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PARTICIPANTS:

PANEL ONE: DOMESTIC AND GLOBAL CHALLENGES:

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Panelists:

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PANEL TWO: CONGRESS AND THE PRESIDENTIAL CAMPAIGN:

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P R O C E E D I N G S

MR. MANN: Good morning. Welcome to Brookings. I'm Tom Mann, a senior fellow in the Governance Studies program. And I'm delighted to welcome you to our post-State of the Union speech event.

I am joined by a stellar cast of my colleagues here at Brookings. To my immediate left is Karen Dynan, who is vice president and co-director of the Economic Studies program. To her left is Rob Puentes, who is a senior fellow working within the Metropolitan Policy Studies program. To my right is Eswar Prasad, who is a professor at Cornell University, but most importantly a senior fellow at the Brookings Institution and works in the Global Economy and Development program. And to his right is Martin Indyk, vice president and director of the Foreign Policy program.

We are dividing our event this morning into two panels. The first, and I don't want this to shock you all, is really going to focus on policy. So if some of you want to get up and leave, you know, really we've had a lot of talk, political talk this morning, and that's important. But the first session is designed to focus directly on policy. And the second session with colleagues of mine from Governance Studies is to look at the linkages between the State of the Union speech and the election campaign and what might or might not be happening on Capitol Hill.

So that's our plan of attack. And I'm going to spare you my personal ruminations on the speech so just live with that. And we're going to begin with Karen. Those of you who were watching the speech may have noted that about the time that it began or perhaps just before the administration released an associated document called "Blueprint for an America Built to Last." So the question we begin with is is that a serious document? Does it focus on the real problems the country confronts now economically? And is there anything fresh that we ought to be especially attentive to? Karen.

MS. DYNAN: Thanks.

So what the blueprint does is it elaborates on what was in the speech. And, you know, turning to the speech, what's interesting was as I was watching people react to the speech over my Twitter feed last night the term that kept coming up again and again was "laundry list." And I think that's right. I think the speech laid out many, many, many specific policy proposals but didn't really weave them into a single narrative.

So I think the good part of that is that he made the case for what government does. He moved the debate from, you know, do you like big government? Do you like small government? So here's a list of things that government does or might do if you like them or not. And that seemed good. But what the speech lacked was a clear fiscal plan to address our most significant economic challenges.

So first and foremost would be the current state of the economy. And just to put a few numbers behind that, we lost 9 million jobs to the recession. The job growth we've seen in the recovery hasn't been enough to keep up with population growth. So we actually need to make up 12 million jobs now to get back to normal labor market conditions. The unemployment rate has been above 8 percent for almost three years now. That's unprecedented since World War II and the underemployment rate, if you count folks who are not working as many hours as they'd like or who have given up looking for work because they're so discouraged, then you're at that 15 percent of the workforce. And then just another pernicious element of the labor market situation is that 40 percent of the unemployed have been without jobs for six months or longer. And every day they go without jobs is either losing skills, the labor force is eroding, and it makes it harder to put these folk back to work.

So what we really need to address this significant economic challenge is we need a two-part plan. And the first part is measures that address the short-run labor

market problems, partly through boosting aggregate demand. So the president, you know, in his Labor Day speech he put out a package that would essentially do this. And he came back to some of those measures last night. He talked about extending the payroll tax cut. He talked about more infrastructure spending. He talked about ways to get workers back in to help them find jobs. And he added a few new things. So most significantly he added a proposal which would have to be passed by Congress to have the FHA refinance underwater mortgages that were issued by private issuers as opposed to Fannie and Freddie, such that they can take advantage of the really low interest rates the Fed has created for us. So he did list these things but he didn't package them together, and he didn't put any specific numbers behind it. So he didn't really lay out a clear plan there.

But then there's the second part of what we need to do now and that is to address our long run debt problems. And people argue it's not a big deal for the economy right now because these problems aren't showing through to financial markets in the form of higher interest rates on long run government bonds. But I think that's just wrong. I think these debt problems are creating this cloud of uncertainty about, you know, whether financial markets will suddenly react and how the government's going to tackle these problems, what that will mean for firms and businesses. And that is hindering firms and businesses from planning, from spending, from hiring. And again, the president kind of hinted about the deficit issue. He talked about specific ways that you can reduce the deficit. The blueprint has a sentence saying we need a plan to tackle our long run deficit problems but he didn't really come close to laying out a clear comprehensive plan.

So just to sum up, I think there certainly were interesting elements of the speech but I think the lack of a clear fiscal plan really was a disservice to the economy. I

think people might say, oh, it was the right thing to do politically and none of this stuff will pass anyway this year so what difference does it make? But I think it is a disservice in the sense that it's not focusing the national conversation on what needs to be done. And that could end up being quite relevant next year when we come to actually tackle these problems, or worse yet if something unexpected happens, if we take another body blow to the economy and we do suddenly have to deal with these problems.

MR. MANN: That sort of gets us right into the politics which I said we wouldn't be dealing with because, I mean, the presumption of your argument is that somehow election campaigns sort of create the basis of a mandate that then empower and motivate those elected to act in a fashion that will resolve them. It becomes very tricky when you have divided party government in a time of sort of intensely polarized political parties and if I were to ask you what is the republican plan for dealing with our short-term and long-term stimulus and deficit debt problem, how would you respond to that?

MS. DYNAN: I mean, I don't know, I'm not, you know, implying that there's a better answer on the other side. I just do think that someone needs to get out there. I actually think it's a problem that nobody's been out there really, you know, laying this out clearly and, I mean, laying out the need for a plan, laying out the need to sit down and create a plan because I think it's something that needs to be in our national conversation.

MR. MANN: Yeah. Maybe we'll pick up on this later because this debate is very much present in Europe now where the focus has been almost entirely on deficits and debt and austerity programs to deal with them. And now you're gradually seeing a change in sentiment and that for God's sake what we need to do is get these economies growing again. And cutting spending offers, other than sort of somehow

reducing uncertainty, doesn't promise much in that regard.

MS. DYNAN: Yeah. Well, I mean, I think that was, yeah, I think that's right. And I think, you know, I think the lesson we should take from Europe is that, you know, let's figure it out now before, I mean, like I said, I think there'll be an opportunity to figure it out after the election is over and we don't have to worry about these political issues but I think, you know, on top of that there's a real chance that we could suffer some sort of unexpected negative shock to the economy. And the IMF was out yesterday, you know, talking about the dismal prospects for the world economy, talking about the prospects for perhaps things worsening in Europe. Those things could have a significant negative effect on our economy such that we need to react. And if that time comes we don't want to be caught off guard.

MR. MANN: Fair enough.

Rob, let's focus to the growth side, the jobs side of the agenda. The president said that we've made progress on his long-term goal of increasing exports. He talked about manufacturing, clean energy, talked about infrastructure. Is there something compelling in that package of proposals?

MR. PUENTES: Yeah, I think so. Thanks, and good morning, everybody.

I think that, I mean, a lot of that that he talked about isn't necessarily new things. The administration I think has been generally consistent with that package of stuff they laid out. But kind of hearing it all last night it is kind of packaged around a new growth model for the country moving away from kind of the consumption-driven economy that predated the recession to one more focused on different measures of production and on the tradable sector. There was an order to create quality jobs and then sustain some locally serving jobs around our cities and metros.

But in particular I wanted to focus on two of the core assets that the president mentioned around exports and manufacturing and around energy and infrastructure. It's so hard to separate these things. They're kind of siloed but when you hear them like last night they are kind of all wrapped in together and they do build off of some kind of unfinished business I think that started here in Washington and that's been part of the conversation, you know, for a bunch of months anyway.

On manufacturing it's clearly related to long-term growth and clearly plays a critical role in this goal for doubling exports. And when we think about exports it's not just about, you know, putting things in boxes and shipping them all over the place but it really is the economic imperative of our time given the growing demand that we're seeing, particularly from growing nations in Brazil and in India and in China. So it's really about kind of taking advantage of that enormous market demand that's emerging around the globe in order to create jobs back here, in order to have a clear role when it comes to manufacturing.

I think we are on pace to meet the president's stated goal of doubling exports in five years. It seems like a very dubious and very challenging goal to meet but it does look like we're on track to meet that. Some of it's due to kind of quirks in the monetary system, the low value of the dollar, but some of it is definitely due to things that the president and the administration has already put in place. The Ex-Im Bank, you know, providing more and more loans, giving support and additional resources in particular to states in metropolitan areas so they can boost their trading partners and all that. So there is a lot that's going on and exports is clearly going to be a big focus and it probably should be.

On the energy side, you know, there was a big chunk of the speech that folks probably know that was dedicated to energy. And I think the president called it the

“All of the Above” Energy Policy which included everything from offshore oil drilling to clean tech. It had an energy efficiency kind of overhang. So it really did -- it ran the gamut in terms of energy policy. I think it would have been great if they had talked about maybe using some of the resources from fossil fuels to fund some of the clean tech stuff that they have going on but again this is energy work that’s been going on in the administration since the very beginning. But clearly this is an area that’s going to be critical to growing jobs and improving the economy.

Infrastructure got another big shout out. The president has always talked about that. I think it was framed around we stopped the war overseas. Let’s use half that money to retire the debt; the other half goes into infrastructure. You know, it’s a little more challenging to do than it was kind of laid out. But clearly I think the main message on that is we’re rebuilding countries overseas. Let’s start rebuilding, you know, the U.S. infrastructure, again, in order to support manufacturing, to improve exports, to create quality jobs back here at home. It’s not that kind of quality of life kind of message. It really is a straight kind of economic imperative. I think that was a really good shift.

And there was also a big focus on the infrastructure message around cutting through red tape, getting projects done. There was enormous frustration with how long it takes, you know, to get some of these projects off the ground. It takes far too long. The administration is trying to figure out how we can prioritize certain projects and get those things done.

So again, a lot of unfinished business. I think here in Washington things that they reiterated and brought back up. What was left unsaid I think has to do really with the heart of all these issues and that’s out in our states and our metropolitan areas. Again, if we’re trying to double export, if we’re trying to improve on clean tech, I mean, all these issues are really rooted on the state and metropolitan level given the dysfunction

that's happening here in Washington. And I think the president said it himself, kind of some pessimism that the really important things we're going to get done. There is an awful lot that's going on outside of Washington in the state and the metropolitan areas. We've got to capture some of that innovation. So while the president I think did a good job kind of portraying himself as a federal president and talking to Congress about what Congress can do, he really needs to become more of a national president and talk about what we can do in a partnership with states, metros, and particularly the private sector.

MR. MANN: Rob, I was struck by yet another effort to try to figure out how to pay for and thereby persuade republicans in Congress to launch a serious infrastructure bank. It seems like a gimmick that is to say right now interest rates are as low as we can ever imagine them. It's almost like we can't afford not to borrow for things that will prove productive over the long haul. It just gets more expensive over time. What's holding it up? And this looked like a pretty gimmicky way that is, oh, we'll take the money we're saving from the wars in Iraq and Afghanistan. That was purely rhetorical. Is there any serious talk about getting the infrastructure bank going?

MR. PUENTES: And it's also clear when he talked about the construction jobs and just how hard those have been hit. So it does seem like a gimme. It's really a very -- not even bipartisan. A non-partisan issue. When you leave Washington and you talk to folks outside the beltway, there isn't a very different message when it comes to infrastructure. People clearly understand the priority that we have to rebuild what's in place now and then put in place that kind of infrastructure that's going to propel us into the 21st century. Funding it is clearly going to be, you know, the big challenge. There are lots of ideas that are out there. Taking more advantage of public-private partnerships, taking advantage of perhaps some foreign direct investments. This is a little bit of the speech last night.

So there are lots of ideas about how we can do that but I think it's not just around finding the money to do it but we've got to figure out ways to cut through some of the regulatory red tape that's holding these projects up. Environmental regulations get a lot of the focus of that but it's not the only thing that's holding these projects up. And clearly when you go overseas you realize just how important it is that we have some of these protections in place. But we have to focus on those projects that are clearly meeting measures of national standards. Again, if we're trying to double exports in five years, that clearly leads you down a path to certain investments particularly around our ports. For example, they're widening the Panama Canal. We're going to have gigantic ships floating up the Atlantic Coast and nowhere to dock because the ports are too small. They can't handle them. They need to be dredged and all that kind of business. That's a national priority. That really needs to be something that we focus on with a laser because again, we're not going to be able to do all these other national objectives unless we have infrastructure that's still in the 20th century.

MR. MANN: Karen, one of the catchier parts of the speech which we saw coming for weeks, if not months, was the Buffet tax which I take as a new alternative minimum tax for millionaires and billionaires. Is there any value associated with that proposal other than political?

MS. DYNAN: I think the answer is we don't know yet. We really haven't seen the details on what exactly this means. It was an interesting, catchy part of the speech and I don't know. You know, I think there was this general theme of fairness and I think to the extent that the president is worried there about the stagnation of medium wages in this country, I agree with him 100 percent that that's a real problem.

Can I just comment on some of the stuff Rob was saying?

MR. MANN: Sure.

MS. DYNAN: You know, I think that fairness and the medium wage stagnation that was behind some of this emphasis on manufacturing, you know, I largely agree with what Rob said but one part of that speech that made me uneasy was the part of the discussion that really kind of smacked of industrial policy. For example, we saw -- he talked about tax preferences for manufacturers, maybe especially for high tech manufacturers. He talked about it in the context of clean energy and I think that's where we really need to be super cautious. I mean, I understand the idea that we want good jobs for the middle class, but I think we do need to be super cautious when it comes to things like industrial policy. History has taught us that we just aren't good at picking winners. And I think, you know, this last resurfaced in a kind of passionate way in the 1980s when we had the fascination with what was going on in Japan and in particular whether some of the efforts by their Ministry of International Trade and Industry were what explained the high growth in Japan. And I think, you know, as history unfolded it's turned out that there's a lot of skepticism about whether those initiatives really did Japan good and whether their economic success is really explained by more standard things like a high saving rate and good tax and business policy.

MR. MANN: That's a good segue, Eswar, into the international economic issues. There was a lot of talk about outsourcing and policies to persuade, if not compel, corporations to create jobs here. There was a bit of protectionist rhetoric directed to China and elsewhere. It was really quite an aggressive speech in that sense. But were there implied policies underneath that that suggested some turn or does it strike you mainly as sort of typical election year let's stand up for American jobs rhetoric?

MR. PRASAD: Let's start with the big picture, Tom. The fact is the rest of the world, or most of the rest of the world except perhaps some pockets of Pakistan and Afghanistan love President Obama. The sad reality is they aren't going to be much

help to President Obama in his reelection campaign.

One can think stepping back from the speech a little bit about the context in which President Obama was framing his discussion of international economic policy. Two issues dominate. One is Europe. The second is jobs, which is a domestic issue but has an international element. On Europe the general sense is that things are getting worse. I am an optimist. I think things are going to get better before they get really bad. (Laughter) And the timing is not going to work well for President Obama because I suspect that we will see some significant progress or apparent progress in the context of Europe in the next couple of months that will pull them back from the cliff. But the euro sum project as it's presently structured is not sustainable and I think these tensions will come home to bear in the latter half of the year. Not good timing for President Obama but there's not a great deal he can do about it. We have Secretary Geithner, other minions of the government. They're trying to persuade the Europeans to do the right thing. I don't think the U.S. is going to be able to accomplish very much on that score.

The second issue is jobs. Every country around the world wants jobs, not just the U.S., but even countries that are apparently doing well. Many of the emerging markets like China haven't been able to deliver much job growth despite high economic growth. And everybody is looking to the export sector to generate jobs. And this is where there is a tension between what President Obama is trying to do and what the rest of the world is trying to do because the paradox remains that the U.S., despite all of its weaknesses, still remains the big bad gorilla around and the U.S. economy has started recovering and there is a sense in the rest of the world the U.S. coattails are still the best ones to hang onto.

Now, countries like China are growing fast and are likely to continue growing very fast over the next couple of years, but the realities of the sort of imports that

China takes in, especially if it's going to continue with its investment-led growth is not really going to help the U.S. So on the exports front what did President Obama's speech offer? As is typical it offered red meat and what would be a less carnivorous equal, perhaps tofu. (Laughter) Some real content in terms of policies. And what I found interesting was the segue from the more protectionist sort of talk to the more policy-oriented issues. On what might be interpreted as prediction and sentiment, I think the administration has already laid down a very clear line in the sand that it is not going to sit back and tolerate what it sees as unfair competition from other countries with China, of course, being the primary competitor.

Now, what the U.S. has done in terms of concrete accomplishments, of course, is sign a few free trade agreements with Korea, Panama, and Colombia, and those are trumpeted in the speech. Now, the reality is that the amount of exports to Panama and Colombia are not that great. Korea right now accounts for less than 5 percent of U.S. exports, so even the vision of millions of Koreans buying American cars I think is not going to come to fruition any time very soon. Now, it's true that exports have gone up a lot in the last couple of years but it's off a level. It shrunk quite significantly during the time of the global financial crisis. So right now exports are up only about \$200 billion relative to where they were in the year before the crisis, 2007.

The interesting thing is of the countries that the big trading partners of the U.S. has there is one country to which exports from the U.S. have actually doubled over the last five years. That country happens to be China. The paradox of course is at the same time the U.S. bilateral trade deficit with China has been rising over time. So there is this awkwardness in the sense that one would like more market access in China but at the same time the U.S. is going to be forced into a position where, because of political winds on the Hill, it's going to be important to be very tough on China. China, of

course, is going through its own leadership transition in the next 12 to 18 months so they're going to be in no mood to back down.

And the problem is not just about China. Ultimately, the way these two big powers tango is going to have fairly serious implications for the overall global trading regime. And that in a sense is going to be a real concern and President Obama's speech lays down a marker for China and I think it's going to lead to much more heated rhetoric. But at the top level in both countries my sense is that sense will prevail and we will not have too much of a flashpoint on this particular issue.

What I found interesting in the speech again was the nice segue from domestic to international policies because he does make the point that America needs to be more competitive if it is going to export more and get more jobs in the exporting sector and stanch outsourcing. There are taxes and other policies that come into play but ultimately he does make it an issue of American competitiveness. And I think the segue from talking about international policies and trying to assure a level playing field and then talking about what policies are necessary to ensure American competitiveness on that level playing field was, I think, a sensible toll to take.

So he hit in my view the right elements on the international side. And I suspect we'll see a lot more of that in the coming year. Engagement with allies, engagement with those who are seen as competitors, and at the same time a tough line on our competitors, especially China. So I think it's set the right tone for the year ahead.

MR. MANN: Well, that's an upbeat report. I wanted to ask you about one specific proposal which he didn't elaborate but is very much there which is corporate tax reform and the notion of a global minimum tax as a way of persuading companies in many respects to avoid -- stay away from some of the tax avoidance strategies and actually for resources to come back home. Is that a silly idea? A reasonable idea or

what?

MR. PRASAD: It may matter but only at the margin. Frankly, I think it's important to talk about tax competition and given the attention that is being paid to this issue especially in Europe and especially as it relates to the financial sector it's something that we will have to deal with over the latter half of this year. But frankly I think that in substantive terms the other elements of the speech, thinking about issues like infrastructure, the U.S. fiscal deficit, those are far bigger problems. And as Karen pointed out, I think the rest of the world would also have liked to see some clearer view about what is going to be done to tackle the U.S. fiscal problem in the long term.

Now, I can sense that going into the election season he may not have wanted to toss balls that the republicans could easily swing at but laying out a mission for what should have been done over the long term, at least in terms of the objective I think was a part of the speech that the rest of the world as well was looking forward to because Europe is a big problem right now but the amount of public debt that the U.S. is accumulating is going to be a source of global financial instability in the years ahead and a clearer message on that I think would have been well received by the rest of the world.

MR. MANN: It was noticeable that there was not a single reference by my recollection to Simpson-Bowles or any of the efforts to try to reach an agreement. I think it's clear the president came to a belief, if not a realization that he really had no negotiating partner on Capitol Hill, that what the republicans have in mind is a plan that he would consider radical, and in fact, counterproductive because of the tax cutting rather than tax increasing elements to it. So he decided to play it strictly by the politics of this election year. And other than the throwaway saying he's been ready. He was ready in the spring. He looked back at Speaker Boehner and he said he would continue to be ready to talk about restructuring the safety net programs to deal with these problems but

obviously was not interested in reengaging on that.

Martin, the president began and ended his speech with really quite moving references to American servicemen and women. The beginning at Andrews visiting the last troops coming home from Iraq and another refrain on the taking out of Osama bin Laden and the SEALs and the rest. He obviously takes great pride on delivering on his promise to end the War in Iraq and he hinted at the beginning of the end of the War in Afghanistan. But then there's Iran. Surprises do have a way of, like financial crises in Europe and other things, of making a mess of the best laid plans. How does the national security front look to you?

MR. INDYK: Well, interesting, Tom, you know, politics are supposed to end at the waterfront and foreign policy is supposed to be bipartisan. And in fact, compared to the incredible polarization that we see in domestic politics and the gridlock on Capitol Hill, there has been an amazing amount of bipartisanship in foreign policy during Obama's first three years. But what we saw last night was the use of foreign policy for political ends which again is unusual. And normally democratic candidates for the presidency are concerned about the vulnerability of foreign policy for them, that they'll be portrayed by their republican adversaries as weak on foreign policy and so it's normally something that is not used in a political season.

But here the president did it and I think did it quite effectively in the way that you suggested. First of all, by playing on the fact that he is ending two wars in the greater Middle East. This could easily be portrayed as weakness but, in fact, it's immensely popular across the political spectrum and there are only very few republicans -- Senator McCain and maybe Senator Lieberman. I guess he's not a republican yet, at least. (Laughter) But that's it. There is a great resonance behind the idea that we are bringing the troops home. And so he plays on that. And I thought used it very effectively

as the spine of his speech in terms of turning that into a patriotic moment rather than a moment of weakness that, you know, we're pulling out, we're withdrawing from the world. No. We're coming home with our heads held high and we should be emulating the example of our great warriors.

So I thought that that was a particularly effective use of foreign policy for political purposes. And of course, the crowning point, the jewel in this crown is he got Osama bin Laden. And that more than anything else makes him Teflon when it comes to any kind of attack from the republicans in this campaign season.

In terms of policy that you saw coming out of this speech, the first point is the one that Eswar has already made which is about China in the context of jobs. And here I think what we saw was not just politics but also a very strong personal feeling on the part of the president that the Chinese are basically not playing the game by the rules. They're acting unfairly at the expense of American jobs. And so he's going to take a stand on this. He feels personally quite angry about it and so I think it's not just politics. There's policy behind this.

How it plays in the context of the bilateral relationship with China is going to be important to watch because China itself is not going through an election but it's going through a leadership change this year as well. And there's an expectation I think on both sides in both governments that this is going to be a rocky year in the relationship. But that, you know, we have to kind of keep it within bounds. Both sides are going to be playing to their publics but it needs to be kept within bounds. And that is going to be the challenge for the president in the way that he handles this.

The second issue that he raised was the Arab awakenings and what is happening there. And what is interesting to note was that he did it in a way that was measured. None of the freedom agenda of George Bush. He did not play to his inner

Obama in this regard, which is to bend history in the direction of justice. That's the inner Obama. But notwithstanding the great courage and dignity of the Arab people in toppling their governments and demanding freedom and democracy. His was very measured in recognition of that. And in particular when it came to Syria -- which is the big question of are we going to actually do something beyond sanctions to topple this brutal leader -- he basically was more professorial. You know, Assad will come to understand that he can't stand against the will of his people. But nothing about we're going to make him understand it through the force of our intervention.

And then finally there was Iran. And Iran he was very tough on. He made very clear. Rhetorically he was close to banging his head on the podium. He didn't do that but that was the essence of the passion which he said, "America will not allow Iran to acquire nuclear weapons and all options are on the table." Meaning the military option is on the table. And, of course, that would be the ultimate irony in this situation that he wants to show in the political season that he's going on Iran precisely. That's where the criticism -- the only criticism he gets in foreign policy is from the republican candidates and the debates is that they'll be tougher than him on Iran. Mitt Romney has said, you know, if he's president Iran will have nuclear weapons; if I'm president, Iran won't. So is the president kind of saying I'm going to double down on this one? I'm going to match you and raise you. I'm going to take care of Iran's nuclear weapons. So the ultimate irony that the president who has in effect ended or is in the process of ending these two wars in the Middle East would, as a result of the need to be tough towards Iran, and starting or getting involved -- I shouldn't say starting. Iranians could well start it but getting involved in a third war in the Middle East.

The last point is that he made a very stirring point about how American is back. And all around the world people and governments are looking to America to take

the lead. And it was quite stirring rhetoric in which he said America remains the one indispensable nation in world affairs. And as long as I'm president I intend to keep it that way. That's very interesting language and it is a radical departure from Barack Obama, the multilateralist who is trying to shape an emerging global order in which the rising powers of China and India and Brazil and Turkey are all going to have a place at the high table along with the United States. That kind of policy which led to one of his senior aids describing it as leading from behind, a rather unfortunate choice of words. But it did capture much of his approach which I think happens to be the right approach to the challenges that we're facing in the world. But in this political season he wanted to take on the declinists. He wanted to say again to the republicans who were accusing him of not taking a stand for America that he's going to ensure that America remains the indispensable nation. And that I don't think captures where his policy is but it does capture where -- the way in which foreign policy is being used for political purposes in this campaign season.

MR. MANN: That's a fascinating point. That struck me more than anything else in the speech. And if you think about it, it goes directly to the republican attacks on is he really an American? And doesn't he really think ours is the country in decline? He doesn't really understand who we were. And I thought this was the strongest assertive statement on that point. But other pieces of the speech were very much connected to it.

MR. INDYK: His grandfather and grandmother.

MR. MANN: Exactly.

MR. INDYK: Their role in it.

MR. MANN: I wanted to follow up with one piece on Iran because you gave us some insights into the inner Obama on some other matters. I'd love to know if

the inner Obama confronts what could easily be a choice. Either Iran gets a nuclear weapon or weaponry and we deal with it as we've dealt with situations similar in the past through containment of various sorts or we join what seems to be the growing drum beat for military strikes in Iran which I would imagine potentially could put us in a new war and a rather extended one in that part of the world. Where is the inner Obama on that choice?

MR. INDYK: I think he's conflicted. I think that if you pose it in the kind of extreme scenario of Iran deciding to break out, throwing the inspectors out and making a dash for nuclear weapons because it's putting all of the capabilities in place to be able to do that, I think in that extreme case Obama could well order a military strike. That's not his preference. He doesn't want to start a third war in the Middle East but if the Iranians go for it I think that ultimately he would do it. Why? It's not about politics. It's about the new world order that he's trying to help construct and shape. It's about, you know, if Iran abrogates its commitments under the Nonproliferation Treaty in the face of the whole world opposing it and that triggers an arms race in the Middle East or an Israeli military strike on Iran, the whole -- one of the principal foundations of the emerging international order is going to collapse. And I think that will be his justification for it. And it's why he's told the military to prepare for that possibility and Leon Panetta has made very clear that that option is on the table. But that's why I say an extremist.

I think that he, in order to try to prevent that from happening, he is now focused on trying to get the international community behind these very strong what he calls crippling sanctions to try to convince the Iranians that they should come back to the table and negotiate curbs on their nuclear weapons. But again, you know, it's the multiple ironies of the Middle East that in order to stave off military action he pushes very hard on the sanctions which has the effect of pushing the Iranians' backs to the wall and

then they decide either to strike out in some other way with terrorism or closing the Straits of Hormuz or going for the breakout strategy. And so, you know, the unintended consequence of all of this effort to avoid war could indeed lead us in the end to a war. And so we're in a very tense and dangerous period at the moment.

MR. MANN: We have about 10 minutes to entertain your questions. We have mics so please let me see a hand emerging or two. Let's start with the gentleman right there.

MR. ALTMAN: Hi. I'm Brad Altman. And all the presentations were quite positive and Obama is going in the right direction except on the financial issue in dealing with the financial problems. How likely is it that financial problems are going to override everything everybody else said?

MR. MANN: Karen, would you like to?

MS. DYNAN: Sure. So when you mean financial you're talking about the unsustainable trajectory of the federal debt? We don't know. This is part of the point I was trying to make. I mean, people are quick to argue that it's not a problem because we haven't seen U.S. government interest rates go up. And there's kind of a standard way that people look at it. You know, if investors are really afraid that we weren't going to repay our debt then we see the interest rates go up and then we'd see the economy hurt through that channel. And we haven't seen the interest rates go up but there are lots of explanations for why they haven't gone up. And Eswar may be able to speak to them as well. I think part of the explanation is, well, if you're not going to invest in U.S. government bonds, where do you want to take your money? I mean, not Europe. Right?

So we don't know how likely these problem are to blow up. As I said, even though we haven't seen this show through to interest rates we do think it's a problem for the economy because it's creating this cloud of uncertainty about the

possibility it could blow up. I think we should take a cautionary lesson from Europe and from three years ago when we were at the height of the financial crisis that financial markets can change, you know, very suddenly. Investor sentiment, it's a tricky thing.

MR. MANN: Eswar.

MR. PRASAD: Yes. So the U.S. is benefitting from the fact that it still has the biggest, deepest, most liquid bond market in the world. And, in fact, this problem you're talking about, the U.S. debt, is actually the U.S. providing even more of those services to the rest of the world. How enlightening of us. And the problem is that the rest of the world is in turmoil and there aren't any other good financial markets that can take on this burden at a time of global financial turmoil. Now, the problem for the U.S., of course, is that while it keeps our interest rates low it goes against the strategy of boosting exports so the currency is going to remain very strong related to other currencies. So in this, as in many other issues, there is a mixed blessing to be seen and I think what Obama is again pointing out in the rest of his speech is that the U.S. needs to do a lot more setting all of these issues aside in order to deal with the fundamental competitiveness issues for the long term.

MR. MANN: Let me add just a slightly contrary note on this score. I think another reason, other than the dollar is the only secure currency and people are willing to pay us to hold it, is another fact which is that the status quo now works to the advantage of the deficit and debt problem. That is to say the agreements in place may not be very smart cutting but it's cutting on the spending side and the expiration of the tax cuts in and of itself with the discipline on spending would basically turn the situation around dramatically for the intermediate term and give us the decade we need to begin to slow health care costs which is where the long-term problem resides.

Now, it's true the economy would be too soft to absorb that big a hit at

the beginning of 2013, but that's a really powerful status quo that the president could work with to make progress on this issue. On the other hand, leading with his chin on a plan for deficit reduction, in the face of a republican plan to dramatically cut taxes, in the case of some, eliminate all capital gains and dividends taxes would set him up politically to lose the election. So this is a case where the policy baseline and the politics, I think, overwhelms the case for a vision on deficits and debt, especially given the reality of where interest rates are now and the programs in place.

Next question.

MR. CLINTON: Bill Clinton, a retired physician.

I don't think I heard the word "inflation" last night. As a retired person I fear inflation far more than I do a modest tax increases which would happen if the let the Bush Tax Cuts expire lock, stock, and barrel. I just wonder where you think inflation fits in and if there's a risk in the future of a sudden burst of inflation that will just surprise everybody as if they hadn't been watching.

MS. DYNAN: I can speak to this. You know, I understand the concern. I spent years forecasting the economy at the Federal Reserve Board and forecasting is a tricky business. I think right now the greater worry is actually not that inflation is going to take off. It's that inflation is going to start -- we're going to see disinflation and maybe even sink below zero, which by the way would make our economic problems worse because it's hard enough for people to pay off their debts. Now, imagine if wages started falling because prices were falling and it's even harder to pay off those debts.

It's hard to see where the inflation would come from. So labor costs right now are just extremely soft and that's because of the soft state of labor markets. We did see this burst of commodity price inflation a year ago. People were very worried about that but the fact is that the increases in commodity prices have kind of leveled off. So I

think the one, you know, thing that people worry about is, you know, some sudden change in public sentiment such that they started to expect hyperinflation and that that could then become self-fulfilling because if you expect it then, you know, if you're a business person you're going to set your prices higher. But it's just, again, in the current economic climate where there's just so much what we would call slack in the economy it's just hard to see it happening.

MR. MANN: Eswar, do you want to add to that?

MR. PRASAD: There's nothing obvious on the horizon that makes inflation the key problem we should be worrying about. It's really growth. But you're certainly right that one cannot rule out the possibility that we reach a tipping point with the level of debt and with the amount of money in the economy that it does create a problem but it's something that we've decided to postpone given all the troubles we have to deal with right now.

MR. MANN: Garrett.

MR. MITCHELL: Thanks. I'm Garrett Mitchell and I write the Mitchell Report.

I want to pose a question that I think covers three of the disciplines on the stage -- government, economic, and the metropolitan studies arena. It's ironically triggered by a comment that Martin made about the sort of relative bipartisanship on foreign policy during the last few years that we haven't either paid much attention to or it hasn't gotten much notice. And here's the question for the three of you.

Twenty years ago your colleague Alice Rivlin wrote a book called *Reviving the American Dream* in which she talked about a kind of new federalism, if I may put it that way. And then a short time ago she and Bruce Katz from a metropolitan studies group talked about this notion of the new federalism in which, for a variety of

reasons that I won't go into here, the states are probably ready and capable to assume some of the burden that the federal government has been assuming. And so what we might look for over the course of the next few administrations is some formation, some form of this new federalism that could be as anecdotal as having governors and perhaps even mayors participating in super committees and then stepping up from that to ways in which actual programs and projects and initiatives are taken over by the states so that you would have some form of -- I hate the term "revenue sharing" -- but revenue sharing and work sharing. In other words, a different look at how governance in the country ought to look going ahead.

And my question is this: (a) is that realistic, from a political point of view; (b) is it realistic from a governance and financing point of view; and (c) do you see any signs, either in the speech last night or in the rhetoric that sort of leads up to it, that there may be some thinking in that regard either in the Obama administration or somewhere in the depths of Congress?

MR. MANN: Rob, why don't you begin?

MR. PUENTES: Sure. Thanks. On the latter, I don't know to the extent the speech kind of hinted to that. I think there were some references to kind of Race to the Top, some education reforms I think that clearly were designed to spur innovation when it comes to education on the state level. I don't know if the rest of it did that. In fact, I think one of the critiques that we had from this is that it did seem federally focused. Right? And again, it was kind of the president talking to Congress, you know, what they can do together. And it really left out exactly where you were going, that so much of the action is happening on the state and the metropolitan level. So that old pyramid structure we had before of the federal government on top kind of raining resources down on the states and metros has really been flipped. And so much of the -- all this is kind of

bottom-up, this innovation that's happening. And the issues that I kind of ran through on exports, on energy, on infrastructure. You know, we're not looking to Washington to be the innovator when it comes to this.

And we talked about the infrastructure bank. That was a good example that Tom raised. Conversation here on the national level has been going on for decades, I suppose. It's always the next greatest idea. The states are actually doing this. There's a tri-state thing that's happening in the West. There are some cities that are working on it. Connecticut has their green bank for energy innovation. So we're going to have to look far more to the states and the metros for this innovation. It is around -- I think you're right -- kind of remaking American federalism and thinking about what are those things that the federal government has to pay attention to because they're national in scope and the things the federal government has to do. But so much of this is really being taken over by this pragmatic caucus of governors and mayors and private sector leaders all across the country that are crafting their own solutions because it's a big country. And the solutions for, you know, around exports in Los Angeles are going to look very different than they do in Wichita, for example. So we've got to capture that innovation, we've got to translate it, and we've got to make sure that those lessons are being shared among the states in metropolitan areas and that we're not just waiting for Washington to send them down from up top.

MR. MANN: But remember the ideological polarization of the parties and the strategic partisan battles are not limited to Washington. They are found in most of the states. If you want to know which states are filing the suit to declare the individual mandate unconstitutional, look to see the party of the governor and attorney general. Look at Wisconsin and Ohio and Florida and get a sense of the extent to which ideology is really dominating politics. So we've got cross-cutting currents. We've got very

pragmatic mayors and leaders in metropolitan areas who are working with government and doing really impressive things to build the new economy and yet we have ideologies in place and utter war breaking out in state capitals that are no different than what's been happening in Washington. The question is which way we end up going.

MR. PUENTES: You're right. And we think the mayors, I mean, there's so much innovation that's coming out of these. The party, generally it's aligned, I mean, there's a lot of big city democrat mayors. But you can't forget about the states. I mean, there's so much of their ability to act and their flexibility relies on having a state that's willing to work with them. And we've still got 30-something new governors that are in. They've only been in for 18 months or so. They're still on the hook for acting. They've got their own budgets to balance and you've got republican governors in places like Michigan and Tennessee and democrats in New York and Colorado all saying generally the same thing, particularly when it comes to these elements of the productive economy. Sure there's always going to be the political polarization in some of the state capitals are crazy, dysfunctional, there's no doubt about it. But, you know, if we're looking to where we're going to hang our hats in the near term you still have to look to the states I think.

MR. MANN: Listen, it's time to pass the baton. The one thing we didn't talk about that I think was very important, I'm sure Bill Galston will bring up, which was the president's discussion of his former body, job in it, the United States Senate and recommendations for reform of the filibuster. Maybe nothing could be as important as that in terms of politics and process. But for now please join me in thanking our colleagues.

(Applause)

MR. MANN: And please, we'll begin within 60 seconds.

MR. GALSTON: Okay, if I can call this rowdy crowd to order and we

begin the second episode of the 2012 edition of the long-running Brookings hit series evaluating the President's State of the Union Address.

I'm Bill Galston, a senior fellow in governance studies, and this is an all governance studies panel, which will give you sort of a leading indicator of where the center of gravity of our discussion is going to be.

I'm not going to spend a long time introducing my colleagues from governance studies. Their lengthy bios are available to you in your packets. Suffice it to say that Pietro Nivola is a senior fellow in governance studies, he holds a chair, and he's a former vice-president directing governance studies.

To my left, stage right, Elisabeth Jacobs, a fellow in governance studies, whose work, very intriguingly, crosses boundaries of politics, economics, and sociology, and addresses a range of issues, including economic security and mobility questions.

Let me just tee up this conversation by asking a question: how should we listen to a State of the Union Address? Who is speaking to us? To whom is the speaker speaking? And what is the speaker talking about and not talking about?

And this points to one of the interesting and distinctive features of the American Constitutional system in the first place, namely that the President wears multiple hats in a way that really isn't paralleled anywhere else in the advanced democracies, because the President is the Head of State, equivalent to a king or a queen or a President in parliamentary systems that also have a Prime Minister. He is the Chief Executive Officer of the government. He is the leader of his party. And in years divisible by four, he is also a candidate for election if he's ending his first term.

And I would submit to you that all four of those presidential characters were on display last night in a very interesting and intertwined way.

Second question to ask yourself as you're listening to a State of the

Union Address, what should you be listening for? And a State of the Union Address proceeds on a number of different planes simultaneously, on the plane of ideology, on the thematic plane, on the plane of policy, and we heard a full discussion of that in the previous hour, on the plane of governance and, of course, politics.

And as the President is putting his chips down on certain squares, he is refraining from putting them down in other squares, and a speech, especially a State of the Union, is significant for what it does not say as well as what it does say.

And finally, there is the question of the audience. To whom is the President speaking? And from year to year and speech to speech, that questions admits of a different answer. There have been years when the President of the United States was speaking as much to foreign audiences as to the people of the United States. This, I would suggest, was not one of those years, and that is a distinction that makes an important difference.

And within the American electorate, to whom is the President speaking? That too changes from year to year and it reflects a broad political judgment and a broad political strategy.

So, that's a general framework for listening, not only to the President's State of the Union, but to the astute commentary that is about to follow. And here's the way we'll proceed: I will ask first, Pietro Nivola, then Elisabeth Jacobs, to deliver introductory remarks. They have prevailed upon me to step out of my moderator's role for a few minutes and offer a few of my own thoughts.

If anything particularly interesting has come up that distinguishes our various analyses and positions, distinguishes them not by excellence, but from one another, then we'll have a little bit of cross talk. And then in the remaining 10 minutes or so, perhaps 15 depending on how things go, we'll go to questions from the audience.

We started a little bit late and therefore I have received permission to end a little bit late, sometime between 25 and 20 of 1, and with that, Pietro Nivola.

MR. NIVOLA: Thanks, Bill. Glad to be up here.

Let me begin by just saying, this is another case of both good news and some bad news in last night's speech. I think that, on the whole, this was a much better speech than was given last year. It was delivered with verve and passion, and if you'll recall, last year's speech, the basic motif was winning back the future, winning the future.

So, that was kind of more of an attempt to change the subject from what was -- from bad times to much better -- to sort of better times in the future. And so, the speech was full of sort of futuristic investment plans and the like, though I'd say the one missing component last year, and it was pretty conspicuous in terms of forward thinking plans was, no endorsement of the Bowles-Simpson Commission on deficit reduction.

But the main trouble, I think, with winning the future last year was that it wasn't the kind of thing that would gain a lot of traction while people were principally preoccupied with the here and now of joblessness and the economic slump. The recession was very much on the minds, front and central, on the minds of most people.

So, it was hard to sort of captivate them with visions of the future or the long-term.

Last night's message was different. It was much more persuasive, I thought. There were no sort of utopian schemes in there, or at least there were fewer of them. There was no mention, for example, of how we might be able to get to 80 percent of our electric power through purely clean energy sources and that sort of thing.

But above all, there was a new theme, and that new theme, of course, was concern for basic economic fairness in American society. And I think that theme touches a chord.

Most Americans, I think, are troubled with the glaring inequities and excesses of recent decades, and especially during the years leading up to the recession. And, by the way, I think this concern is at both ends of the political spectrum, it's not just the left wing. You can see it in traces of what the Tea Party complains about too.

So, yes, I think channeling some strains of Teddy Roosevelt's populist zeal made great sense and it will resonate in the course of the campaign. That's the good news, especially in a strictly political sense, of last night's message.

Here's the less than great news, or the more debatable part of what he talked about last night, and I want to say three things. First of all, in American society there are real cultural constraints on how far you can push something like the fairness issue. The national electorate is looking not just for a President of the middle class, but a President of all the American people. And, in fact, back to your question at the outset, Bill, I mean, the audience last night was the center of the American electorate as a whole.

As you know, Americans are traditionally receptive to appeals for equality of opportunity. They're much more skeptical about making a case for a quality of results or status. There was a recent -- there was a poll, I think it was a Gallup poll back in December, that found that well under 50 percent of respondents were not eager to see the government step in to close the gap between rich and poor, for example, even though 70 percent favor measures that address equality of opportunity.

Now, the President, I think, understood this very well and handled it very skillfully last night. The central message -- I think is the main part of his speech that really was pay dirt, "We can either settle for a country where a shrinking number of people do really well while a growing number of Americans barely get by, or we can restore an economy where everyone gets a fair shot, everyone does their fair share, and everyone plays by the same set of rules. What's at stake are not democratic values or

republican values, but American values.” That was exactly the right note to strike.

But notice there’s a world of difference between invoking a fair shot and calling for a fair share. You’re going to find, in the course of the campaign, that this difference is going to be very carefully parsed; it will be very closely scrutinized.

The Republicans are going to raise questions about this type of thing. They’re going to contest the notion that the wealthy are not paying, necessarily, their fair share if you don’t raise the marginal tax rate up to 30 percent. So, look for that in the course of the campaign. It’s obviously going to be something that Obama will have to address.

And the Republicans will especially make this case when approximately half of all households don’t pay any income tax at all, federal income tax.

So, that leads me to my second observation, which you may find a little naïve. I was a bit disappointed that the whole notion of comprehensive tax reform got short shrift last night. It would have been nice to see a more full-throated endorsement of full on tax reform in this society. We have an extremely Byzantine tax system and I think it’s at the root, not only of a lot of inequities, but a lot of inefficiency.

So, when I -- you know, we can talk later about what I mean by tax reform, but it goes well beyond just making sure that a few more millionaires pay a higher marginal tax rate. What we need in this country is to shift the whole tax burden away, a little bit, from not just taxing earnings, savings, and investment, but also toward taxing consumption.

And so one last comment and then I’ll shut up. I also thought there was too little discussion of what is, I think, the central domestic policy predicament of our times, and that is, how to secure the safety net of the modern welfare state, how to render its huge entitlement programs sustainable.

So, those are my two cents, Bill.

MR. GALSTON: Thank you, Pietro, more than two cents, at least three cents.

Elisabeth?

MS. JACOBS: All right, I think I have two and a half cents, so I'll start with the observation that I went back before the State of the Union and read States of the Union for Presidents in similar positions as the President's in right now, so, election year State of the Unions, and the most obvious comparison is between Reagan in 1984, who was facing a pretty rough economy and looking for reelection, and actually during this first panel I went back and reread that speech yet again because it occurred to me that there were some lines that sounded kind of familiar based on last night's speech. "America is back", for example. That, literally, is right there in Reagan's speech in the very beginning. And similarly this formulation, "The State of the Union is getting stronger", that was Obama's formulation. President Reagan, "America is much improved and there's good reason to believe that that improvement will continue."

So, clearly, I wasn't the only one who went back and read past States of the Union. And I think, I mean, it was a smart thing to do. The President's got smart people around him, far smarter than I, and I think it was wise. Reagan was, obviously, very successful. I would point out that it was probably not because of his State of the Union that he got reelected, but it was a masterful way of kind of navigating tough economic times and simultaneously addressing the fact that times were tough but looking forward in a way that felt grounded in reality, and it's pretty clear that President Obama attempted to do the same and I think was pretty successful.

So, some of the points I have to make actually echo what Pietro said, and so I'll try and keep it brief. The first one is this idea of economic fairness, clearly,

was sort of one of the big takeaways from Obama's speech last night. And I think it was a good one. I think that, obviously, he's been kind of dancing with this idea of inequality and the problem of inequality in our society, which is a tricky one for exactly the reasons that Pietro has highlighted. Americans like equality of opportunity a lot, Americans don't like -- do not like equality of results.

So, trying to figure out how to talk about the problem of inequality without kind of frightening Americans into worrying that he's a socialist who's looking to impose a ceiling on how well you can do in America, it's tricky politics, particularly, obviously, during an election season.

And I think the fairness theme actually allows him to kind of make a case that's less frightening, in a way, in part because it lets him talk about inequality in the context of opportunity.

And as Pietro was talking I was thinking about Alan Krueger's speech at the Center for American Progress, which was really linking these ideas of inequality and opportunity with the idea that Krueger put out, and I think that it was implicit in how Obama was talking about fairness, that too much inequality can make opportunity impossible, and that that's, really, sort of the link that he's trying to make. This isn't about equality of results, this is making sure that we can continue to be an upwardly mobile society, that we can continue to have the real opportunity that we think of as American, but at a certain point, the level of inequality, the shape of the income distribution, can get in the way of that being possible. And I think that's really what he's trying to flesh out and I think it's pretty smart. It allows him to get around this charge of the politics of envy, because he can say, this isn't about envy, we want everyone to succeed, we're just at a point right now where because of the way things work, everyone can't succeed, and so we need to kind of re-jigger things to make sure that our ultimate goals are still possible.

And I'd say also that I was looking at some focus group results last night from swing voter's responses to this formulation of fairness, and it tests quite well. I mean, I think, you know, we're up here from governance studies to talk about the politics of this speech, and from that perspective, you know, there's a risk to talking about fairness, all of the ones that Pietro and I have just talked about, but Democrats, somewhat unsurprisingly, liked that fairness message a lot, particularly the Buffet rule, this 30 percent of your income is taxed if you make over a million dollars, that that's just going to be kind of a basic way of how we do things. Now, what that means, exactly, is up in the air, but is the basic principle of kind of fleshing out what this means.

So, Democrats exceeded 80 percent on this 0 to 100 scale, they really like that idea.

More surprisingly, Republicans exceed 70, so they like that idea too. Seventy is a pretty good number on a scale of 0 to 100. And perhaps even more importantly, independents are at above 70 as well. So, that suggests that this fairness frame is actually a good one for Obama. Obviously things change, but going forward, I think, he's potentially kind of figured out how to talk about the issues of inequality and mobility in a way that test well, and from a political perspective that's obviously what he's aiming to do is keep his job.

So, that's general point one and a half, I guess.

I have a couple kinds of musings on the policy specifics, and obviously the first panel was really here to talk specifics about policy, but I tend to think about policy both as policy but also the politics of the policy, so I thought I would bring that into this panel as well.

The first is a point just about the way the President talks about manufacturing. I think based on my Twitter feed responses and the conversation this

morning so far, I think that the manufacturing that the President is talking about is very different from how I think many Americans think of manufacturing. The President isn't talking about widgets and assembly lines. That's not -- I mean, I'm not inside his head, but I'm fairly certain based on knowing how people are talking about job creation and manufacturing, in the policy world, he's talking about advanced manufacturing, which is really about robotics, it's about high tech computing, it's very high skill, high tech future.

And I think whether it's, you know, a problem or not that he didn't make that clear, I think it's worth putting out there in terms of thinking about what his vision is all about. It's not a sort of looking backwards towards, you know, our assembly line age, it really still is in keeping, in some ways, with the Clinton knowledge economy, but with, sort of, some more substance to it.

I'd also say that the wonk-o-sphere, including the first panel, have given Obama some flack for industrial policy. I don't have a firm position on this, but I would point out that in a sense we do have an industrial policy right now, it's just incentivizing things that don't make much sense, and so we have some options in terms of what we do. And I think the way the President's framed it is essentially saying, well, why don't we change those incentives to make some sense?

You could argue that the right thing to do is just to completely remove what we've got in place now and have a real free market driven policy, but I would argue that the status quo isn't nothing. We've got a status quo in place that's incentivizing things kind of backwardly -- backwards.

So, that's my second policy point.

A third related point on the manufacturing bit is just that I'm sure many of you in this room have read *The New York Times'* Sunday piece about Apple and iPhones, and more broadly, really, about the global supply chain and the serious

challenges that the U.S. faces in trying to ultimately kind of create this vision of advanced manufacturing as the bedrock for our economic future.

If you haven't read it, I highly recommend you do. It's one of the best pieces of reporting I've read in a long time. But in some ways, I wish that -- I'm sure the President read it and I'm sure he just decided that he was going to punt and ignore it, but having read that piece and then listening to the speech, there's a big gap between the President's rhetoric and what we face in terms of challenges, and I'm glad it's not my job to figure out what to do about that gap, but I wish the President had addressed that a little bit more directly, because he skated over a lot there.

Two other economic policy/politics points. The first, on job training, I was heartened to hear the President mention it. I was not happy to see it as usual, kind of skated over. It surprised me over and over and over again over the course of the recession and the recovery how minimal a role and how quiet the conversation has been about job training given we have a long history of very confused and not particularly effective job training in this country and it seems like we have this kind of political moment to really think hard about what to do and we keep on not doing it, punting.

So, I was glad to see the President mentioning it, but I don't feel like it was a particularly serious mention. There are 5.6 million long-term unemployed Americans today and Obama proposes retraining program that would -- you know, the way he pitches it is this ambitious 2 million workers retrained. That seems to me to be a serious gap. Obviously, the entirety of those 5.6 million long-term unemployed Americans don't need to be retrained, but at the same time, a 2 million person retraining program strikes me as sort of an unambitious goal given the opportunity for really thinking hard about that.

And, lastly, on the same theme of labor market issues, Bill mentioned in

his opening remarks that States of the Union and other addresses are just as important for what they say as what they don't say. The President made no mention of unemployed Americans or jobless Americans. He made a push, a very clear and admirable push, for extending the payroll tax cut. He mentioned nothing about extending unemployment benefits, which will expire, and given the number of long-term unemployed, it seems reasonable -- and the level of the unemployment rate at this point as well, it seems reasonable to think that our existing federal extension of unemployment benefits is something that should stick around.

Most economists agree that it's good policy for a variety of reasons. Most economists agree that it's significantly better policy than the payroll tax cut from an economic perspective. From a political perspective it's quite obvious why the President would push the payroll tax cut but not mention the unemployment benefits extension. I think it will be interesting to watch what happens with that. I'm not particularly optimistic about the fortunes of the unemployment benefits extension given the President's clear unwillingness to go out on a limb for it. And based on conversations I've had with folks on the Hill, I don't think it's something that's likely to happen.

So, I would point those two out. And then I'll finish with just a note on -- kind of going back to the broader thematic points, and that's, I think the President really understands, it was clear from the speech, that the erosion of trust in government is a huge threat to our country right now. I mean, he said as much pretty explicitly. And I think it's both good policy and good politics the way that he's brought that to the forefront.

It's good policy because Americans hate government right now, Americans don't trust Congress, they don't particularly trust the presidency, I mean, it's a mess. Everyone who's sitting in this room, I'm sure, knows this, so it's good politics to kind of do what you can to rise above the fray and try to do something about it.

And the policies that he put out there, as far as I know, this idea of ending the filibuster on nominations, I think, and Bill knows this policy arena better than I do, so you should correct me, but I believe that it's the first time that that's really out there as a proposal for something to be done about it and I think that's admirable.

Arguably, there's, you know, more that should be done on the filibuster in the Senate, but to start with something like nominations, it's clear, it's easily explainable to the American people in a way that Senate procedure is not always, it strikes me as both good politics and good policy.

And I'll finish, going back around to where I started, with this idea of the focus groups that I talked about earlier, these swing voters, Colorado swing voters, they liked the fairness message a lot, but they were deeply skeptical of Obama's ability to translate that vision into action, which speaks directly to what I was just saying about the importance of trust, the future of our democracy, and a lot of real polarization showed up not in terms of their response to Obama's message, but in response to who was to blame for the fact that Obama had a very slim likelihood of actually doing anything about all of these proposals that they liked a fair bit.

The Democrats in the group -- these are swing voters, but many of them had party allegiances -- the Democrats blamed GOP obstructionism, the Republicans blame Obama, and to the best of my knowledge, it wasn't clear who the independents blame, and it seems to me that that's actually a big question going forward given the importance of the independents in deciding elections in America these days.

MR. GALSTON: Well, thanks so much to both of you for a very challenging and interesting set of comments. Fortunately as both of you were talking, I was busy crossing items off my list of what I had to talk about, which simplifies my task considerably.

I'd laid out a template at the beginning of what to listen for in the State of the Union. I'm just going to comment on a few of those points and following in the wake of both of my colleagues and offer a little bit of data in support of particular propositions.

Let me begin with a textual point, since my academic training is actually in the close reading of texts. If you look at the basic ideological orientation of the President's speech, it's really quite remarkable and quite telling. The speech was, I think, a very eloquent invocation of the ideology of fairness, solidarity, collective action, and common purpose. Really, the classic themes of the progressive era and of Teddy Roosevelt's New Nationalism, et cetera.

He was virtually silent on the classic American values freedom and liberty, and that tells you everything you need to know about the ideological contest that awaits us over the next nine months, because I don't know of a single Republican, elected official or wannabe, who can utter three sentences without mentioning the word liberty. That's not a criticism, that's just a fact. And liberty is as close to the heart of American public culture as any value possibly can be.

And so, I think that one of the issues before us is the extent to which the President can go down this more solidaristic and communitarian role without running afoul of the more libertarian instincts that are not confined to Republicans or Independents in the American polity.

So, so much for ideology. Now let's think for a minute about the governance issue. You know, Elisabeth talked, and I think quite rightly, about mistrust of government. What is, I think, so remarkable about our times right now is that, you know, it's mistrust of everything. I have a Gallup survey here from just last month. Adults, national adults, are asked, you know, are they satisfied with the size and influence of major corporations, and 30 percent say they're satisfied, 63 percent say they're

dissatisfied. Well, that sounds like the perfect predicate for left wing populism, you know, rail against the corporations.

Then, question two, are you satisfied with the size and power of the federal government? Satisfied, 29 percent, dissatisfied, 60 percent, even worse than the big corporations. That sounds like a predicate for a populism of the right.

And then when you look at Independents, you have only a quarter of Independents satisfied with either the influence of big corporations or the influence of big government. If there was ever an opening for Libertarian populism, that opening is this week, a plague on both your houses against corporate oppression and government oppression. Just leave me alone. There's a lot of that out there and it's a wild card in our nation's politics. It is, as political scientists would say, orthogonal to both political parties and it is a challenge to both political parties.

Now, I would pose the following question and, you know, it is, I think, a challenge to the President but it's also a challenge to political analysis, and that question is this: Given the level of mistrust of government to which Elisabeth pointed, which the data support, the focus groups support, given also the fact that at the end of the day the President's 2012 State of the Union Address announced a very activist public agenda, as the debate goes on, when the activist agenda encounters the mistrust of government, is it like matter and anti-matter meeting in a big collision leaving nothing behind except a discharge of energy in all directions? What happens? How do the American people balance their desire for action to help resolve our economic problems against their mistrust of the President's chosen instrument for achieving that action and those results? That's not a rhetorical question. I really don't know the answer, but it is a big question facing the country it seems to me.

Third comment, about the State of the Union Address in the context of

the agenda facing the country. There are two kinds of elections, it seems to me. In one kind of national election there is agreement on what the problem is, but disagreement about the solutions, and in a different kind of election, there is a disagreement even on the identity of the problems.

Now, for a long time, I have believed that this election is going to be closer to a type one election than a type two election, that is, everybody agrees the problem is the economy; the question is what to do about it. And in a very high level of generality, that is true.

But after listening to Mitch Daniels' response to the President last night, I'm a little bit less sure that it's true when you go down a level. The President is talking about the jobs feature of the economy. Mitch Daniels, on behalf of the Republicans, and I think accurately representing them, is talking about the size, the scope, and the cost of government as the key feature of the economy, and the Republican argument, stripped to its essentials, is that it is the size and scope and cost of the economy that is dragging the economy down.

And so the Republican agenda focuses a lot more on the fiscal issues, the tax reform issues, et cetera, about which the President was conspicuously, as Pietro pointed out, nearly silent, and as Karen Dynan pointed out in the previous panel, nearly silent.

And so, you have, if not dueling agendas, very different conceptions of what the economic problem actually is, and part of what's going on in this general election will be a fight for the control of the agenda. And if the Mitch Daniels style argument about how -- what the core economic problem is prevails, then the Republican nominee, whoever he may turn out to be, and interestingly only one of the two front runners complies with the Buffet Rule at this point, and it's not Mitt Romney, then we

have one kind of election, but if the President's framing of the problem prevails, we're going to have a very different kind of election.

The final point that I want to make has to do with the audiences. The President was trying to speak, and I agree with Pietro here, to the broad middle of the country. That is to say, he was trying to speak to his base in a way that would appeal to Independents as well.

The focus groups and dial groups to which Elisabeth referred, do support the proposition that at first blush, he managed across that bridge reasonably successfully. The question of whether the bridge is quite as solid as the debate goes on as it was when the President's bridge was first received, strikes me as a more difficult question because that's where the Independents' mistrust of the national government, which is twice as high as Democrats' mistrust of the national government and of government as an effective instrument of national power, is going to become so important.

The other question is how key elites are going to hear the speech, and in particular the business elites who are responsible for many of the decisions as to where business activities are going to be placed, for example. And Elisabeth referred to the remarkable *New York Times* front-page story on Apple manufacturing. That's the tip of the iceberg. There was a survey that I just read of 10,000 graduates of the Harvard Business School that goes into great detail on the fundamental reasons why it is that so many manufacturers are choosing to manufacture offshore, and with all due respect to the President's argument, the problems are so much more complex and so much more challenging than a modest change in the U.S. tax code, that I don't even know where to begin.

The problem is much deeper and every sensible business leader,

including business leaders who are very well disposed to the President, will tell him that to his face if he asks. In other words, the economic challenge facing us, if the idea is to focus on manufacturing and get manufacturing jobs back to the United States, is very much complicated, deeper, and I believe, graver and more challenging than the President indicated.

And, by the way, that's one of the problems with the very important truth that Elisabeth pointed out. If you're talking about advanced manufacturing rather than widgets, you're talking about a form of manufacturing that generates many fewer jobs per dollar of value added. That's one of the basic drivers of what's going on.

So, very, very difficult economic problem and the President, I think, was identifying it but with very broad brushstrokes.

I now want to pose a question, first to Pietro, and then a different question to Elisabeth, and then after that we'll have some time left for questions from the floor.

You know, Pietro, you made, I think, a very important distinction, which, I think, the President on one level would accept, between a fair shot and a fair share. Absolutely right. And if you parse that as equality of opportunity versus equality of results, you're absolutely right.

But suppose fair share is understood not as getting your fair share but as doing your fair share. That, it seems to me, was the President's emphasis, particularly with regard to wealthy Americans and the tax burden. And, as you know, since I've shared the data with you, there's a mountain of evidence suggesting that when it comes to doing your fair share of paying taxes, the President is on reasonably solid ground.

So, do you think that distinction between doing your fair share and getting your fair share makes sense? Does it do any political work?

MR. NIVOLA: Yes, you read the -- or remember the passage very closely, Bill, and you're right. I mean, the President was careful to say "doing your fair share" not "getting your fair share", and so indeed. But I guess from the right side of the spectrum the question would be, okay, if you have half of households not paying any income tax at all, are they doing -- are they playing by the same rules as everybody else?

Anyway, they're going to go back and forth over these questions every which way.

I want to pick up on, I guess, the comment you made just before this one which I thought was really fascinating about whether there's a break down of any consensus on what the nature of the problem is and if I could say something about that. I'm not sure that I think that's what's really going on. I think, you know, both sides here are deeply disturbed by what's happened to entrepreneurship, innovation, the pursuit, on both sides, is for more growth, more prosperity, clearly.

Mitch Daniels, last night, was basically saying, you know, to reach those ends we have to get the government out of the way. The President was saying, no, got to get the government in the mix. And I think the President made a pretty powerful case by citing the example of the automobile industry, which was, you know, an amazing success. Who in this room or anywhere else would have predicted that GM would, in fact, return to being the number one automaker in the world? It's amazing.

So, he picked his case there very skillfully.

Where they disagree is, I think, again, on the means. For the GOP, the debt, the debt problem, and the deficit, are front and central. What they are calling for is more de-leveraging as quickly as possible, actually, both in the public sector as well as in the private sector.

The President and the Democrats are saying, wait, not so fast. If we de-

leverage too quickly we're going to be doing what they're doing over in Europe, which could put us back in the soup. So, what they're calling for is, indeed, a proactive role of government in a counter-cyclical sense, government intervention to prevent us from slipping back into another recession.

I think the problem that both sides have is that neither side is really willing to address some of the basics that are required to get back to growth and prosperity. For the Republicans, as we all know, if you're really serious about closing the deficit, you have to entertain the possibility of some tax increases. I personally think they have to be broad-based and not just at the top of the income ladder.

On the Democratic side, you know, there is an issue with entitlement spending. I mean, you can't put your head in the sand about this. One has to address that. So, that's where the big chasm lies.

MR. GALSTON: Thanks. That's a really interesting parsing of the question.

I have a question for you, Elisabeth, it's sort of a painful, personal question for me for reasons -- for me, not for you -- for reasons I'll describe, but first, you tossed me such a wonderful soft ball that I have to take a swing at it. You know, in your very closing remarks you talked about the erosion of trust in government and part of that being congressional gridlock and the President's proposal last night to have an up or down vote on all nominations within 90 days. And you, you know, conjectured that the President was the first to come up with that idea or to propose it.

MS. JACOBS: The first politician.

MR. GALSTON: The first politician.

MS. JACOBS: I know he didn't come up with the idea.

MR. GALSTON: Well, you know, but this gives me -- you know, Norman

Mailer once wrote a book called *Advertisements for Myself*. I personally think that should have been the title of every single book he ever published, but that's just me. You know, but one of the hats that I wear is policy advisor to a nonpartisan civic organization called No Labels, which on December 13th came out with its *Make Congress Work* agenda, of which the 90-day up or down vote for nominations was one of the twelve items in the agenda. And, you know, so there was a big cheer in the congressional reform community last night when the President uttered those words. But there has been, you know, pressure building from it, not just from the top, but from civic groups throughout the country.

Now, here's my painful, personal question. I spent two and a half years as Walter Mondale's Issues Director, as you may know, and so I remember President Reagan's 1984 State of the Union Address quite vividly. And, you know, in a way you're right. I know that the Obama campaign has gone -- the Obama Administration -- pardon that slip -- the permanent campaign, you know, the Obama campaign in 2008 went to school on the Reagan campaign, and I have no doubt that they read Reagan's '84 address very, very carefully.

But there are some interesting verbal differences that point to the underlying substantive differences, which make a political difference. Reagan's formulation, if I recall correctly, is that the State of the Union is "much improved".

MS. JACOBS: I can check the text for you, in fact.

MR. GALSTON: I think that's what he said.

MS. JACOBS: Yes. Much improved.

MR. GALSTON: Much improved. Obama contented himself with saying that the "State of the Union is stronger". If he had said "much stronger" I think he would have gotten, you know, the Bronx cheer from the country.

Now, why could Reagan say that the State of the Union was much improved? Well, you can look it up, but in the prior year, 1983, the economy had produced four million jobs, that's about 300,000 a month -- more than 300,000 a month.

MS. JACOBS: Right, which is what we need to be doing right now.

MR. GALSTON: Which is what we need to be doing right now but haven't gotten close to in any one-month in this recovery. Unemployment, which peaked at 10.8 percent right around the 1982 election, had come down nearly two full percentage points by the time Reagan gave his speech in 1984. There was a real sense of dynamism, of forward motion in the country, that people could feel and not long after that speech, the Reagan campaign unveiled its famous *Morning in America* ad, which I will never forget as long as I live, because it captured the popular mood.

It's not even close to dawn in America right now, right, and the people know it, and so, you know, from a political standpoint, President Obama has a much tougher road to hoe, it seems to me.

And so, you know, I wondered if you'd reflect for a minute on the differences in Obama's economic/political situation as opposed to Reagan's, because I think it makes a difference.

MS. JACOBS: It does. I mean, I think you essentially made the point I would make, which is that on one hand, they're the most comparable cases that we have, but they're actually not comparable cases. The recovery was much farther along in Reagan's case than it is in Obama's, and so he has the difficulty of both touching on the progress that the country has made, and claiming some credit for that so that people sort of understand that it's been worth having this guy around, but simultaneously not being overly optimistic and therefore, you know, missing the ability to connect with the fact that there are still many, many people who are struggling.

I think Obama's got a much harder, steeper hill to climb than Reagan did, and that's part of why I give him a great deal of credit for this particular speech because, I mean, Reagan, in some ways, had it pretty teed up to give a killer speech. Obama didn't. And I don't think he gave a killer speech, exactly, but I do think it was pretty darn good given the circumstances, and it remains to be seen, given those circumstances, what kind of momentum he's able to build and whether the frameworks that he introduced in this speech that seem like they actually resonated pretty well -- if we want to, you know, base all of our predictions on 80 swing voters in Colorado, I don't know, but based on those folks and my general sort of sense of how people are responding, it seems like he's off to a pretty good start given the hill he has to climb.

MR. GALSTON: Fair enough. Okay, we're right on schedule. We have about ten minutes for questions from the floor. And in the name of geographical fairness, I think I will start at the back, if there are any questions at the back, and then work forward. Yes, and there are roving microphones.

When you ask a question please identify yourself and please make it a question.

DR. POPLIN: Hi, I'm Dr. Caroline Poplin. I'm a physician, among other things. My question is: why doesn't the President, since he's now a bit able to talk about taxes in terms of fairness, also link taxes with the deficit? Mitt Romney is a good example of how increasing somebody's taxes will not reduce their ability to produce jobs. It's questionable whether Mitt Romney ever produced any jobs.

MR. PIETRO: Okay, good question. I think that he should have linked the question of taxation to the deficit. The question is -- I mean, he did up to a point, but, you know, it was mainly some discussion of tweaking the corporate taxes in various ways and providing tax incentives and so on, for -- to spur growth.

And, of course, growth is supposedly, you know, revenue enhancing. So, that was one part. And the other part was, by getting, I guess, millionaires to pay a larger share. The trouble with that, of course, is that we know that that's not going to produce the kind of revenue that's going to make a big dent in the deficit, right? It's not enough money, and when we talk about tax reform, it has to extend well beyond the rich. It has to involve everybody at some level. And there are ways to do this.

Let me suggest here that it would be refreshing someday to hear from our political leaders some serious discussion of maybe totally swapping the corporate income tax and possibly even the payroll tax for a value added tax or a carbon tax or some combination thereof. We are the only major industrial country that does not have a value added tax at the national level. We have state sales taxes, of course, but we don't have -- and one has to -- in order to attain much greater productivity and much greater efficiency in the system, you have to begin to shift from just taxing earnings, and so forth, to taxing some consumption.

MR. GALSTON: Let me just add to that, and then we'll move on to the next question -- I'm sorry --

MS. JACOBS: No, no, go ahead. I just don't want to move on until I have my two cents, but you should --

MR. GALSTON: Then, no, I'm sorry, you first and then I'll play clean up after.

MS. JACOBS: I'll be quick. The point is just, the President did, in last year's State of the Union, he directly tied the issue of tax fairness to the deficit. I mean, he has a specific line, I think I lost it, but it's -- I printed out all of my States of the Union and have my folder with the specific idea that I could quote if I needed to and I can't find the quote -- but he did specifically talk about the fact that the Bush tax cuts have

contributed to the deficit and that one of the things we could do to pay down the deficit would be, you know, re-jiggering individual income taxes in order to make sure that the wealthy pay a fair share, et cetera.

I think, and, you know, I certainly wasn't privy to the negotiations, but my sense is the very, very, very backseat that deficit talk took in this speech was an explicit choice with the idea being that it sort of complicates your frame to start talking about deficits at the same time you're talking about fairness, and that he sort of alluded to the idea that you might use taxes to kind of make things work for everyone. But it was a much easier kind of -- to be vague about it, I think he felt like he would get more bang for the buck and avoid falling into the Republicans' trap. What the Republicans want to talk about is deficits. What Obama wants to talk about is fairness, and he can talk about fairness when he gets down in the details with people. If people want to have a back and forth, he can relate his fairness message to deficits, but he doesn't have to do it directly.

And I think that one could see that as almost like a lesson learned between last year's state of the union, when he really tried to tie the two together distinctly, and this year's, where it was much vaguer and, you know, we can imagine how to connect the dots, but he certainly didn't make it explicit.

MR. GALSTON: Well, I agree with both of you, and let me just say, there is a mountain of survey evidence suggesting that the American people don't believe that there's just a little bit wrong with our tax code. They think it's completely broken, like the government, and so they do want not just tweaking of the rates for individuals or corporations, you know, there is a vast public desire for comprehensive tax reform that could achieve the dual objectives of fairness, both actual and perceived, and revenue. Right? There's not contradiction between the two. And I actually think that the President missed an opportunity to steal a march on the Republicans by wrapping his arms around

the idea of tax reform as part of the fairness agenda. And I think he has left some political space there that they will probably try to occupy.

MS. JACOBS: Well, except that a lot of his fairness agenda he put through the tax code.

MR. GALSTON: Yeah, but it's tweaky, it's not --

MS. JACOBS: Oh, yeah.

MR. GALSTON: -- it's not systemic; it doesn't even begin to sidle up to (inaudible). Yes, sir?

MR. SCLIZER: First of all, thank you for your comments. I'm John Sclizer. There was one sentence during the speech that was touched on a little bit here but not really addressed and that's that question about Social Security where the President talked about the fact that, of course, we have to protect seniors and I thought he opened that area up a little bit, and I wanted to see how you might interpret that in relationship to a political -- politically in terms of his speech and the follow on. Thank you.

MR. PIETRO: You know, I didn't pick up on that like you did. What -- I mean, I didn't see an opening there to, for example, raising the retirement age or anything that would fundamentally, you know, change the existing system. Do you want to just fill in?

SPEAKER: Yeah. I thought the implication was that -- and I may be wrong -- that's the first time I thought that he had mentioned that he might look at that issue provided we protect the seniors. I could be wrong. It's one line and I do not have it in front of me.

MR. GALSTON: Well, you're right. He did say that and it was in the context of a discussion of some -- returning to some sort of grand bargain.

MS. JACOBS: Right, right. But it's not the first time --

MR. GALSTON: No, not at all.

MS. JACOBS: -- he's mentioned it. That's for sure. It's been there. I mean, I think he was maybe the vaguest he's ever been about it last night and that makes perfect sense going into an election when seniors actually show up and vote in large numbers. And, so, I don't think it's a year where we're going to see any kind of meaningful action, let alone meaningful rhetoric around Social Security reforms. You'd have to be, I think, a little bit nuts to try and open that can of worms. You may disagree. I mean, obviously it's a huge issue in terms of budget politics, but when it runs into electoral politics, it seems to me you might as well punt and wait on it until you actually know whether you've got the job or not.

MR. GALSTON: I think that's fair enough. I mean, I interpreted that one line, which caught my attention as well, sir, as indicating that he is willing to rejoin the grand bargain talks that were abandoned so tumultuously last summer, if he's reelected President, and that, you know -- but that the terms of entry, you know, on his part, will be a willingness to discuss Social Security and Medicare, and the terms of entry on the Republican side will be the willingness to discuss revenues.

He's not going to allow himself, as a second term President, to be backed into the same corner that he was backed into last August. No way. And so, I actually think that line had to be in the speech, because that was virtually the only thing he had to say about our fiscal problems, and I don't think he wanted to be accused of having totally ignored the elephant in the room. He got as close to ignoring it as he decently could.

MR. NIVOLA: Can I just quickly -- I mean, you know, I agree with Elisabeth that you don't want to say anything threatening about Social Security and Medicare in an election year, I mean, that would be crazy, but you do have to say

something about how you're going to shore up these programs for the long haul. If you don't really say anything at all about that, maybe that was the implication of that one sentence, but if you don't speak to that at all, then you're kind of, you know, dodging the big question.

MR. GALSTON: Well, here are his exact words, just for the record, we're going to have to end here. "As I told the Speaker this summer, I am prepared to make more reforms that reign in the long-term costs of Medicare and Medicaid and strengthen Social Security so long as those programs remain a guaranty of security for seniors."

Now, you know, that opens the door, but in no way walks into the room, and I think you're both right, that's as far as he's going to go this year, details to come next year if there is a next year.

And with that, you know, let me thank our panelists and thank the audience for its patience.

(Applause)

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