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ECONOMIC SECURITY IN A CHANGING WORLD

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The Brookings Institution
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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

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 is 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. HASSERT: 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 shines 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 plants 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 President's 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 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 to 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.)