiconductor foundries overseas where there is really one person out front who pushes "start" in the morning and the rest of the plant is more or less a machine.

So firms locate plants overseas, and you could imagine why they might want to do that, and I will talk about it in a minute. But it also not that is troubling, they also want to locate their headquarters overseas. This is this so-called propensity for firms to see what we call corporate inversion. That is also readily apparent in the data. Economists have been studying why it is that this activity has been going, and there is some dispute whether it is good or bad in

the literature for America. I would argue that the dispute about whether it is good for America actually signs the light on the one policy that we ought to pursue.

Why is there a dispute? The dispute about whether it is good or bad for America that these plans and firms are deciding to locate activity overseas goes like this. The U.S. has the second-highest corporate tax in the world. If you combine the local and federal level, my latest calculation for that is it is about 39.6 in the U.S., and Japan is ahead of us by a couple of tenths if you add their local taxes in.

But we also have a very I guess loose system that allows firms to locate activities in foreign subsidiaries in low-tax countries and then use transfer pricing to move the money around from country to country. The way that that could potentially actually help the U.S. firms as a whole is that because of the transfer pricing, firms who are able to locate a plant overseas can lower their effective tax rate significantly and potentially compete with a firm from a low-tax country in a way that they would not before.

It strikes me that this is really crazy, that we have forced our firms into a world like this. Joel Slemrod at the University of Michigan has opined that it seems likely that the compliance costs of the U.S. international tax code exceeds the revenue that we raise from it. I had one tax counsel for a big auto maker tell me once that they moved their international tax return around with forklifts.

So it seems kind of crazy that we would do this, and in the literature it suggests lately at least that we are truly shooting ourselves in the foot. Kimberly Clausing presented an excellent paper at a Brookings conference here about a year ago that I was a discussant for where she looked at the mobility of capital across countries around the world and found that capital

tends to locate in the low corporate tax country in a big way, so much so, she found, that it seems that there is a Laffer curve in the corporate tax data.

I guess that the Laffer curve always seems somewhat implausible to me at least in the short-run if you are talking about say the top income tax rate, but the corporate tax Laffer curve to me is pretty easy to believe in because all you have to do is trust that all of those people making seven-figure incomes a few blocks from you are earning their pay every year by moving the money around to the low tax places to avoid U.S. corporate tax, and if they can do that, then they earn their pay.

The study of how they do that has progressed a little bit, and I find it pretty troubling because transfer pricing is something that Treasury officials are pretty good at holding at least within the bounds of reasonableness, and if you really want to hit home runs with transfer pricing, then a way a firm has to do it is that it has to locate something that gets paid a royalty offshore. So if you are Microsoft, then you have to claim that a lot of the intellectual property in the latest version of Windows was made in Ireland. If you can do, then you can locate a profit in Ireland and have the U.S. pay royalties to the Irish sub.

So I think that what we have done is by being the high tax place we have given our firms a strong incentive to move things offshore to avoid the high tax rate, but also to move the stuff that matters the most for our long-term growth, this generation of intellectual property offshore, and we are beginning to see I think troubling signs that this is having a real effect on the organization of American industry, and there are great R&D booms and tax havens right now and a lot of it is funded by U.S. firms.

It is not only the case, however, that intellectual property is the stuff that is

moving around. It is also true that capital moves as well, and one metric of this that was discussed at length in an article in *The Economist* about a month ago about a paper that I just finished with my colleague Aparna Mathur is the very strong pattern clearly in the data that these capital flows have a big effect on blue collar wages, and we found very strong evidence, of quite statistically and economically significance that the high elasticity of capital flow in response to the capital tax is having a big effect on blue collar wages and my guess is if economic historians look back at this time and find that the median wage behavior of the U.S. economy to be disappointing, that one key factor that they will be able to attribute it to is capital flight with being basically the high corporate tax place on earth.

In tax policy, it seems a good rule of thumb that we teach undergraduates that unless elasticities are restrained, start with the tax rate which is the highest when you are thinking about what you want to reduce. I think as I look at the challenges ahead, I know that there are many, and I think that in the near term having a reform that makes it a place where a typical CEO will actually think that it is not crazy to locate his new plant in the U.S. because of the tax code, I think that if we could reach that point it is going to help us with everything else. So that is my one proposal, to reduce the corporate tax rate, and you could say how much, and I think the average for OECD countries is now on the order of 6 or 7 percent, counting local taxes below where we are, and I think that would be the minimum of where I would want to go.

MR. HUTCHINS: Very interesting. I hope we will have some time to come back and talk about the contrasts about those two thoughts, but I want to ask Gene a different question, which is, Gene, I know we are supposed to talk about a single policy option, but in your new book you lay out a whole bunch of different ideas. I wonder if you would like to

address a framework of a thought process for getting at the issue that we are dealing with.

MR. SPERLING: Glenn knows me enough to know that there is just no hope that I will even stay.

MR. HUTCHINS: That is why he is going last, by the way.

MR. SPERLING: But Glenn, actually, you said that in Washington people pride themselves by just ignoring the question.

MR. HUTCHINS: Exactly. I'm putting you in a trap here.

MR. SPERLING: That is actually not right, and Bob would admit this, too, that actually when you are doing things like presidential debate prep, et cetera, what you are actually telling the person is to kind of segue quickly in a way that looks like they answered it. So if somebody asks you are you for a capital budget and that is not what you want to talk about, you say, I was just actually up visiting on the Capitol, and then you segue to health care reform.

(Laughter)

MR. SPERLING: In my effort to take Peter's question seriously, I was going to try to talk about one concept and it is something I am writing something on right now, but I think for transparency's sake it is probably trying to come up with a single concept which the way to go not to the Hasset agenda, but to the Sperling agenda, but I think it plays very much into the discussion today.

I think that what really hurts the ability of both political philosophies, both political parties to connect to the American people, is that each of them have a blind spot into what I think is the true nature of how Americans look at risk. I think that for most Americans there are two phases of risk. I think there is a part of the American character that is very much

risk-averse about significant falls downward and actually very much want the very type of broad, guaranteed social insurance.

And yet I think there is another part of the American risk character that is very entrepreneurial, that is very upwardly mobile, very much based on their aspirations, and that rather than this being the agenda of one party or the other or one person or the other, that a lot of Americans have both of this risk characteristics and I think that each side fails a lot because they each have a bit of a blind spot to the other.

When you look at the conservative blind spot, I think that this has been well discussed today, which is in its harshest form you can describe it as Jared Bernstein does, you are on your own, social Darwinism, but I think in a more generous sense you could say that people who are very focused on things like individual choice, et cetera, are blind a bit to the degree that Americans do want a certain degree of risk protection and, therefore, completely continue to advocate an increased shifting of risk to the individual through the various things we have talked about today, from Social Security privatization to individual health accounts, at the very time that people are feeling a greater degree of insecurity. From a policy perspective, this is like learning into a right punch, and I think that this blind spot has very much hurt the conservatives in reaching out to people and connecting in the state of globalization.

On the progressive side, I think people on the progressive side are very much seeing this blind spot and seizing on it, and I think that the kind of proposals that we are seeing today are very important and good, but I also think that there is a risk of progressives being so focused on this that they lose out to their own blind spot on the American risk profile so that in a sense the progressive agenda becomes the safety net nation. Democrats and progressives make

absolutely clear to the world that if something bad happens to you in your life, Democrats or progressives are the ones there for you which is I think very important.

The problem is that most people when they want friends in life, first of all, do want friends who will be there when they are down. Most people also want friends who will be there for the good times, for their dreams, for their aspirations, and I believe if you become a party or a political philosophy that is only focused on the downside, you miss that part of the American character which does dream, which does aspire, which does want to move up, and does want to attain wealth. I always point out that even Huey Long, the ultimate populist, used to start all of his redistribution speeches with "Every man a king, every man a king, you can be a millionaire." He was still playing on the dreams of Americans of moving up.

As I look at policy development right now, I think both sides are feeling an instinct to overcome their blind spots, but I think that each side still does it in the most marginal way. Let me explain, and this will be a little bit of a brief for some of the ideas that Howard, Jacob, Jeff and others were putting forward. When I am speaking more with conservative friends, Republican friends, I find them repeatedly saying, yes, we ought to be doing more for those who lose out in globalization, we have to do more. But let's really talk about what the benefits for growth you get for economic security are.

Most of the benefits that we talk about have a presumption of widespread understanding, access, and knowledge. In other words, the reason why I do not think most of our policies we have so far add up to a hill of beans in terms of economic security is that when you go up to the Hill in 1997 to talk about the fast-track initiative, you have to get briefed on the difference between TAA, dislocated adjustment assistance, NAFTA TAA, and you have to get

briefed up, and then you say I am the Presidents National Economic Adviser and I am going up to talk to a senator who has been in the Senate for 24 years, and if I have to get briefed up to go tell them what the difference is, how the hell is a 28-year-old guy who just lost his job supposed to feel the slightest bit of security? So if you are serious about having programs that are going to relieve the anxiety and relieve the potential for backlash, you are going to have to have things that are wide and universally accessible.

Consider one thing that is well-known, bankruptcy. Every single entrepreneur in the United States understands that if they were to invest in their great new idea and it fails, they are not going to debtors' prison. It may not be pleasant, but they will have a second and third chance, their children will not grow up and stark poverty because they had a bad idea. That knowledge of that safety net for entrepreneurs is one of the things that encourages Americans to be risk takers, and this is one of the points that Robert Shiller takes.

If we want Americans to still be taking personal individual risks with their education or with their career paths, if we want them to not have a backlash mentality, then that requires rather universal approaches. You cannot have a world where any of us can pop into any major city in the United States and know exactly how to get a film from Blockbuster or a pizza from Domino's, but like if the most devastating thing happens to a typical worker in their life, and I mean this, there are not 8,000 people in the United States who would know who to call or what benefits they are eligible for. So that means if you are serious about this, you have to be for something that is universal, simple, bold, and accessible. If you are on the conservative side that is a significant concession because that is acknowledging that we are going to need a broader, simplified kind of method if we are going to have that message.

I say honestly that I could not tell you right now which of the proposals we have heard today which is my favorite or which I would like, but the idea that I think The Hamilton Project, Jacob and others, are pushing these kinds of broad-based universal approaches is the right discussion to be having. With all the issues on getting work incentives right and reducing moral hazard, I think that is very important, and I think if people on the conservative side do not truly adopt that, they will miss out. They will just marginalize it, they will have a talking point, but not an agenda.

On the progressive side as well, I feel that now that there is a wink towards wealth creation, there a wink are small baby bonds. I think the things that Peter has been working on in inertia and default is very important. But there still is not as much of a boldness that I think has been displayed since President Clinton put forward the USA Account proposal. There has not been the sense that progressives actually to put something that would deal with wealth creation and savings for middle-income and lower-middle-income people as one of the top three things they talk about, as something that would actually cost some resources. Again, I think both sides can kind of check the box, but I think the basic blind spot will occur.

My last point is that in addition to marginalization, I do not think the right way to deal with this kind of mix in the American character is to try to have proposals that are mixed, and I will end with Social Security because I think it describes it well. The notion that there is a three-legged stool to retirement security, that one leg is kind of your house and savings, has lots of risk. Secondly, is your pension which also has potential for risk and investment. And third is Social Security which is a guaranteed, rock-solid benefit. Some people would say why not move more to partial privatization because it will have some guaranteed and some risk. I think that is

the wrong approach, and I think that is what fails with the American people.

I think what they want are things like Social Security, wage insurance, the things that will protect them from downward falls, to be rock solid. I would not inject too much risk and investment into those areas. I would keep those as strong as possible but build on top as a separate and more universal 401(k), or a proposal I have for flexible educational accounts. I would go more for the individual choice in bold models when people are looking for the upside for investing and keep those separate. And I really do believe that the parties and the candidates and the people who understand the two phases of American risk and are bold and strong and appealing to both sides will do the best in having a pro-growth progressive agenda that has both pro-growth and security and connects with I think the typical American worker.

MR. HUTCHINS: Very interesting and provocative, Gene. Well done. We were supposed to turn to questions a few minutes ago, so what I will do is since my first question was really Peter's, I will ask the first question.

Bob and Kevin's statements or proposals raised two questions in my mind, and let's assume for purposes of this question that we are not just trying to create economic growth, but we are trying to create broad-based economic growth by which I mean sort of shared and inclusive growth which I take to be one of the goals of The Hamilton Project.

Question one, what have we learned from the two tax initiatives of the last two administrations—"raising taxes" in the Clinton Administration, and the growth that followed from that, and "cutting taxes" in the Bush Administration and the growth that was generated from that—in terms of what did we learn about how tax policy can be used or not used to generate different kinds of economic growth?

And in your two statements, yours which was focused on income tax rates, estate taxes and a Medicare tax, Bob, and yours, Kevin, on corporate taxes, is there the makings of some sort of grand compromise, if my head is in the right direction, both with respect to fiscal balance and the type of economic growth we are seeking? Fifty words or less.

MR. KUTTNER: No, I do not think there are the makings of a grand compromise at all because, as I pointed out, you cannot find a Republican in town, maybe Senator Chafee who the RNC suddenly discovered the virtue of investing in, who would put the Bush tax cuts on the table. And you do not have that, then the only thing the Democratic side could do if it wants fiscal balance is throw what is left of social investment on the bonfire, so I do not think there is a grand compromise.

I think the history of fiscal policy in the Clinton years when you had budget balance, you ever had surplus in the last couple of years, and the only slight pain was that very wealthy people who had enjoyed tax cuts throughout the 1980s had a slight tax increase; that was sensible fiscal policy. I guess wish that we had found even more public funds not for a fiscal stimulus, that is a cyclical issue, but for social investment which is a long-term issue of what kind of an economy you have, where you pay for opportunity programs.

For all the time about an ownership society, if you look at where the expanded ownership society came from, and this goes to Gene's point about are we talking about risk in the sense of protecting against bad things or encouraging people to take risks, so much of the middle-class ownership society is about public policies and public outlays, the G.I. Bill, FHA loans, college aid, all this stuff that I grew up with that really helped a lot of lower-middle-class and lower-class people become middle-class, that social investment aimed at what people think

of as self-reliance, not social investment aimed at dependence, and it costs money. You either borrow money to do it which increases the deficit, or you have a progressive tax system that pays for it based on the ability to pay, or you do not do it at all.

I want to take one more minute if I may and I want to quote something from a friend of mine, Chuck Collins, who is the guy who organized Responsible Wealth:

Multimillionaires Against the Estate Tax, and Chuck describes giving a talk to a group of veterans all over 60 years old. He polled them and he said, How many of you got a low-income mortgage from the VA or the FHA when you were young?" Most of the hands went up. "How many of you graduated from college without any debt thanks to either the G.I. Bill or because you went to a public university?" Two-thirds of the people raised their hands. "How many of you thought this was a waste of tax dollars?" Nobody raised their hands. "And how many of you helped your children through a parental down payment of an assistance program to help start a home or a business?" There was lots of nervous laughter and lots of hands.

What was once available to everybody is now too narrowly available to kids with wealthy parents, and this is not risk in the sense of cry baby, this is opportunity and ownership and helping people realize the American Dream, and it takes tax dollars.

MR. HUTCHINS: Kevin?

MR. HASSETT: Thanks. I think that the grand compromise, if you want to say it, is something that one could conceive of as being an objective of The Hamilton Project, because when I think of the folks who are associated with it, they tend to be people who understand economics and base their judgments on empirical evidence and understand, for example, that if you want the wage go up, then you have to increase the capital/labor ratio or get

really good capital or something. But I think that too often in the Democratic Party that is a kind of populism that if you took Marx and Engels and just sprinkled the words Wal-Mart here and there, then it would look just like what the Democrats are saying today, this view that capital and labor are opposed to one another and that there are these terrible companies and they are out there to hurt the workers.

I think that that view may have had some historical relevance, but it is not relevant for today. Where we are today, if you want to help raise wages, if you want to spread prosperity widely, then you need to get capital formation up. That is how wages tend to go up, is that workers get more capital, they become more productive and their wages go up. Yes, I think that there is room for a compromise down the road because I think that the data are suggesting, and I know that President Clinton used to talk about this very thing, about workers and firms not necessarily being enemies and capital formation being important for economic growth.

So part of the problem from my perspective is that it seems that something is lost along the way of that view, so it seems like it is impossible now to leave the place that we are as more or less the high corporate tax country, that it is viewed as some kind of sin to try to become a more attractive place to capital, and that is exactly the kind of mumbo-jumbo that I think The Hamilton Project was formed to help stamp out.

MR. HUTCHINS: Mumbo-jumbo is precisely how we think about it. Gene, you are up.

MR. SPERLING: I guess I take a slightly different approach than Bob on the grand compromise which is that where he and I would agree is what you would actually agree to. I do think, and this is almost more of a practical political observation, there are certain things that

are very difficult for a single party to do alone. There is a certain degree in Washington where you have to have a certain bit of holding hands and jumping together. And I think it is responsible for people who want to take on the big problems to kind of think in a divided country, in a divided government where are those areas where one could find some grand compromise? I think, for example, a repeal of the Bush tax cuts would be a meaningful thing for the President or Secretary Paulson to put on the table and should encourage Democrats to be willing to come and talk about some more difficult issues like Medicare reform.

Now where I agree with Bob is if they are not going to do it, I am not for unilateral disarmament. I think it is wrong. I think it wrong to ask typical Americans to make sacrifices. Money is fungible, resources are fungible, and if you have resources to give the most well-off people huge tax cuts, I think it is very hard for a member of Congress to come and say we just have to cut your Social Security or your Medicare benefit. So to me, one of the reasons why this kind of irresponsibility on the upper-income tax cuts has been so expensive is not just the cost itself, but it has taken away the sense of mutual sacrifice that you would need for a grand compromise. So I think we should be pushing for it, but where I agree with Bob is if they say stuff like let's do an entitlement commission alone, then I think we have to walk away from that, everything has to be on the table. I am for pushing for our vision even if they are not willing to come to the table.

Let me say why think Bob's choice on progressive taxation was a particularly good answer. I think that if you break down a lot of the struggles maybe people are having is that a lot of people look at the global economy, they look at economics and they think that the open market, free enterprise, more open trade, is still perhaps the best way for creating wealth

and productivity, but at the same time, they are looking at the wage trends and they are seeing that those productivity gains are not being evenly shared and we are having increased inequality. That is a context where you especially want progressive taxation because the higher income gains to the degree that they are rechanneled into giving people second or third chances, a G.I. Bill, the types of things Bob is saying, at least gives a stronger defense for that type of economy.

What we have not though is an economy that increasingly looks winner take all, combining with a tax system that exacerbates the winner-take-all notion by trying to lower towards zero taxation on accumulation of wealth, and I truly fear that we are going to become a society where if you can ever attain a decent amount of wealth, you can watch your wealth accumulate tax free at very little risk, extremely lower taxes than people working for a living, and that makes progressive taxation extremely important particularly with the trends we are seeing for those who both believe in an open pro-productivity economy but want to see a more even distribution.

I just think that one of the ways, and going to my point before, is that nobody has been more opposed to the repeal of the estate tax than me, and I think I have worked pretty hard on that, but I do think that we would also do better by making clear that we are just not in a no position. For example, taking some of the resources that would go to 5,000 or 10,000 estates in the estate tax and using that for a more generous universal 401(k) says to the American public we actually are for wealth creation, we would just rather have a plan that helps 60 or 70 million of you who want to some day have an estate, as opposed to 6,000 or 7,000 of the wealthiest families who already have an estate.

MR. HUTCHINS: Questions? We will have a microphone coming back here.

MR. GALE: Thanks. I am Bill Gale with two quick comments and then a question.

The comment on the possibility of a compromise, I agree with everyone who says it would be great if we could get a compromise, but I want to emphasize or put some background onto something that Bob Kuttner said about the impossibility of reaching a compromise if a compromise is something that is thought of as increasing taxes and lower spending, and that is, 80 percent of the Republicans in Congress and almost 100 percent of the Republicans on the Ways and Means and the Finance Committees have signed written pledges to not raise taxes, and that is a very hard constraint to get around and it makes that kind of compromise very difficult to obtain.

The only way we could possibly get to that is if you read the wording of the no new taxes thing carefully, if they let the Bush tax cuts expire, that does not count as a tax increase. So that is the only hope for raising revenues unless there is massive disavowal of something that they have signed.

The second point is, Glenn, you asked the question about what do we know about the 1990s tax cuts and the 2000s tax cuts, and I thought I would actually answer that question since no one else did. You can think of tax cuts as having two sets of effects, the change in marginal rates affects incentives to work, save, invest, et cetera, and those go in the direction you would think, the 1990s tax cut's increases reduced those incentives, the tax cuts in this decade increased those incentives. But there is a second effect which works in the opposite direction, which is it depends on how the tax cut is financed. If you finance tax cuts with spending cuts or cuts in wasteful spending, you will get an increase in economic activity, if you finance them with

deficits, you will get a reduction in long-term economic activity according to studies by the JCT, the CBO, et cetera. What is happening there is that the budget deficit acts as a drag on economic activity either through its effect on interest rates or its effect on national saving or both, and according to CBO studies and the JCT studies, over the long-run those termites eating away at the capital stock do more damage than the marginal rate cuts do help. So the net long-term effect of the tax cuts we have had financed by the budget deficit is likely to be negative according to almost all of the studies. Conversely, the Clinton tax cuts, to the extent that they were financed by budget surpluses, could have had growth-enhancing effects.

So those are my two comments. I have an even quicker question for Kevin. I heard everything you said and I understood it, I just want to ask you to try to reconcile your notion that corporate capital is leaving the country en masse with the observed fact that we have massive capital inflows in the country, and like the Bush Administration says, that is because this is a great country to invest in and investors all around the world want to come here. How does the notion of the corporate tax stamping out corporate investment compare with—

MR. HASSETT: I will answer that. I also want to respond to the earlier thing you said with a comment of my own. It is just that the Chinese government is buying U.S. treasuries, it is kind of a different ball game than the type of plant location decisions affected by the corporate taxes.

The point about the compromise on the Bush tax cuts reminds me of something I noticed in the Democratic primaries in 2004 when every Democratic's tax proposal was precisely to repeal the Bush tax cuts, and it struck me as odd because if I were sitting down with a candidate thinking about what we ought to do, then we would, at least I would, the candidate

probably would not, write down a model and solve for what the best thing to do is, and it seemed odd that we are basically at eternal bliss right before Bush got to office and that we could return to eternal bliss if we just could go back to where we were when Clinton left. And it seems like somehow the Bush tax cuts have really enraged people, they have really marked people, sort of like a bad spot on a marriage or something, it is just something you cannot forget, and I think that as long as that is where it is with people, then there will not be a grand compromise. But if you think, for example, of taking the current code with all this revenue we have on the baseline from the AMT and all this revenue that we are losing because we allow really gold-plated deductions for health insurance and for huge homes and so on and you gathered revenue back by capping the deduction for health insurance and capping the mortgage interest deduction and a million other things, then you might end up at a place where you might have a lot more revenue but rates were not higher than where we are because the base was wider.

It seems to me that if you want to have a compromise, then you have to give up the anger and then try to work within the system because I think it is very easy to find lots and lots of money without making rates go up.

MR. GALE: Allow me to respond. I do not think that pushing to repeal the tax cuts is a really good strategy right now. I think the action is going to be what happens if and when they expire. You said something else. What was your point just before that?

MR. HUTCHINS: If you cannot even remember it, I am going to ask for the next question.

MR. : I want to keep the string going because, Kevin, you are ignoring the elephant in the room which is false doctrine, namely, supply-side economics, that it true that

virtually the entire Republican political leadership believes or at least says that they believe that tax cuts for themselves. Judd Gregg, Chairman of the Senate Budget Committee, says we cannot have two-sided pay-go because then tax cuts would have to pay for themselves twice, once with the supply-side effects, and then once with the pay-go requirement. That is the obstacle to a grand compromise that the entire Republican leadership, lately they have been saying, no, they do not actually pay for themselves, and they do an elaborate rhetorical dance to suggest that in fact they do. That is the obstacle to a grand compromise, as is the fact that the President cannot afford to look like his father and go back on a no new taxes pledge.

MR. : I think, Jim, that is true that there are people who believe highly implausible things.

(Laughter.)

MR. : I concede that that is true, but I think that also the notion that there is not much of any feedback at all, especially in places like say the corporate tax when we see the Laffer curve in the data is equally as big an obstruction to finding a reasonable compromise on things. So it seems like one side has had to go to the extreme to say that these wonderful happen, and angles descend and play their instruments if we cut the tax rate and we get more revenue, and the other side seems to think that they will actually harm growth, tax cuts, because the interest rates will go up so much and there will be no response or so on. So I think that people will have to try to be more sober and rational about it on both sides.

MR. HUTCHINS: Gene?

MR. SPERLING: We have seen moments in the last 15 years where one party has controlled each branch of government enough that they could do a certain amount on their

own, but I still think that is going to be rare and I still think on the most controversial issues you need some bipartisan buy-in.

I think that the point that Bill made about people making pledges on taxes or absolute pledges of any kind are very irresponsible. I think those are the most irresponsible. I imagine there are quite a few people on both sides who have also taken what you would imagine is very irresponsible pledges on Medicare and Social Security as well. I think the point is that you have to try to create an environment where each side is really putting stuff on the table. I think, Bob, that like it or not, this is an issue that has to be dealt with to have a bit of mutual sacrifice, to have a bit of true mutual compromise, so that things do not have an our way or the highway.

I think when you can create in those rare moments a political environment where those things can happen, people can build rationales together. Money can be raised for national security. If you are doing an estate tax for universal 401(k), it is revenue-neutral, it is not affecting overall tax cuts, and people might feel more comfortable on how they affect deductions or things like that.

I was debating Greg — the other day, and as he went through with his absolutely anti-tax, he would not change anything, he then ended by saying I would raise the gas tax by a dollar. That was striking to me. But I think the point is, and we have to be serious on public policy, which is unless your only fantasy is having huge majorities in both houses and the President and controlling the White House, I think that on each side it is responsible for policy makers to put forward what their ideal agenda is and push that and push it with force and boldness, and I think that is important to do, but I think that serious policy people should also be

looking for where could the common ground be done that would advance the country that could allow sacrifices that each side would not take.

If people want to write that I am kind of a wussie and centrist and all that crap because you say that, they can go ahead, but the fact is, if you care about your country, I am serious, if you care about your country and you want to make some progress, unless you are going to have everybody agreeing exactly with you, you got to think about some of these things if you want to dream of things getting better.

MR. HUTCHINS: Gene, in that regard, I am going to set a good example and renege on a promise I made, which is we do not have time for another question. I am sorry. Thank you very much for this panel. For some reason, folks think that you might want to hear from the next group, so we will move on to the next panel. Thank you very much.

(Applause.)

* * * * *

MR. CHAIT: Why don't we get started with our final panel of the afternoon. Let me quickly introduce the folks on the stage here. To my immediate right, probably the most familiar name on the stage is Robert Rubin, who was the Secretary of Treasury in the Clinton Administration, currently with Citigroup, and author with Jacob Weisberg of *In an Uncertain World*. To his right is Roger Altman who also served as Treasury Secretary—I mean, as Deputy Secretary.

MR. ALTMAN: There is quite a bit of difference there.

MR. CHAIT: I understand that this is a sore point, this constant jostling between the two over this, so I want to be precise. And currently a trustee of the National Park

Foundation, New Visions for Public Schools, the American Museum of Natural History. To his right is Peter Orszag who is the Joseph Pechman Fellow in Economics Studies at the Brookings Institution, and was a Special Assistant to the President for Economic Policy in the Clinton Administration and a neighbor of mine. And to the far right is Laura Tyson who is at Berkeley currently, and Dean of the London Business School, and was Chair of the Council of Economic Advisers in the Clinton Administration as well.

I am going to start by throwing the first question to Laura Tyson who wisely has spent the last 5 years in Europe, having fled the country, and may have picked up some interesting thoughts on some comparisons between Europe and the United States. Europe is often bogeyman of the right. When an anti-liberal alternative is brought up, people sort of cite Europe as the epitome of everything you could possibly do wrong in economic policy. That seems to be one of the main roles it plays, but maybe you have developed some other thoughts about how they do it in Europe and whether you have noticed some of the models there and how they can apply here. So why don't you start with that?

MS. TYSON: The first thing I am going to say is that the panelists, we discussed this and the thought was I might be able to add a slightly different perspective. I have only been in Europe for 5 years. That does not make me an expert in Europe. Furthermore, I want to say that Europe is not a monolith, just as the U.S. is not a monolith. I, when I am in Europe, constantly point out the differences among the states in the United States to my European friends and that in fact I do not represent United States policy on anything right now. Americans tend to think about Europe as very monolithic, and it absolutely is not, and it is particularly not in economic policy.

I was very struck by the discussion on one of the panels about really we were trying to get at this basic issue of could we have had the extent of prosperity and growth and productivity in the United States without the deterioration in income equality that we have experienced, so that is a deterioration in the coverage of the unemployed that we have experienced, and I think Europe shows that the answer is, yes, we could have had the productivity benefits, we could have had the growth benefits, we could have the inflation benefits, we could have had the good macro performance we have had with somewhat less inequality. And I think that there is a very clear chapter of this, by the way, I will refer to it, The State of Working America. I do not think anybody here is from the Economic Policy Institute today, but every year they do a book on labor markets, The State of Working America 2006 clearly has a very good chapter in it on international comparisons.

You can basically follow the evidence, and what you will see is that there are a number of European economies that have —

(tape interruption)

MS. TYSON: (In progress) — as the United States, and they have done about as well as the United States without having a dramatic increase in inequality. In fact, the U.S. is the only OECD country which has shown a strong tendency to have inequality rise, it has been stable or declining throughout the rest of the OECD with the exception of the United Kingdom. In the U.S., mobility has tended to decline, and that has not happened in other OCED countries. In the U.S., the child poverty and infant mortality rates are the highest. And, of course, these performances in some of the other European economies have occurred, these strong relative performances, with strong unions, strong protection for workers, much higher taxes than the ones

we are talking about here today, and these countries have achieved U.S. productivity growth rates and lower unemployment rates.

I was asked to perhaps mention one in particular. We have not debated today, and this is another debate that I cannot answer but it is an important one, I am about to talk about a small country comparison. A lot of people will say we cannot learn from a small country in a large country, but, by the way, we have never demonstrated that to be true. The country that has been getting a lot of attention recently, and as if *The Economist* knew we were preparing for this session, there was actually just a week ago a little column, just a little column, it is a little country, on Denmark and a term which is being used a lot in Denmark, and a term which is being used a lot in European circles which I can barely say, "flexicurity," is the term that has come up to describe the Danish model.

It is a very interesting model because there are very generous unemployment benefits, but there are also very compulsory take-a-job requirements on those benefits which make it essentially a wage insurance program for everybody. These benefits are not associated with any limitations on firms hiring and firing. So in fact, contrary to what many Americans think about Europe when they think about Europe when they think about France or Germany where there are very great difficulties in firing and, therefore, very great resistance to hiring, in Denmark you can hire and fire with very low severance requirements. About a fifth of the Danish work force is moving in and out of jobs each year. That is comparable. It is a high turnover situation. And the unemployment benefits are available for 4 years. Lower-paid workers are eligible to receive up to 90 percent of the wages they received in their previous job. There is, as I said, obligatory take-a-job or go-to-retraining requirement on these benefits, and

this system looks like it is working.

If you look at private-sector job growth, it is strong. If you look at the unemployment rate is low. If you look at the inflation rate it is low. If you look at the productivity level it is essentially at the U.S. level. There is nothing in the growth rates to suggest that Denmark is paying a penalty for having a high level—this is associated, by the way, with a high expenditure of resources. This is not a cheap policy, and it is part of the reason why taxation rates in Denmark are quite high.

This is not to mention in addition the fact that health care coverage in Denmark is universal, and it is not to mention the fact that actually Denmark has one of the lowest poverty rates in Europe, and has the lowest poverty rate for children in all of the OECD countries. So I think that before we assume there is not anything we can do that does not require us to sacrifice, innovation, technological change, productivity growth, trade competitiveness. By the way, the Danish also runs a surplus of about 3 percent of GDP, the fiscal surplus. I think we have to look at some of the international evidence, and I chose to tell you about the Danish evidence because really throughout Europe now, people are looking at this model very carefully as things they might do in Germany, France, or the United Kingdom, to make their systems more flexible, less rigid, but at the same time to continue to adhere to a social compact which says to people when you are hit, there is a social insurance system for you to call upon.

MR. CHAIT: Does anyone want to dissent? Is there something rotten in the State of Denmark?

(Laughter.)

MS. TYSON: Is there something rotten in the State of Denmark.

MR. RUBIN: Laura, you may not know the answer, but I must say in listening to all that, I think I would like to move to Denmark. But leaving that aside, what is their view on immigration? I don't mean of me necessarily, but more generally?

(Laughter.)

MR. : In your case, it would be quite negative.

MS. TYSON: They have not had to date a serious issue with immigration, I would say. It is not an issue which has yet—it is an interesting question because, of course, a system like that would be a very attractive magnet and that has not been the case.

MR. CHAIT: Roger, why don't I throw it to you and see if you've got anything on whatever.

MR. ALTMAN: That is easy. Before I start, I just have to say that when you were introducing me, John, and you briefly referred to me as having served as Secretary of the Treasury, I could not help but think that for those of you who remember the late and quite great Lloyd Bentsen for whom I worked, he would have found it quite interesting and been slightly displeased to learn that I was masquerading as Secretary of the Treasury while he actually was serving as Secretary of the Treasury.

(Laughter.)

MR. CHAIT: I'm in the wish fulfillment business.

MR. ALTMAN: In any event, I am going to take a different tack because I do not know much about Denmark, although I think that is really quite fascinating, Laura.

To me, the overarching question that is posed by the title of this panel is this one, is it a foregone conclusion, is it inevitable, that American incomes and real job security in this

country will decline or continue to decline in the face of, A, accelerating globalization, and, B, the decline of employer-provided health care and pensions? Is it inevitable?

I encounter a great deal of pessimism on this question, and in meetings we have had over the past few months with Senators and House members in connection with The Hamilton Project, I have sensed quite a bit of pessimism, and it is clear that they feel besieged by constituents who are very fearful and very angry about the impacts of these two trends on their lives.

But I think that the implicit thrust of The Hamilton Project, and I certainly share this in every possible way, is the answer to that question can be no. It is not inevitable that incomes and real economic security decline in this era. But at the same time in every meaningful way, this country is on the wrong track to avert that outcome. I think to some degree that is what The Hamilton Project is trying to assert, that if we change course in a very fundamental way, we can again as every generation before us has done leave our children with higher standards of living, and, parenthetically, a safer world, than was bequeathed to us, but we are certainly not on a track today to do that, and I do not think there would be much disagreement in this room about that.

Peter made a couple of observations in his opening remarks that I just want to come back to because they are germane to this overarching question, fundamentally that we need to better prepare our citizens for this world and these two particular trends in two fundamental ways. One is to better prepare our citizens to compete and succeed before any economic difficulties might befall them. In other words, to better prepare them to be strong in this era. Then secondly, to better prepare them when economic difficulties do hit them. In both cases, I

really think this is what we are trying to do with this project.

I am not going to recite all the proposals that we have made to date nor those that are forthcoming, except that you know, I think some of you, we are focused in the first category in terms of calling it advanced preparation, so far we have focused on savings and increasing private savings, and we have focused on education, and today, of course, we have talked about a stronger safety net. It seems to me that in both of these areas, we are particularly on the wrong track because we know what is happening in terms of private savings in this country, they are negligible, and we have to have higher savings both to fix our external financial situation, we have the largest current account deficit ever recorded, and we have to have it to finance higher levels of investment in this country which are integral to resuming growth and standards of living. Every piece of evidence tells us that there is a premium or a higher return to those in our society who are better educated, and as India and China and other like nations join the world economy and the 1.2 billion lower-wage workers in those two countries alone become part of the global work force which, by the way, expands it by about 40 percent, we have to place a much higher premium on educating our own citizens and figure out much more dramatic ways of doing so, and affordable ways of doing so than we have done so far.

In terms of the safety net, the statistics on, for example, the percentage of Americans who are today covered by a federally insured defined-benefit plan, the figure today is about 20 percent, it is obviously the lowest in many decades, employers are shedding pension coverage generally, and particularly shedding defined-benefit plans, and the percentage of Americans who receive health care through their employers has fallen to 60 percent, and that is the lowest level in 20, 30, to 40 years. So the importance of a stronger safety net is obvious, and

Laura's example I think illustrates what other more forward-thinking countries have done, but ours is pretty poor.

So the main point I want to make here at the start is that I think that is the question that flows from the title of this panel, and I think that the thrust of The Hamilton Project is that, no, it is not inevitable that incomes and real economic security are going to decline despite the power of those two trends of accelerating globalization and the transferring of responsibility for health care and pensions from employers to individuals.

MR. CHAIT: Let me throw this out to all the panelists, because during the Clinton Administration you had five really spectacular years of growth where you had pretty broadly shared economic benefits, but that is in many ways anomalous to the whole pattern of the previous 30 years. A lot of people in the center-left, myself included, really became enamored with the possibilities of growth—with liberal possibilities of growth to be the central driver of rising living standards. But with the more recent experience we have had where we have had not very broadly shared growth, do you have to look at those 5 years as an anomaly or as something that can be repeated with a correct policy?

MR. ALTMAN: I think the answer to that question is not one word. In my own judgment, we are not in the 1990s and the real point is that it is a different world here in 2006 than it was in 1993, 1996, or 1998. It just is. And it is really profoundly different even though the number of years isn't all that many.

So the challenge is different and the policies that are required are different and it is not about, and I want to emphasize this because I want to make this particular point about The Hamilton Project, it is not about just going back and restoring the Clinton era and the policies

that were precisely pursued then. The challenges today are different and the policies necessary are different.

As to your precise question, I do think it is possible, and you can see by the remarks that I make, that we can get onto a track of once again rising standards of living. Whether the sparkling successes of the Clinton years, where we didn't just have rising real incomes, but we had falling poverty, we had success on almost every imaginable measure, whether that can be repeated, I don't know the answer to that. I think it is probably unlikely to see the success on every level as was experienced then. That is my answer.

MR. RUBIN: Let me add a comment, Jon. I think it is a very complex set of circumstances we face right now. Larry Summers gave a speech about a year ago in which he said, and it sort of repeats something Roger just said, that the rise of China and India with the enormous expansion in the range of tradable goods and services – Alan Blinder has written about this in Foreign Affairs – and their absolute cost advantages at current exchange and wage rates across pretty much this whole range of tradable goods and services, really is an historic change in the global economy. I think Larry, if I remember it correctly, said it probably is almost surely the most important change since the emergence of the United States over 100 years ago, and maybe the most important change since the Industrial Revolution.

This creates a set of complexities and uncertainties that are very different than the kind of stuff we all learned in college, at least in my opinion, and Paul Samuelson, as you all know, wrote an article about 2 years ago in which he talked about how complex it is to think about trade in this new context, and all of us know that the comparative advantage models that all of us learned had a whole bunch of assumptions, many of which are not being realized at the

present time as evidenced by these vast trade deficits that we have.

One thing that seems to me for sure, Jon, in living in this very different world, I do not know what we can accomplish and we cannot accomplish. I tend to have a relatively positive view that if we meet our challenges, that with the immense dynamism of our society, its historical embrace of change, its willingness to take risk and one thing and another, that we have tremendous comparative advantages, but we have enormous challenges which all of us know about, the financial imbalances, our education system, health care, energy policy, and so much else that we are not meeting, and I think most fundamentally, we have a dysfunctionality with respect to our government right now. We have a government that not only are we on the wrong track at least in my judgment in policy on almost all fronts, but we have a political system that seems unwilling to reach across party lines to get together to find effective ways to move forward. And say what you will about the 1990s – and I think there was a tremendous amount you could say that was good about the 1990s, including the policy paths that we were on that I think are applicable now, although the specifics have obviously changed, and the circumstances changed – even with all the intense partisanship of the 1990s, there was a fair bit of reaching across party lines, as you may remember, on budgets and on many other matters and I think we have to get back to that kind of willingness to reach across party lines and the functionality of our political system has to increase substantially in a world in which if it does not happen, these very rapidly growing competitors of China, India and elsewhere, although they face their own challenges, could have a very serious adverse effect on us. I do not think it has to. My instinct is we could do well, although it is going to be very complex, but not unless we do very much better on meeting our challenges.

MR. CHAIT: Peter?

MR. ORSZAG: Jon, you had basically asked ‘is growth the answer?’, and my answer to that question is that growth is necessary, but not sufficient. If you do not have any economic growth, you are not going to have the opportunity to raise people's living standards, but as we have seen over the past several years in stark contrast, it is not sufficient. One of the central puzzles of the day is this disconnect between productivity growth and median family income. Productivity growth is strong, median family income growth is not, and why that is happening and ways to rectify it and reconnect those two—the traditional Econ 101 model is productivity growth and income growth keep pace with each other, and that is not happening, and obviously a very difficult question is how to reconnect the two, and that is what we are trying to struggle with through the project.

But what is absolutely clear is in the face of that, the last thing you do is make it worse, and that is exactly what regressive tax cuts, which not only exacerbate the fiscal imbalance but exacerbate after-tax income inequality, that is exactly what they do, so that obviously makes no sense at all.

MS. TYSON: I would just add I agree completely with Peter on the puzzle of productivity. I want to put it though in the perspective that I am afraid we have here quite a long-term problem because I think what the 1990s made us forget, and this is the number that strikes me as quite amazing, that if you look at the last 40 years, the only wage group that enjoyed real compensation growth in line with productivity was the top 10 percent of the wage distribution. That is the only group. The bottom 90 percent did not see their compensation track productivity.

Add to that Larry Summers's sort of supply shock which is basically all of a sudden because of technology and the embrace of markets you have India, China, and many other countries creating much more pressure particularly on the bottom half maybe of the wage distribution, and Alan Blinder's numbers would be the bottom 80 percent of the wage distribution. So this is a very, very serious set of challenges coming upon quite a long period of time when the distributional benefits of growth have not been shared. And I will not say fair, but anyway, in a way which is surprising to economists because you can no longer get up there with a straight face and talk about productivity and media incomes because you are not revealing what has been the situation for quite a long time, so I just want to say that.

And then when we talk about things like employers dropping pensions and health, it is also important to point out that if you look at that within the wage distribution, upper-income workers are not getting dropped from health insurance, upper-income workers have lots and lots of choices about pension plans, and actually have the capability given their income to do okay with sophisticated defined-contribution plans. All of the dropping is going on at the bottom end of the wage distribution which has already not been sharing in the compensation growth relative to productivity and has more pressure coming now from low-wage competition in the rest of the world. So this is a very serious set of challenges which does require I think that we think more about progressivity because the country has been going in the opposite direction for quite some time.

MR. : Moving to Denmark certainly looks better now.

MR. CHAIT: That is an interesting answer. That is the intuitive response if you have huge growth at the top that is not being shared by the rest, you simply have to have the

government essentially redistribute some of that growth back to everyone else. Is that oversimplistic? Is that wrong?

MS. TYSON: I wanted to associate myself with Peter, though. I would not say we want to do this at the expense of growth. He said growth necessary but not sufficient, and I am agreeing with that completely.

MR. CHAIT: To the extent it could be done not at the expense of growth, is that an overly simplistic answer?

MR. RUBIN: I think, Jon, what we did with respect to the 2001 and 2003 tax cuts, I totally agree with Peter and Laura together. We took an already very difficult problem and made it worse for absolutely no reason. It was totally unnecessary in terms of any economic purpose we wanted to serve. We could have served any economic purpose we wanted with tax cuts that were targeted, temporary, or one thing or another.

But I do think there probably is a lot of potential in other areas, Jon, and I do not think you are going to be able to rely on the progressivity of the tax code to address this problem in large measure. I may be wrong, and people have to model that. But I am very struck by the effects that some infrastructure has had, for example, in having very large multiplier effects. Was it called the Metro Center or MetroTech in Brooklyn? Which then causes all kinds of other activities to develop. Basic research which gives rise to all kinds of activities. And it is true that basic research by its nature is available to everybody, so you could do it in China just as well as you could here. But the fact is, there is an awful lot to be said for having people in the same areas. Obviously, if we did a far better job educating people then we would have a much better work force, and that would encourage investment and hiring and one thing and another. So I

think there is a tremendous amount that we could do here.

Having said all that, when you have a globalization of a labor supply, and of course a vast array of goods and services, it does create a new set of challenges that are very complex. I think we need a great deal of new thought in this area. My own instinct is to think that there are limits to what you can do. I think we should go back to at the very least the Clinton tax rates, and I think you could even do a bit more if you wanted, but I do not think you can rely on progressivity of the tax cut to solve this problem would be my instinct.

MS. TYSON: May I say one thing about progressivity? I think one can talk about that term in terms of taxes, but also in terms of benefit programs. For example, what I said is the unemployment compensation is very generous on average throughout Europe and tends to be more generous at the bottom because of the notion that somehow or another that is really where the problem is like the unemployment rates for low-skilled in Europe or the U.S. and every place are higher than they are for skilled workers. Therefore, you want to have the benefits be progressive in that way. So progressivity can mean more than just taxes.

MR. ORSZAG: And just really quickly, two quick points. One is that within the tax sphere, you should not just look to marginal tax rates because I think there is a significant concern as you start to get marginal rates that are significantly above the Clinton rates. Coming back to an idea that I had mentioned earlier, there is a lot of money that we spend, \$500 billion a year, in the form of deductions and exclusions that are not delivered efficiently and that could make the code both more progressive and more efficient at the same time.

The second point I want to make is on education because it has come up several times. There is a lot that we can do to make the education system more effective in a progressive

way. In fact, there is research that Princeton and Brookings have done together suggesting that one of the reasons, Laura had mentioned that mobility in the United States does not look great internationally, and that our education system as a whole is one of the transmission mechanisms for why that is. If you look at the top 25 percent of colleges, for example, three-quarters of the students are from the top quartile of the income distribution, and under 5 percent are from the bottom. So the higher-education system, and we normally look to education as the great leveler, is actually exacerbating problems from some perspectives, and that is not mostly because of underlying skill differences in those populations.

MR. CHAIT: I think we are to the Q and A portion. Bob Kuttner?

MR. KUTTNER: Both Laura and Peter used the word puzzle.

MS. TYSON: Used the word what?

MR. KUTTNER: Puzzle in why did the income become so much more unequal.

I am not so sure it is a puzzle, I think it is a challenge in the sense that all of the leading equalizing institutions either were undone by deregulation, globalization, marketization, or were deliberately undercut by public policies. So some of the public policies can be reversed, but I think the Europe point, and Europe gets a very bad press here, is really interesting because if you look at enough European countries you can find enough things that are being done right. I was not proposing progressive taxation in the sense of take money from him because he is rich and give it to him because he is poor, I was saying if you are going to have this social investment, you are going to have to pay for it, and if you are going to pay for it, you might as well pay for it without socking to low-income people even more. Europe is a more open economy than we are. They have more of a tradable sector, yet they have managed not to have the income inequality,

and they do it by social investment.

So I guess I have to turn this comment into a question.

MR. CHAIT: Yes.

MR. KUTTNER: No, there really is a question here. Given the real aversion in this country to taxes and the great success that Grover Norquist and company have had demonizing taxation, where are we going to get the revenue to pay for the social investment to pay for the rising inequality?

MR. ORSZAG: I think that one obviously first step is to stop the erosion of revenue. We already talked about the 2001 and 2003 tax cuts which were not only regressive but also deepened our fiscal hole. Another important topic that has come up and that is of the same magnitude of those tax cuts is the corporate income tax. The corporate income tax is bringing in 1 to 2 percent of GDP. Historically it was bringing in twice that. If we follow the direction of moving further away from the corporate income tax, that is exacerbating the problem that you have identified, and, again, in a regressive way. So that is another area in which I think serious thought has to be given to how one can shore up the corporate tax, again, cognizant of and recognizing that we are in a very much different world than the 1960s because capital is much more mobile across international boundaries and that raises a whole series of complexities in the corporate income tax. I did not give you a full answer, but it is more of a "stop digging the hole deeper" kind of one.

MR. RUBIN: I actually do not agree with that, Peter, on the corporate income tax. I spend most of my time with companies and I hear an awful lot of talk about locations, and I think there are a lot of factors that are causing people to locate abroad, but I must say I do not

hear people talk about the corporate income tax as a particularly important factor in that regard. In fact, I do not hear it mentioned almost at all. This notion that somewhere these vast numbers of people are trying to flee the country because of the corporate income tax, this is a bad paraphrase since I do not remember the exact phrase, you can have your own opinions, but you cannot have your own facts, and that simply is not the fact.

MR. ORSZAG: If we could just pause for a second to make sure that we are clear. Even if it were the case that the corporate income tax was under increasing pressure because of mobile capital, I think we would need to shore it up, and all the more so if it is not.

MR. RUBIN: Okay. I was not really addressing your comments so much as I was a prior comment.

(Laughter.)

MR. ALTMAN: I just want to insert one quick thought in response to your question, Bob. I may be a minority of one here, not just up here but in the whole room, but I think the era of demonizing taxes and the effectiveness of doing so is coming to an end. I do not mean that we will, should, or for that matter even contemplate going back, as someone said, to that Bolshevik Dwight Eisenhower, or whatever they said. The effectiveness of that approach is just eternal, we should just accept it and view it as part of the landscape, you know like the Rockies or something. I think a lot of surveys show that, so I do not believe at all that we have to accept the fact that under no circumstances, whether it is rolling back the 2001 and 2003 tax cuts for the top two brackets or so forth, that under no circumstances we are going to be able to raise revenue. Quite the contrary. It is likely that we will find ourselves in a circumstance where that is possible and actually occurs really over the short- to medium-term.

QUESTION: Thank you very much. In part inspired by the work of the project, I have gone back and plowed through a lot of Hamilton's writings as Treasury Secretary and have tried to come up with some thoughts on what Hamilton's view would have been today of the economic situation inside the United States. In my opinion, he would be, number one, horrified at the idea of the erosion of our actual high-technology manufacturing base. We have seen in the auto sector just in the last year an erosion of a major portion of our machine tool capacity which is the best in the world and far beyond anything that India and China will be able to produce for quite some time to come.

I think he would also be horrified at the erosion of our core infrastructure, energy, transportation, water management, and other factors, and I do not think he would have hesitated to consider the effective use of the federal government with capital investment.

And in the more recent period between Franklin Roosevelt, Dwight Eisenhower and John Kennedy, the common experience had been that government investment in major infrastructure including R&D investment produced a substantial return on the dollar, somewhere between \$5 and \$15 for every dollar spent. So I guess my question is, I would like to get an idea from the panelists if you have any thoughts on this idea, I know Secretary Rubin just mentioned, more investment in infrastructure, how we might be able to use that as a means of both reversing the collapse of our actual manufacturing base, high-tech manufacturing, and what kind of role these sorts of policies might play.

My final comment is that I always thought that the greatest achievement of the Clinton Administration, beyond any of the particulars on economic policy, was that after a long period of erosion there was a certain sense of the confidence in the role of government in

promoting the general welfare of the country. I think that this is a principle that would be in line with Hamilton, and I would to see more work from the project and comments now on that.

MR. ORSZAG: I have given up trying to channel Mr. Hamilton.

MR. ALTMAN: I would make two points. The first step towards increasing what I would call strategic investment, infrastructure, research, some of the other points Bob made, is to begin to rectify our fiscal situation. We really have no chance of making new investments, and I mean substantial ones, absent that. It is really basic and it is really required, and we will not get on and do what you are talking about, with which I agree conceptually, absent a real change in fiscal policy. We are all familiar with the dynamics of that, we are all familiar with the actuarial liabilities of the federal government and so forth, but it is pretty bad. And when you hear the current administration say that, wow, it's great, we just have a \$300 billion deficit, you know things are in bad shape.

As for the erosion of our base, yes, there has been some erosion, but I do not accept the notion that it has been as catastrophic as you say it has. For example, here is a little-known fact. Automobile employment, and I mean assembly line employment in this country, is not declining. It is true that we pick up the newspaper today and see that Ford has offered buyouts to its entire work force which is discouraging at some level, in a national sense it is discouraging, but assembly line employment is not declining. What is happening is that it is recycling. It is recycling from in effect the Midwest to the transplants, as they are called. Toyota is building one of the biggest plants in the history of the world just outside San Antonio to make trucks. I have actually seen some stuff on it. It is going to be one of the highest tech manufacturing facilities on the planet, and Alabama is about to become the largest state in terms

of auto production.

You read a lot about how grim it is, but I do not think the facts are in line with what you read. Yes, there has been some erosion, no doubt about it, but it is not catastrophic, and it is not all going straight downhill for the rest of our lives and our children's lives and all that. Not at all.

MR. CHAIT: Peter?

MR. ORSZAG: I have two brief comments. The first is on infrastructure. My own view is that we do need additional investments in infrastructure, but also frankly need to use and price the infrastructure we already have more effectively than we do now. We have in many areas things in place that are not used efficiently. In fact, London, for example, has been very effective in using pricing to more efficiently use the infrastructure that already exists.

The second point on trust in government, I think the point you made is a very good one which is that trust can be built from positive experience. Senator Obama has said, and I agree with it completely, progressives or others who believe in government should be ruthless in trying to seek out inefficiencies in government and things that do not work right, because without that, we are not going to succeed in convincing the American public, convincing is not the right word, demonstrating the effectiveness of government in the areas where it truly is quite important, including many of the ones that we were discussing today.

MR. CHAIT: For those who are concerned that former Clinton economic officials have been underrepresented on the panel, we have Gene Sperling with a refreshingly different perspective.

(Laughter.)

MR. SPERLING: I will yield to others if they have other questions, but I am actually trying to further your goal of getting Laura to be a U.K. expert.

This whole day today has focused a lot on income maintenance in terms of insecurity. The one question out there is, how does universal health care play in? When you look at the U.K., it does seem at this point, obviously, the immigration issues are very large, and on the trade/globalization side, at this point the levels of anxiety seem less significant. My question for Laura, both as a health care expert, when you look at things Jacob Hacker talks about, and Elizabeth Warren, it does seem either health care related issues or losing health care does seem to be fairly central and why people both experience the initial losses and then the depth of the losses.

So my question is, being both in the U.K. and the U.S., how much are the health care issues as opposed to the income maintenance issues central in the economic anxiety story?

MS. TYSON: I do not know about the surveys, but I think that a couple of things that came up in the discussions today, first of all, it is the case and I think the evidence is really important here that given the trends in technology and globalization, the risk of dislocation, of a challenge to family income which is unexpected, that kind of volatility, that kind of risk is rising for workers not just in the United States, but in other parts of the world. It seems to me if that is the change that is happening, driven by these much larger structural forces of technological change and globalization, then you have to say that that is what workers and families are going to be subject to.

The system we designed by accident, it was designed by accident, the system we fell into by accident, of having health insurance tied to your employer is just ridiculous in this

kind of environment. We could debate about what form we should go to, but I think it is not debatable what form we should go away from. This is just a system that does not work anymore relative to the broader structural trends.

That does not mean that there are not major issues about what we should move towards, about the fact as someone said today correctly, the issue of the escalation of the health care costs not just in the United States but in Europe is an issue. So while I think my personal experience of listening to and reading the press in the U.K. and listening to the debate about trade in the U.K. is that you are absolutely right, Gene, there is not a sense that people carry around the issue of health insurance. It is as if it has been taken away. So one of the big sources of anxiety to the individual family and worker has been taken away.

People still worry about the cost of the system, is it delivering efficiently, how much of the service should come through private suppliers and how much should come through public hospitals, things like that, but the issue of not having to worry — I am making my colleagues laugh. They cannot believe it. I come back to the United States and I am thinking about my own health care here. It just does not make any sense to anyone that I am dealing with three different health care possibilities. So I do think it is a very big issue and I think my own view is that if I had been sitting up here today and talking about security and the major thing you could do on security, I would have talked about health.

MR. CHAIT: Let me just say we will be talking about it next year.

QUESTION: A quick question. It seems like the question you guys have been posed is a false dichotomy, and that is, instead of talking about growth versus income distribution, my question is, will you be willing to give up some growth for income distribution

and security? I was a little concerned that the last time we met in June there was a nice discussion, but I think at the end we came down as saying, no, we want as much growth as we can get. So the question is, are you willing to give up some growth for the equity?

MR. ALTMAN: With all due respect, I do not agree with the question in the sense that I do not think that that is a choice we need to make. One of the tenets of The Hamilton Project, one of our three guiding principles, is that economic security and economic growth are complementary, not contradictory. Unfortunately, we have been trained for a long time in this country to think that if you are going to provide a stronger safety net you are going to give up some growth, and we do not accept that.

I think that there are policies that will abet broad-based growth, meaning wider distribution of the benefits, which will actually foster higher long-term growth. Therefore, actually if we have the right mix of policies in this country will be choosing better income distribution and faster growth.

QUESTION: So, Roger, you are saying we would give up some short-term growth to get some equity in order to get long-term growth. Is that what you are saying?

MR. ALTMAN: I don't think you have to give up either.

MS. TYSON: No, he is saying he does not think there is a tradeoff.

MR. ALTMAN: I don't think there is a tradeoff.

MR. CHAIT: Bob?

MR. RUBIN: Yes, I would agree with Roger that I think there ought not to be a tradeoff, but if there is a tradeoff, I would not give up growth because I think once you get going down that slippery slope, I think you get yourself into all kinds of problems. President Clinton

said the best social program is a strong economy. I also think that is the best path toward economic security and to broad-based income increases. So I would not make that tradeoff, but I do not think you have to make it. I would agree with Roger. My instinct is you do not have to make that tradeoff, but I would not make it.

MS. TYSON: I think the good news is even if you ultimately have to make the tradeoff, we are sufficiently far away from it that I do not think we have to worry about it. That is, I think we are too far inside the production possibility frontier, there is enough inefficiency and enough ways we can improve the system without getting to that tradeoff. So I think politically it is an extremely dangerous debate to have because you are debating a hypothetical from the point of view of where we are right now.

MR. ORSZAG: And it is not just political.

QUESTION: So why is it that if you make Larry's point about India and China which a lot of people are not going to talk about publicly, but if you really make that point, many people would say they would take action against that. So why is that? They must not believe that growth and equity are the same.

MS. TYSON: No, they don't.

MR. RUBIN: Actually against what?

QUESTION: You repeated Larry's comment saying that China and India are going to be the greatest revolution since the creation of the United States.

MR. RUBIN: Might be.

QUESTION: Might be. And most people in the United States would hear that comment and be nervous, so they must not believe—

MR. ORSZAG: Could I comment? Because the Samuelson article has come up in many different contexts and it is sort of the basis for a lot of that discussion, and I think it is very important to be clear about what the Samuelson article says and does not say. The Samuelson article says that you can have situations where other countries grow especially in sectors where you had been exporting, and that can reduce your income relative to last year. The reason it reduces your income is that the gains from trade are reduced. That is not the same thing as saying shutting off trade would raise your income, because this year it is like you had a bigger pie and the pie shrunk, but it is not like you can get the pie back to some bigger amount by anything you do.

So in terms of the policies themselves, and I think that is the key thing, that observation does not actually open up the tradeoff that you were delineating.

MR. ALTMAN: I agree with your last sentence, and I referred to this in my own comments at the beginning, many Americans fear this, you're right, and that is very unfortunate, and that fear actually is quite widespread. But the emergence of China and India and the integration of their populations into the world economy is also a big opportunity, ultimately perhaps the biggest markets in the world for American goods and services. And also this country is much wealthier by virtue of trade than if there were not trade, the Institute for International Economics across the street estimates a trillion dollars a year wealthier by virtue of trade.

So I think the task is to put ourselves on a different track economically, give Americans a reason to believe that we can again resume upward growth in standards of living despite the challenges I talked about, and turn the emergence of China and India into something that is seen as an opportunity, not a threat. That is not easy, I know. Not easy at all. But

actually in economic terms, it can turn out that way.

MR. CHAIT: Bob?

MR. RUBIN: I just had one more thought, if I may. Peter and I have talked endlessly about this, a lot about the Samuelson article. I am not an economist, I'm a lawyer, and Peter is an economist. But let me just add I think it is fair to say, Peter, that Samuelson's article is the beginning of a discussion, not the end of a discussion, and I think he is still, if I remember correctly, Peter, operating on all kinds of assumptions that are consistent with models of comparative advantages and so forth, not on these enormous trade imbalances that we have today and what are probably disequilibria exchange rates. Once you get into disequilibria exchange rates, I think you do create a whole new set of issues.

Having said all that, and this is not supposed to be a trade debate and so forth, I think one of the dangers of all this is what Ben Bernanke said about in Jackson Hole, which is if it turns us politically against trade and towards protectionism, that gets us into a far worse world and that is something we have to avoid at all costs, all costs is as strong statement, but we have to work powerfully to avoid, but the way to avoid it is to address all the issues we were talking about today.

MS. TYSON: I should also say that there is another very important point I think about the Samuelson article which actually gets back to progressivity, because what I would say is we should be honest here, and it is very dangerous to be honest about those of us who really want to continue to embrace trade liberalization are very interested in the growth of China, India, and other countries, but we also need to recognize that there is a significant amount of downward income pressure and/or job loss associated with this for a large number of American workers.

We cannot kid ourselves and say that that is not true.

What do you do about that then? What Samuelson says is, economists have always said there are these wonderful aggregate benefits from trade and they are big enough that they can be shared with the losers, but it has been a shell game. We have never done that. And if you take those 40 years where we have not had median compensation going up with productivity, essentially there is no reason why the average American looking at wage rates in China and India and reading the stories of things going abroad should not be worried. Actually, they should be worried, because we do not have in place a set of policies which has ever delivered to the losers. When manufacturing jobs started going abroad, we did not deliver to the losers. We let them move on to other jobs, and if they got the other jobs at the same wage, that is fine, and if they did not, that was fine, too. We see now an increasing number of Americans are not getting jobs at the same wages, they are being unemployed for long periods of time, so why should the average American believe it?

I think what The Hamilton Project is trying to do, and this is really why I think it is so important, is say we have got to really change the policies, if we do not, then the average American who is right in their supposition is going to try to stop this because it is in their self-interest to stop it.

MR. RUBIN: Laura, here is where you and I may have a slight difference. I agree with everything you have said, except I have one question. I think if we immediately said, okay, this is where we are today, and the average American worker certainly has not done well, we have stagnant real wages for the last 30 years, but I suspect if we turned against trade liberalization and tried to reverse that right now into a protectionist mode, we would be worse

off.

MS. TYSON: We would be worse off. I would not disagree with you, Bob. No, I would not disagree with you. What I am saying is I can understand why the average American might say this is not working for me and it is going to get worse.

MR. RUBIN: You are right.

MS. TYSON: I think we absolutely have to say if you go to a protectionist response to that, you will be even worse. It will not be that you are better.

MR. RUBIN: But you are right, too.

MS. TYSON: Yes, I agree with that.

MR. ALTMAN: It is a good thing you agreed with Bob because I think otherwise he was going to offer to fly you to Denmark tonight.

(Laughter.)

MR. CHAIT: I think we have come full circle now after Denmark, which seems to be the underlying theme of the whole discussion either explicit or implicit.

MR. RUBIN: Wasn't Hamlet Danish? Hamlet was Danish, I think.

MR. CHAIT: Is that right?

MR. RUBIN: Yes, and he didn't know what to do, which is neither here nor there.

MR. ORSZAG: I want to thank Jonathan for moderating. I also want to thank all of the panelists here and all of the previous panelists, and thank you all for sitting through a marathon session. I hope that the topic justified your time.

* * * * *