AMERICA'S FISCAL CHOICES
STRENGTHENING THE ECONOMY & BUILDING FOR THE FUTURE

Conference on America's Fiscal Choices

Strengthening the Economy and Building for the Future

October 5, 2010
8:30 am – 4:30 pm

Newseum
555 Pennsylvania Avenue, NW
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Center on Budget and Policy Priorities

Dēmos

Economic Policy Institute

The Century Foundation

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Transcripts

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Panel 1:
Welcome and Setting the Framework:
Economic Growth, Investment and Deficit Reduction

9:00 am – 9:30 am

Speakers:
Greg Anrig, Century Foundation
Katherin McFate, Ford Foundation
Tamara Draut, Demos
Lawrence Mishel, Economic Policy Institute

[*] ANRIG: Good morning, everybody. Is this working? Yes, good morning, everybody. Welcome. Thank you so much for coming.

My name is Greg Anrig. I'm vice president of policy and programs at the Century Foundation. And on behalf of the Century Foundation, the Demos, the Economic Policy Institute, the Center on Budget and Policy Priorities, and the Ford Foundation, who's sponsoring this event today, welcome you to our conference, "America's Fiscal Choices: Strengthening the Economy and Building for our Future."

Our premise is that the debate over the federal budget has become far too constrained and bogged down over relentlessly repeated claims that don't accurately reflect the possibilities facing the nation, so our goal today is to broaden the discussion by injecting some less familiar ideas and insights into the way we think about these issues.

We have a very densely packed agenda. We want you to learn something pretty much every minute from now until we adjourn promptly at 4:30, aside from a couple of breaks. So please refer to your folders for background materials and detailed bios of the participants. And there are also some reports from the sponsoring organizations that you may have seen off to the side there that you may find useful.

We're going to start off the first half-hour by framing these issues as the sponsors of this conference see them, and we're going to start off with Katherine McFate, who is the program officer for government and performance and accountability in the Ford Foundation's governance and civil society unit. And then we'll hear from Tamara Draut, vice president of policy and programs at Demos, and Lawrence Mishel, the president of the Economic Policy Institute.

We'll start with Katherine.

(APPLAUSE)

MCFATE: Good morning.

Almost 75 years ago, Edsel Ford created the Ford Foundation to strengthen democratic values, reduce poverty and inequality, and advance creativity and human achievement. Lofty values, good aspirational values for a country that was climbing out of the Great Depression and looking at the rise of fascism in Europe.

After we entered World War II and defeated Hitler, we made a renewed commitment to expanding democracy at home and abroad, because our political leaders understood that a robust democracy requires an educated, engaged citizenry and an expanding middle class. So our political leaders -- Republicans, as well as Democrats -- made direct investments in public universities and passed the G.I. Bill that sent my father to college and probably the fathers or grandfathers of many of you in this room. We created the largest army of college-educated workers the United States had ever seen.

But they didn't stop there. They made investments in our interstate highway system, in a national communications structure, in emerging aerospace and science technologies, in medical research, in municipal water systems, and in our electric grid.

All of these investments ratcheted up the quality of life for American families and communities across the country, and they knitted us together into a national project of shared prosperity. They let us know that we were inextricably linked to one another, that our fates were linked.

So today, now we enter the second decade of the 21st century, and we look around and we see we haven't really kept faith with that greatest generation. We see bridges and roads and levees that need repair. We see water systems that in some cases are poisoned. We see exploding gas lines in California and a public education system that we know is failing at least a third of our kids and we're not sure that is really preparing the other two-thirds for the challenges that they will face in the 21st century.

We see growing income inequality that's pulled the country apart and made our economy less resilient. And just as the effects of our failure to make these investments in our public structures has become undeniable, we find ourselves in the midst of the worst economic decline since the Great Depression.

We have hard fiscal choices to make. We have hard policy choices to confront.

As we go into these conversations today, let us do so with an eye towards maintaining and protecting and building on those public structures that our parents and grandparents left for us and think about what it is that we need to leave behind so that our children have the same opportunities that all of us in this room have had.

As we enter into these conversations about what choices we're going to make, let's ask, will this choice actually increase the number of decent jobs for the 15 million Americans that are still struggling to get back into the labor market? Will that choice build an expansive, inclusive economy for the future? Will this choice protect the vulnerable and strengthen the middle class?

These are not going to be easy conversations that we're having. They're not going to be easy choices. And they're just the beginning. It's not going to be a quick solution.

We're assuming that all of you will be engaged in these kinds of conversations for the next several years. This is just the beginning. We hope it will be a good start. Thank you.

(APPLAUSE)

DRAUT: Good morning. I'm Tamara Draut from Demos. Thank you so much, Katherine, and thank you to the Ford Foundation for supporting this conference.

There are also a lot of funders here in the room that I want to thank who over many years have supported all of the institutions who are sponsoring this conference. Like Katherine said, we're going to start a great conversation today.

Before we dive into the details, though, Larry and I want to provide a little bit more context. You know, a lot of the budget discussion, at least here in the Beltway and often in the media, is focused on how we can reach a certain target over a specified period of time by either raising taxes or cutting spending.

But we think this is the wrong target. Instead, our institutions believe that our fiscal choices should flow from the answer to a pretty simple question: What kind of nation do we want to be? From that question flow our fiscal choices and the need to find a responsible way to pay to achieve the goals we set as a nation.

As Katherine mentioned, we enter this conversation confronted by a wide variety of challenges, historic income inequality, rising and prolonged unemployment, an urgent need to shore up our physical and social infrastructure, so that we can create jobs now and build a solid foundation for the future. And, yes, one of those challenges involves identifying a glide path to reduce our deficit and stabilize our finances.

We've structured this conference very purposefully. If you look at the agenda, you'll see that everything is organized by a time horizon. This is on purpose. We believe each of these challenges have a different time horizon. One of the things that has happened is we've conflated all of the issues. There are time horizons that we need to be very conscious of.

DRAUT: So, what do we need to do in the short term? In the short term, the absolute, number one priority is, we have to get our economy back on track by getting back to work. If we don't do that, we are going to have a long period of a drag on growth, which is going to make it even harder for us to stabilize our long-term financial picture. So, what should this recovery look like? We believe the recovery must focus on rebuilding the engine of our economy, the middle class. We need efforts to create jobs. We need to invest in key sectors that can lay the groundwork for decades of robust growth. And we need immediate relief to the states, so that we can protect the quality of vital public structures that benefit us all, like safety and education.

How long it takes to rebuild the economy, and whether the recovery actually expands or further erodes the middle class, will depend on the policy choices we make.

All right, what about the medium term? In the medium term, we set out two important goals. One is to ensure better retirement security by both strengthening Social Security and improving the system of supplemental savings in this nation. The other big mid-term goal is to identify the revenues that we need to build on our national strengths.

Only by doing so can we make sure that each generation finds the nation in a better place. We're not going to meet our common needs as a nation, or be able to compete in a global economy, using the same or lower levels of revenues that we had in the past.

Now, on to the long term. We need to address the number one contributor to our structural fiscal imbalance: escalating health care costs. It needs to be said over and over again: we do not have an entitlement crisis in this nation, we have a health care cost crisis.

Finally, for the long-term prosperity of our nation and the future well-being of all generations, we need to recommit ourselves to building our infrastructure, so that today's young people and all those that follow inherit a nation on the rise, not one on the decline.

Now, you'll be happy to know that there are not going to be any PowerPoint presentations today. There is going to be one, though. Larry and I are quickly going to run through some key trends of data, and we couldn't resist. I mean, you can't have a conference in D.C. without one PowerPoint.

So, with that, I'm going to turn it over to Larry, who will get us started.

(APPLAUSE)

MISHEL: First I want to talk about two key aspects of the economy that we think need to frame the choices that are made in budget policy moving forward. One is the fact that over the prior 30 years, prior to the recession, that income growth was vastly unbalanced, that most of the income growth went to the very top. And the second key feature is the fact that we expect to have high and persistent unemployment into the future.

So, let's start with the income growth. Now, as you can see, the upper 1 percent since 1989 saw their incomes grow by 108 percent. The upper tenth of the upper 1 percent, however, saw their incomes grow by 162 percent, while the bottom 90 percent saw their incomes grow by just 7 percent. That's pretty unbalanced.

What that means is that the top 1 percent garnished about 56 percent of all income growth in that time period, and the upper tenth of 1 percent -- one out of 1,000 households -- gained about a third of all the income growth, while the bottom 90 percent received about 16 percent of all the income growth.

What that means for us is that those who have gained little over the prior 30 years should not bear the burden of future deficit reduction.

Secondly, we have high unemployment, which is now touching 10 percent, and has been so for over a year. It's expected that unemployment will be close to 10 percent for the next year or so, and even in 2013, it will be 6.5 percent.

Six years since the recession began, the unemployment rate will be higher than it ever was reached in the early 2000s recession. That means that all the children graduating high school and college going into the labor market are going to be scarred for their future. That means that children in school are going to be dealing with the poverty and the stress of their parents. It means that private sector investment is going to be slow and our future productivity growth challenged as a result.

Now, unemployment doesn't capture all of the distress in the labor market, as you know. Underemployment is a broader measure, which now represents about 16.7 percent of the workforce that are unemployed or underemployed. Now, that's true for all. But for minority workers, it's one out of four are unemployed or underemployed now.

Now, over the course of the year, many more people are unemployed or underemployed. Over the course of the year, one out of three workers will be unemployed or underemployed, and 40 percent of the minority workforce will be unemployed or underemployed this year -- and next year, in 2011. We don't view the challenge of creating jobs and eliminating the unemployment as antithetical to deficit reduction; we view it as complementary. You, in fact, cannot get to the fiscal situation you want until you first address jobs.

Now, we want to call attention to the fact that fiscal policy is about making choices. And this year, we have seen choices made in what is considered to be emergency spending, which, as you know, is spending that is not paid for. It's added to the deficit.

We've had much controversy over the funding of the unemployment insurance system, which was for just $59 billion. Even though that $59 billion doesn't include some of the portions of the unemployment insurance package of the stimulus plan that were eliminated, like health care subsidies for the unemployed and the bonus of $25 per week for the unemployed.
When it came, however, to the war funding, which is -- we are in the eighth year of the war in Afghanistan -- which is a lot more money, there was no controversy whatsoever, even though that spending was a lot more.

DRAUT: All right. Let's move on to the first medium-term challenge we've identified, insuring retirement security.

Now, we're all familiar with the metaphor of the three-legged stool that's often used to describe the three sources of income that should make up an individual's retirement: Social Security, employer- based retirement plans and personal savings.

And we also know that in reality, most older Americans are sitting on a very wobbly stool that's really only supported by one strong leg, and that leg is Social Security.

For low- to middle-income seniors, Social Security is their lifeline. It makes up 80 percent of the lowest quintile's source of income, and just over 60 percent for middle class seniors. And even if you look at the second-highest fifth of seniors, it's still a significant source of income for even those in the second-highest income quintile.

Now, what about the retirement plans offered through employers?

Now, there are several flaws with this savings market (ph). The first is that most workers don't have access to these plans. This is especially true for young workers, workers of color and lower earning workers. Among those workers, the participation rates are well below 50 percent.

The other flaw is that, even if you do contribute, your life savings is at the mercy of the stock market. We saw this when stocks took a dive when the tech bubble burst, and we saw it most recently with the financial collapse. In fact, right now, people who are about 20 years out from retirement have lost a quarter of the wealth in their 401(k) systems. So, what's left over for most older Americans is Social Security. Now, we believe that the system, which has survived 13 recessions, is fundamentally sound. It can pay full benefits until 2037, and it can be put on even a longer term sustainable path, if we make moderate adjustments to the payroll tax.

But there's a common argument that started percolating, and we all hear it. And it is that we should just raise the retirement age. After all, people are living so much longer than they used to. So, let's take a look at this a little more closely.

All right. Higher earning men gained about five years in life expectancy since 1986. Lower income men gained about a year.

Now, there are two important things here to take away from these graphs, besides just the disparity in the increase in life expectancy. The one is that lower earning men have still not caught up in life expectancy to where higher earning men were in 1986. The second take- away is that, as a result of the changes of the Greenspan Commission in 1983, the retirement age has already been raised by two years, which outstrips the gain in life expectancy for the lowest earning men.

Now, there's very little limited -- there's limited data available for women, but what the data we have do show is that it appears that life expectancy gains for women have actually stagnated, and that it is likely they've actually declined for low-income women.

But one more thing about raising the retirement age. The disparities alone, I think, are a strong reason not to raise the retirement age. But there's one other reason, and that is, this would impact people whose jobs are physically demanding. We might all be so lucky enough to still be typing away at our computers when we're 65, 70, 75. But that's not true for people in physically demanding jobs like manufacturing, nursing, waiting tables.

The best way we think to shore up Social Security is not by cutting benefits, but by shoring up its financing.

MISHEL: Let's take a look at the long-term budget challenge. The conventional way of looking at this is this chart, which my friend, David Walker, from the Peterson Foundation uses. If you look at this -- and it shows all the different categories of spending -- everything seems to be zooming upwards, and interest expenses in the budget are really zooming upwards. So, things look really out of control.

MISHEL: But I think that there's a more accurate view, and it's this view. If you just rearrange the chart and put Social Security and domestic discretionary spending at the bottom, you see the following. You see that stable as -- in fact, discretionary spending and -- and -- and other mandatory spending and Social Security, these things are fairly stable. What you see, really, zooming is health care expenses.

And you see that at -- there's a line for revenue so that at the beginning of the period, you know, revenue falls short of the spending we have, so we have a deficit. And as health care keeps on increasing, the deficit gets bigger, fueling more and more interest payments. This highlights for us the fact that health care is at the heart of the program of the long-term budget.

Now, we also hear a lot about what is driving health care costs, and there's a lot of attention to aging or the baby boomers. This chart from the Congressional Budget Office shows what is driving the health care costs over time, and you can sort of see that what is driving it is called excess cost growth, which means costs in the health care system are growing faster than costs outside of it. That is primarily it. It's not so much demographics.

Now, that's for the public sector, but it's also true that health care costs are rising fast in the private sector. What this means is that the escalating health care costs will not only bankrupt the public sector, they're going to bankrupt every corporation in America. So the real challenge is, how do we build on the health care reform to control health care costs?

OK. Now, looking onto the revenue challenges. This chart is a familiar one. It shows the share of revenues in the economy over the post-war period. Now, some say that history should be our guide to revenues in the future. If you just look at the revenues we had over this period, that is what we should lock into the future.

However, we believe history is not much of a guide. For one, you can see the bottom line, which is deficits that we've had, deficits over this period. So, obviously, revenues were not sufficient for most of this period.

But secondly, the federal government has accepted responsibility for important things, like the health care of the elderly, who we believe should retire in dignity with health care, and the health care of vulnerable low-income populations, especially children. Those costs are with us. They're growing. And so we don't believe that past revenues are, indeed, a good guide for the future.

One last issue on revenues to talk about is the Bush tax cuts. The Bush tax cuts, according to this chart from the Center on Budget and Policy Priorities, is responsible for around half of the deficit we will have at the end of this decade, 2019. And as you know, around half the benefits of those tax cuts accrue to the upper 5 percent.

So, at least from my perspective, if we want to keep them, we should pay for them. If we don't, we should lose them.

(UNKNOWN): All right. We're going to talk a little bit about public investment. You know, it's become fashionable lately to talk about the out-of-control government spending in our nation. It's a really good sound bite, but the question is, is it true?

In fact, non-defense discretionary spending -- outside of the emergency measures we had to undertake during the recession -- has been on a three-decade-long slide, and it really does show. Over the last generation, the public structures we all rely on -- from bridges to schools to high-speed Internet access -- have either decayed or they've yet to been -- be built.

I want to start by talking about our physical infrastructure needs. Now, we are all probably familiar with the annual report card that the Society of Civil Engineers puts out every year that shows that it's going to take about $2.2 trillion for us to -- whoops -- it's going to take about $2.2 trillion -- there it is. We fixed the problem in five seconds -- to secure our bridges, to make sure our drinking water continues to be safe.

Now, projected spending is around $1.1 trillion, so we need to identify, in order to meet and bring our grade from a D in infrastructure up to an A, we need to find about $1.1 trillion more dollars to invest in our infrastructure.

Now, it goes without saying that if we invest in our infrastructure, we're going to create jobs now to help bring unemployment down, but we're also going to create a platform for broad, sustained growth.

Now, what about our social infrastructure? You know, one of the signs of an advanced democracy is their education system. It's a mandate in the global economy. And there's rarely a better bang for the buck than education.

Now, I'm only going to focus on the bookends. We don't have a lot of time, so I'm going to focus on investments in child care and preschool and the other end, which is higher education.

Now, what this shows is, among the 37 OECD nations, the United States ranks 27th in our investments in child care and preschool. Now, this is not -- we're not being out invested just by the Nordic countries, which is how people typically interpret our lack of investment. So let's just take one comparison from the slide. Let's look at Hungary. Now, despite having a per capita income that's about 42 percent that of the United States, Hungary is investing nearly double what we invest as a percent of GDP on child care, and early learning, and preschool.

In the United States, we leave it up to already strapped young families to try and purchase the best quality they can find and can afford, and we leave this very critical stage of life largely to chance.

All right. Now, at the other end of the spectrum is our world- class public university system. As Katherine mentioned, it has helped fuel what was a sustained, broad and robust middle class. But it is now becoming too unaffordable for too many people.

Now, you might have heard that the reason for the rapid rise in tuitions at public state universities is due to the things like students wanting really souped-up dorms and the -- all the football teams building new stadiums and the million-dollar faculty.

In reality, though, one of the main drivers of rising tuition has been a significant decline in the share of state funding that universities receive. That gap in funds gets made up by tuition hikes.

The gap has become so severe that today it costs about the same to go to a public four-year university as it did to attend a private university a generation ago, if you adjust for inflation. This trend, as well as other trends, has resulted in the fact that the United States has the most educated, older adult population in the world, but among young people, those in their 20s and early 30s, we are 12th in the world.

Now, we believe we can do better than this. Our nation's strength, its human and financial capital, its commitment to providing a platform of opportunity for all its people can be recovered and it can be sustained.

Now, we're going to address all of these issues in a lot more detail that Larry and I quickly ran through. Our goal is to show all of you that the best way to ensure we leave the nation stronger and more secure than we found it is to recommit ourselves to those national strengths. It's the best thing we can do for our fiscal condition. It's the best thing we can do for today's generation. And it's the best thing we can do for all the generations that follow.

Thank you very much.

(APPLAUSE)

END

Panel 2:
Economists Panel: Budget Policy, Short-Term Recovery and Long-Term Growth

9:30 am – 10:30 am

Moderated by:
Jackie Calmes, *New York Times*

Panelists:
Jan Hatzius, Goldman Sachs
Paul Krugman, *New York Times*
Martin Feldstein, Harvard

[*] (UNKNOWN): A couple of housekeeping notes, there's Internet Wi- Fi access available in this room, on the back of your name tags you have the log in information for that.

Also, for those following through the social media, our official Twitter hash tag is fiscal choices, and as it's been pointed out, we're not going to do any more PowerPoints for the remainder of the day, we're going to have discussions that, I think, are likely to be very illuminating.

And we're very fortunate, as well, to have journalists moderating those discussions, who, in their own right are sophisticated policy analysts.

So I think we're going to have a very fascinating day, and certainly kicking off this first discussion on budget policy, short- term recovery, and economic growth, I think we're all very eager to hear what everybody says.

So, Jackie Combs (ph), welcome, of New York Times, and thank you so much for doing this for us.

(APPLAUSE)

CALMES: Now, we all can be heard -- you can hear me fine everywhere? OK, I'll assume so.

I read something in the paper this morning attributed to Michael Kinsley, that I thought was sort of appropriate to make me appreciate being on this panel today. It said -- he said intellectual dishonesty is so built into the Washington culture that you have to force yourself to notice it.

So here, as I'm in the final month of covering politics and policy before a very high stakes mid-term election, I can talk to people who actually know this thing factually, as opposed to ideologically, or any other way.

So, I thought I'd just start off, not take up any time with what I have to say, and just ask each of our panelists what they see as the trajectory for unemployment through the end of 2011, and when we might start to see something approximating full employment, and what do we need to do to get there.

So, with that small little question, I'm going to start with Paul.

KRUGMAN: OK.

So on the first half of that question, I only know what Jan tells me, basically. But, no, it's pretty clear that we're looking for, unless something very surprising happens, we're looking for rising unemployment over at least the next few months, slowing economy, it doesn't look good.

And 2011, certainly nothing very good is going to happen, unless, again, there's some really startling event. And I would have guessed that we probably see unemployment continuing to rise, right up to the end, but maybe there's something more that comes on. It's certainly a really lousy outlook for the next year.

And as for when we return to something that looks like full employment, I think the maximum likelihood estimate is, basically, never. I mean, that can't be right. I mean, something happens, in the long run, aside from being dead, something. But there's nothing visible on the horizon that will cause that to happen. There's just nothing out there. There's no policy in the offing that seems to be aiming at returning to full employment, there's no technology that will drive a large amount of business investment.

Historically, the aftermath (inaudible) financial crises, countries recover by having a huge exchange rate depreciation, which then leads to an export boom, but since it's basically the whole advanced world that's caught up in this, and there aren't any other planets to export to, that's not going to happen. So this thing can go on for, basically, indefinitely. For end years, where end may well be a double digit number.

CALMES: So what do you do to improve the picture?

KRUGMAN: OK. So the last time we had a global financial crisis, the recovery to full employment was accomplished by a coordinated, large fiscal expansion, known as World War II. I mean, the best -- I mean, we ought to be doing everything you can. We ought to be having quantitative easing, we ought to be having another round of stimulus.

Really, as best I can guess at what might work, you'd have to have a combination of monetary fiscal stimulus big enough to bring the past utilization back up to a high enough level that business investment really starts going again. And at that point, you know, we often use these metaphors which are pretty bad about jump starting recover, or pump priming, which, since nobody knows what that means anymore, don't work so well.

And -- but, I mean, essentially you have to make a try at jump starting. You have to do a big enough program so that it really does become self-sustaining, which, I think, is, means a big enough program that it gets business investment going.

And, you know, will (inaudible) will President Palin and Treasury Secretary Ron Paul be willing to go for that, and the answer is probably not.

(LAUGHTER)

CALMES: Marty? FELDSTEIN: I don't think Paul and I disagree all that much about the outlook. Certainly about the short term, frankly. (inaudible) it's pretty bleak. We have a GDP gap now, which is roughly a trillion dollars, that's why we have almost 10 percent unemployment, and the GDP gap was almost as large at the beginning of 2009, and the fiscal stimulus package wasn't close to big enough to fill that hole.

It was an $800 billion, roughly, package, but not in a single year. So you had a whole which was, roughly, $800 billion dollars and they tried to fill it with a $300 billion, $400 billion annual fiscal injection, and that left a very big hole. And so we never got lift off, we never got into a recovery. And various temporary measures that we had, the cash for clunkers, the first-time homebuyers, they're finished.

And so, having failed to get into a sustainable recovery, the danger is that we will actually churn down again, we're so close to zero growth when you take out inventory accumulation that any serious adverse shock could hurt.

The rest of the world is not going to help. The dollar relative to the rest of the world is not going to help.

(AUDIO GAP)

KRUGMAN: But how sure are we of that if this happens, say, next year? I mean, we're -- we are almost certainly heading for, you know, regardless of whether the Democrats somehow cling to the House, we're almost certainly heading for political paralysis. I mean (inaudible) even odds on a government...

CALMES: Even more political paralysis.

KRUGMAN: Even more political (inaudible). I was about to say, I'd put a 50 percent probability on a government shutdown sometime in the next two years, 1995 but worse. We'll be looking back to the wise statesmanship of Newt Gingrich.

And in that -- and given the -- in that kind of environment, it's kind of hard to see a TARP II. It's really hard to imagine that in fact we will have the political consensus to do this.
So there is -- I'd say that -- I'd add, I think -- I agree with Jan that there's -- there are two main scenarios, one of

which is pretty bad and one of which is very bad. But there's probably a third one, which is absolutely catastrophic, and that's not negligible now.

Sorry. We can all...

CALMES: Let me get...

KRUGMAN: Let's all end it here.

FELDSTEIN: So what can be done? So one thing that can be done is to work on fixing the situation for owner-occupied housing, fixing the mortgage situation. None of these are guaranteed to fill a trillion dollar hole, but they move you in the right direction. If house prices are beginning to go up, consumers are going to have more confidence. They're going to spend more.

One of the things that's been a drag on the economy, is that, while consumer spending has been rising along with GDP, it's been rising more slowly, meaning the saving rate has been going up.

My crystal ball isn't good enough to know whether it's going to keep going up, but it certainly could. That would be a drag. But if house prices are turning around, that's going to help a lot. So I would say that's one thing that can be done.

Another thing that can be done is to deal with the problem that was just mentioned and that is the commercial real estate. Not the biggest, best buildings, but all of the small town shopping malls, office buildings, factories that are -- that went through the same kind of price boom and decline that residential housing did.

You don't hear so much about it, but, again, commercial real estate prices are off from the peak by about 40 percent. A lot of that is financed on five-year balloon loans that will start to come due 2011, 2012.

The significance of all that is that lending is highly concentrated in the small banks. The local and regional banks, the thousands of banks around the country that small business depend on.

So if we don't fix that problem, those banks are not going to lend, because they are afraid of what's going to happen to their capital as these losses begin to occur. And that's why they're holding back on lending to small businesses, and that's one of the things that makes it hard for small businesses to hire and expand.

So, again, I think that's something that could be dealt with. One could go in and work on the capital effects of fixing the impaired loans, impaired commercial real estate loans on the books of these thousands of small banks that we have around the country.

CALMES: What is the government's role in doing that, though, I mean...

FELDSTEIN: Well, what the government, what this administration has done, finally Congress passed a legislation to use $30 billion of the TARP money to inject capital, with lots of strings attached, into small banks that want it.

Now, it just passed, it remains to be seen whether these small banks are going to want it. The experience of the big banks with TARP funds was they couldn't get out of it fast enough because of the extra, as I say, strings that came with it.

This is, technically, not part of TARP, but if you're a small banker, and you can avoid it, you might not want it.

I think what can be done...

CALMES: Executive compensation isn't going to be a big issue, so.

(UNKNOWN): You might be surprised, actually.

(UNKNOWN): Well, you know, it depends on, who knows, $250,000, I bet there are a lot of small bankers who make $250,000, and that's the max...

KRUGMAN: I did some homework on the Georgia, you know, Georgia's the bank failure capital, and the executive compensation issues (inaudible).

FELDSTEIN: Let me see how I can say it best, if a bank sells off some -- small bank sells off some of these impaired commercial real estate, they're going to take a hit to their capital. Instead of immediately forcing them to cut back on their lending, the supervisors could agree, in advance, that for that source of reductions in capital, they would have a number of years to work it out. So they could amortize that reduction in capital over, say, four or five years.

So that would give a strong incentive for these small banks to sell off the problem loans, that would give them cash that they could use to do more spending. And that wouldn't require any increase in any congressional action.

CALMES: Do either of you want add anything before I move on?

HATZIUS: Sure, so if we talk about, what else could be done, you know, I think Federal Reserve is definitely an institution to talk about. They are going to do more, almost certainly, and it's very likely to come at the next FOMC meeting, the day after the mid-term election. And the question is just whether, you know, what they will do will have a substantial effect.

I think it'll have some effect, but, you know, the numbers of -- for the total amount of asset purchases, if that's the route you go, buying treasuries, the numbers that are required to really move the needle a lot are very, very large.

And, I think there's going to be a natural bias towards caution on more monetary policy makers in this sort of environment. I think that's usually what happens when you're in a liquidity trap, you're at the zero bond for short-term interest rates.

You send the staffers away and ask them, you know, try to figure out what's the optimal policy here, and they go away, and they model things, and they come back with some, you know, enormously large number for the amount that needs to be purchased, and the policy makers say, "Oh, you know, are you really sure that you've taken account properly of all the tail risks that are associated with this? I mean, are your models going to be able to pick up the tail risk that, you know, maybe people are going to lose confidence, the financial markets in some diffuse sense are going to lose confidence." And so, policy makers say, you know, what you are saying makes some sense, let's take a small step in that direction.

And that's why, I think, in this type of situation, stimulus tends to be, basically, underprovided, relative to what's necessary.

And I suspect that that's what we're going to find again. They're going to do quite a lot, but I think it's probably still going to fall short of what (inaudible).

KRUGMAN: And then there's the trap, the same thing, I think in a milder form, that happened with fiscal stimulus. You do something which is in the right direction, but inadequate. And then people say, "Well, that didn't work."

CALMES: Right.

KRUGMAN: And so instead of increasing the dosage until you get it right, you just -- you give up on the thing altogether.

And we -- well, all of this is very familiar, if you look at -- if you study Japan in the '90s. You know, I'm...

CALMES: I thought we were trying to avoid that?

KRUGMAN: Yes, but in fact we are not doing exactly what the Japanese did, we're doing worse. Right? We're -- monetary policy was a little bit more aggressive, but not enough to really make a difference. Fiscal policy has been less aggressive, and shorter lived. So, no, I mean, it's...

HATZIUS: You mean we're doing worse because we've got a larger, larger output gap?

KRUGMAN: We have a larger output gap, we have a surge in the unemployment rate in a way they never did. And so the amount of mass suffering -- and also the political -- the exhaustion of the political will to act is coming much more quickly in our case. So I think we are, actually, going to -- on the current track, we're going to look at Japan's lost decade as a success story, compared to our experience.

(UNKNOWN): What should we do?

KRUGMAN: Well, I mean, it's very hard to do -- what we should be doing is a really big dose of stimulus on all of these fronts. We should be trying to get bank lending going, we should be trying to help homeowners, we should be -- but, above all, we should have another large round of fiscal stimulus, and another large round of quantitative easing. Basically, the kitchen sink, throw everything at it.

And if you ask me for ways that we can solve this problem that live within the constraints of policymakers, who really don't want to do anything bold, and, in Congress don't want to do anything at all, I don't know that I can answer that question. You can't -- that's calling for magic, for creating a policy that does huge things, without actually expending any effort.

FELDSTEIN: So, Jan pointed out that -- well, let me go a different thing. Let see if we can find something that might happen that might move us out of this. We saw the Euro fall from 160 to about 120, very quickly. What happens if the U.S. experiences a comparable fall on a trade weighted basis, a 25 percent fall in the value of the dollar?

KRUGMAN: Yes.

FELDSTEIN: That would certainly give a jolt that wouldn't -- and that might happen because we're not doing something. In other words, the world may, having looked at the problems in the U.S. and elsewhere may say, gosh, there are a lot of big problems there, here in the U.S., the fiscal deficits are enormous. Paul talked about the last big fiscal experiment that got us out of a deep recession was World War II. At the end of World War II, we had a debt to GDP ratio of 109 percent. That's pretty close to what is now forecast for 2020, roughly, 100 percent, according to the Congressional Budget Office.

So if the world looks at all of that, and says, these guys are in trouble, "Why are we holding so many dollars? Why are we continuing to invest in dollar securities?" one of the effects could be a very substantial fall in the dollar. I'm not predicting it, I'm not wishing for it, I'm just saying that if that happened, that would be one of the ways out of this.

KRUGMAN: The problem is that, that leaving aside the renminbi issue, which is something I, obviously, write about, the other currencies against which the dollar would have to fall, are the euro and the yen, and we really are talking about a race between the halt, the lame and the blind here, right? So it is a little hard to tell that story.

HATZIUS: I guess one other thing I'd say, if it happens quickly, then it probably would coincide with instability in -- the sort of scenario that you're laying out, financial markets, so you would probably lose, in terms of the impact on economic activity, what you'd gain on the currency side.

If it happens more gradually, then, yes, I think (inaudible) be helpful, and it wouldn't be as helpful as it was in other countries that went through, you know, a large credit boom/busts that were ultimately followed by big currency depreciation that were much smaller than the United States, because the U.S. only exports 10 percent of its GDP, so it's not Korea, or Sweden in the 1990s, but it'd be helpful nonetheless. And the move that we have seen over the last couple of months has certainly helped.

FELDSTEIN: And it's not just exports, it's net exports, so if exports go up a bit, and imports come down a bit because foreign goods become more expensive, so American's spend their money buying services here in the United States, that moves the trade balance by 2 percent of GDP. That's a big deal, because as you said, that's what fiscal policy -- that's what we may be losing in the fiscal policy. That's what we need to start bringing down the unemployment rate.

CALMES: Let me move from the immediate term to the medium term, longer term, with an issue that is very much in the moment, but very important to the medium and longer term. That's the extension or not of the Bush tax cuts. The CBO wrote just last week that compared with the options examined here for extending the expiring tax cuts, and those options were, you either do all of them permanently, all of them temporarily, just those for so-called "middle class" temporarily, or permanently. So four options.

Various other options for temporary cuts would by 2020, double our deficit projections, and it was only, I think, six weeks ago that the opposition was making a big issue of deficits. That's less of an issue in the campaigns now that Bush tax cuts have taken their place. But even if President Obama got his way, and it was just for 98 percent of Americans, just up to $250,000, the deficit would be four- fifths as large by 2020 projected.

So, with that, I mean, Marty, you've put in print what you think should happen, but if you could just each quickly address: What about the Bush tax cuts?

FELDSTEIN: What I put in print a few months ago was that, I think, we should have -- this is not the time for a tax increase. The economy is very weak. It's very uncertain, so keep the current tax rules for two years; at the end of two years, clean slate. No promises going forward. So relative to the president's proposal to have the middle-income tax cuts permanent, that reduces the end-of- decade deficit by $2 trillion dollars. That's a lot of money.

So I think, and then when Peter Orszag escaped from the administration, his first thing was to write a piece for your fine newspaper saying the same thing, that he thinks they should do two years, and then clean slate.

CALMES: But Peter and you both are good economist, great economists, but politically, if you're going to have a Congress that's going to have more Republicans at a minimum and perhaps be controlled by Republicans, what possible, what possibility is there that there would be an agreement to end those after two years?

FELDSTEIN: Well, you're asking me whether...

CALMES: I mean, this is where I ask...

FELDSTEIN: ... the Congress go from the -- OK.

CALMES: The, you know, Congress...

FELDSTEIN: So here we are in December, so we've gotten through the election and the choice is we do nothing, in which case, all of the taxes end. That seems like a disaster scenario. Or there's a negotiation, in which Republican leadership, the president, say, we -- the future is uncertain. The short term is clearer.

We need the tax cut now. The Republicans have twisted my arm, and said that in order to get the middle class tax cut through the Congress, I'm going to have to agree against my wishes to giving a tax cut to the folks over $250,000, but I'll do that.

And we'll come back, but they've agreed that this is a temporary proposal, and we'll see where the fiscal situation is. We'll see whether this new fiscal commission comes up with some other ways of raising revenue or cutting spending.

So I can certainly believe that it's more likely that there will be some compromise then that we will just fall off the cliff and allow the taxes to rise in this very weak, uncertain environment that we're talking about.

Because the president would have to think, if there is the double dip, what is it going to be blamed on? It's going to be blamed on letting taxes go up. He doesn't want that. So that's why I'm an optimist about a compromise coming out of this.

KRUGMAN: I would guess there would be couple things. First, if we're talking about extending the tax cuts only temporarily, then that is a temporary tax cut, at least in principle, right? And having read my Milton Friedman theory of the consumption function, I should believe that that should have very little effect on consumption; that if people really believe that the tax -- that taxes will go up two years later, they -- it should have very little -- they should cut their spending almost as much as they would if they go up immediately.

Now, we know that's not true of a lot of people because, first of all, people don't make those kinds of calculations, but also, because they are constrained. They can't. They can borrow only at 18 percent interest. They don't have assets. The pure economics case for saying if you're going to do -- extend the tax cuts, that there's really no point in extending it at the top end, is that people making more than $250,000 a year are the least likely to face those kinds of constraints.

And we should bear in mind, by the way, the difference between the Obama middle class only, and full, although it's going to affect everybody in the top 2 percent of the population, the majority of the actual difference, the majority of the additional tax cut goes to the top tenth of a percent of a population. So we really should think of this as not being about people who earned more than $250,000 a year, and could be people who are making more than $2 million a year. And these are people who are very likely to be able to actually do permanent income tax calculations.

So on that grounds there's no reason to extend the upper, the high-end tax cuts. And I guess I am -- I have a very strong sense that we were presented with the unique opportunity to take at least a small step towards fiscal responsibility by the fact that the 2001 tax cut was written, because with (inaudible) reconciliation, actually, was written in such a way that the whole turned into a pumpkin on December 31st of this year. And that if we missed that opportunity, it's going to be very, very hard ever to get back to doing any of it.

So I think the macro cost of not extending the high-end tax cuts is trivial, and the political costs could be very high. It would be interesting, if you really wrote it so that the whole thing expires in two years.

FELDSTEIN: Yes, that is certainly my... KRUGMAN: Two things. My guess is actually Republicans would not go along with it. That they would prefer to -- that that would be their first fight. That they would -- and that they would say, Obama is willing to -- is going to make all your taxes go up in two years and that this would be -- that we would basically, if that's -- if Obama caves on that instead of pushing them into the fight over the high-end tax cuts, that the government shutdown instead of happening sometime late next year, happens late this year.

CALMES: And it's not a small factor in this equation that President Obama is committed by his campaign pledge not to raise taxes in his first term, although two years from now would be the very end of his first term, it would be a difficult position to be in for him as well.

FELDSTEIN (?): This doesn't commit him to raising taxes during his first term.

CALMES: It does if the opposition is defining the expiration of the Bush tax cut (audio gap)

FELDSTEIN: I think the president says we can't afford $700 billion, but that's the 10-year cost, not the two-year cost, and for some reason he thinks we can afford the -- we can't afford the $700 billion, but we can afford the $2 trillion.

CALMES: Three trillion.

FELDSTEIN: I've never understood that arithmetic.

KRUGMAN: Just -- but I just think that trying to think through psychological effects here, I mean, my -- I don't think any of this is reality-based. And I think trying to count -- trying to assuage small business people by convincing them that the president really likes them after all. I think that they -- that a large number of the people who are saying this also believe he's just -- he's getting ready to impose sharia law any day now.
(LAUGHTER)

So, yes, I mean, basically, if you were setting out to devise a stimulus for this economy, it would look nothing like the Bush tax cuts. It's a completely crazy set up, so obviously -- obviously, there are much better ways to use this, and if we had the political ability to actually have an intelligent response, we'd get rid of those cuts, and have a large raft of other programs, some of them taking the form of tax cuts, some of them transfer payments, and a lot of just plain spending -- not going to happen.

CALMES: Yes. You'll pass?

(LAUGHTER)

I'm going to -- one, we'll ask a big question, and that is yesterday Ben Bernanke in Rhode Island was trying to make the argument that has just sort of stymied the administration, but it's we're going to see his -- President Bush's -- President Obama's fiscal commission tried to thread this needle in the coming weeks, where Mr. Bernanke said, you know, we don't want to be constraining right now for the next two years, really, but after that. We need to be taking action now that signals that we are going to get control of our fiscal picture over time.

The public -- you're going to have a election that's going to elect more Republicans. Do you think it's possible to, sort of, get to the point where you can, you know, have more stimulus in the next years, given the Congress you're dealt, and, but take actions in the next two years that would be long term -- have long term benefit.

FELDSTEIN: You cut out $2 trillion, do exactly what you said Ben Bernanke said we should be doing. That is, you keep the tax cuts in place for two years. That's the issue that's on the table. There are a lot of other things that you can imagine, but that's the big issue that's on the table, and it's about long-term, $2 trillion dollars; short-term, keeping it on so that you don't depress the economy even more.

KRUGMAN: Some day, I think -- I mean -- I just think -- I think it's politically going to be a disastrous thing to basically let that -- let them get the foot in the door on those high-end tax cuts. I think they go away now or never. Something I just think we ought to say here is -- to -- why would we believe that two years from now we're going to be ready to return to business as usual?

I think that's almost surely too short a time period, and we really should, if we were able to have a mature discussion of this, which we're not, we would be talking about conditions, rather than dates. I mean, the point at which you want to switch to fiscal restraint is when you're no longer in the liquidity trap, the point at which the Fed would be raising rates under it's normal rules, and in which you can essentially make a deal, where the Fed will hold off on rate rises so as to offset the contractionary effects of fiscal austerity.

And we're not having -- it seems extremely unlikely that we'll be there in two years. Go back to our discussion at the beginning. If we think if you do some kind of Taylor rule, I think any kind of Taylor rule, it would say that we probably shouldn't be looking at the Fed funds rate moving off to zero, but hopefully something comes along, but it's unlikely to happen.

I think even if you take the CBO forecast, that isn't likely to happen until late 2013 or 2014. And the CBO forecast is almost surely too optimistic, so two years is not the right number.

FELDSTEIN: That's -- that may well be true. When I first started flirting with the idea that we needed a fiscal stimulus was early 2008, and I testified, and I think I wrote something for either the Post or the Journal, saying that it ought to be conditioned, rather than a date; that we should have a triggering mechanism that triggered a fiscal stimulus if some what then seemed like terrible thing happened -- the unemployment rate, or I can't remember what my triggering mechanism was -- but something about job growth. And it didn't get very far.

So maybe the world could be persuaded to do something like this, which triggered off an unemployment rate.

KRUGMAN: Can I just -- by the way, just back -- by -- at the end of 2008, we came in -- I was looking at one of the Reinhart Rogoff papers comparing what happens in severe financial crises, and in average in those crises the unemployment rate rises by about 7 percentage points, and doesn't start to come down until it's something that was way smaller than the shock we appear to be facing.

And so far, as Ken Rogoff says, it's -- we are now facing a garden variety severe financial crisis, which is kind of a funny turn of phrase, but we're actually pretty much tracking down the middle bear. And if that's the case, then we -- to deal with this, we would have to be prepared to do very unconventional economics for a very extended period, and the problem is that that realization has not sunk in at all.

HATZIAS: I think triggering mechanisms are a great idea. I think -- I also think they're incredibly difficult to implement, and that's I think true on the fiscal side, and even true on the monetary side. I mean, the Fed's been discussing strengthening the commitment to low interest rates, and basically near-zero rates by saying we're not going to hike until some particular economic condition has been reached.

But it's just very, very difficult to come up with something that you're actually comfortable with in terms of, you know, locking something in and then throwing away the key. So, I think in practice, you know, I think an unemployment trigger, for example, whether specified in terms of a level or in terms of the cumulative decline in the unemployment rate from the peak as a trigger for when you might see some fiscal restraint, I think, in principle is a very good idea. I just don't see it happening.

FELDSTEIN: You could never sell that in the Fed though, because too many of FOMC members say we don't do unemployment; we do price stability. So it would have to be in terms of deflation.

HATZIAS: Oh, sure, sure. No, I think you're right. Within the Fed, it'd be more focused on inflation, rather than on unemployment, maybe, some kind of combination, but more on inflation. I just mean, in principle, you know, in principle it's a similar debate and it's difficult to actually implement.

CALMES: Well, I think we've reached the end of our hour. And I've got, like, so many more questions, but I'll spare you them, and spare the audience, and thank you very much. This was an honor to do this and be with these men here up on stage. So thank them.

(APPLAUSE)

END

Panel 3: The Short-Term Challenge: The Fiscal Squeeze on State and Local Governments

10:30 am – 11:00 am

Moderated by:
Ezra Klein, *Washington Post*

Panelist:
Robert Greenstein, Center on Budget and Policy Priorities

[*] (UNKNOWN): I wish that I could say our next session will be on a more optimistic topic, but it's on the fiscal condition of states and localities.

(LAUGHTER)

And sad to say. We've got a traffic jam. I should say, Robert Greenstein, who's on this panel, is the head of the Center on Budget and Policy Priorities who's one of the partners with us on this effort, this conference, and I want to be sure to thank Jim Horney, who was the lead person for the center in helping us organize this conference and was instrumental in helping us to pull it together.

We will have a break after this session, so try to stay seated and hang in there. And you'll be able to get a drink at about a half- hour or so.

(UNKNOWN): (OFF-MIKE)

(UNKNOWN): He'll be back. We'll get him.

All right. Are you guys miked up? Go right ahead and take seats up here.

(UNKNOWN): It looks like Jackie left her...

(CROSSTALK)

(UNKNOWN): Oh, somebody left a bag. OK.

(UNKNOWN): It's probably Jackie's.

(UNKNOWN): (OFF-MIKE)

(UNKNOWN): Thank you.

(UNKNOWN): OK. We don't really need a full-fledged panel when we have Bob Greenstein to talk about state and local budget policy, or, for that matter, he could do all these panels for us and be very interesting throughout the day.

Ezra Klein is a journalist at the Washington Post. His blog has evolved into one of the great innovations in American journalism, I think. And for those of you who read it, if you're like me, you're addicted to it. So we're happy to have Ezra leading this discussion on state and localities and their budget situation.

Go ahead.

KLEIN: Well, am I on here? Can you all hear me? All right, terrific.

Well, that was rough, and so Bob and I have decided to talk about Top Chef season seven...

(LAUGHTER) ... for this panel to make things a bit easier. No, he actually wouldn't have let me do that.

Well, thank you all for coming.

GREENSTEIN: I thought we were going to talk about the baseball postseason.

(LAUGHTER)

KLEIN: We have different interests.

(LAUGHTER)

So let's begin here on state and local, because this is a -- this is one of the rougher topics and certainly the sub-themes of the previous panel, which is when you talk about the places where you're going to see a fiscal drag on the next couple of years, you're talking mainly about California, where I come from.

And one of the difficulties, one of the political impediments between us and actually doing anything to stop the situation from getting worse is I think a type of a moral narrative that has emerged about what has happened in the states, a moral narrative about overspending, about pensions, about irresponsibility.

And so sort of to begin, why are the states where they are now? Are we seeing sort of a hangover from poor fiscal management? Are we just seeing the recession? Are we seeing a combination? What should we think about, what's happening on the state level at the moment?

GREENSTEIN: I think this is yet another area where there's a confusion between short term and long term. You know, to be sure, there are some significant state policy issues for the long term, structural problems in the tax code, where they tax goods but not services. There are some long-term pension issues.

But none of those are really large factors in the really deep fiscal holes that states are in now. I mean, there are two key facts here. The first is that states have had an unprecedented revenue decline. They're now collecting 13 percent less in revenue, adjusting for inflation, than they were before the recession started. That's an enormous decline.

The second key fact is rainy-day funds. So states build up rainy-day funds during good times to draw them down during bad times. What is now recognized and rarely reported is that the rainy-day funds that states built up during the last recovery, before this downturn started, were the largest on record as a percentage of state budgets.

Nick Johnson knows this better than I, can correct me if I remember the figure wrong, but I think, if I remember, in the aggregate, state rainy-day funds were something on the order of about 11 percent of state operating budgets. I mean, if you think of what that would be at the federal level, that would be a very large rainy- day fund. This downturn is so deep, the revenue decline was so large at the state level, and it's lasted so long, that states have just burned through the rainy-day funds and are deep fiscal distress. So this is really overwhelmingly a story of factors beyond states' control.

To be sure, California, New York, Illinois, the response, the deadlock in recent months hasn't really been the political response you would want, but that's not the cause of the big holes that states are now facing.

KLEIN: And how long should we expect this to last? As I understand the basic outline of the situation, you have the recession come, and we pass a stimulus bill, which I'm told is too small, and that stimulus bill has a lot of state and local funding, and that is beginning to drain out. But the recovery, as we've heard, is not quite moving at the same speed.

So what do states look like for the next two or three years out? What is the -- what is our fiscal outlook? Is it going to get worse? Is it going to get a little bit better?

GREENSTEIN: In the last panel, I think Jan Hatzius and others talked about how the fact that every state but one is required to balance its operating budget every year. That means that, when you get into a downturn, state revenues fall, and the need for state expenditures rises. So, employers lay off more people. They lose employer-based health insurance. Some of them qualify for Medicaid. Some kids who were in private schools are moved to public schools. There are increases in demand on states and drops in revenue.

So, I think Jan talked about the fact that these ongoing short- falls and the budget cuts -- and, to a lesser degree, tax increases states will institute to close them -- are adding to the drag on the economy. That's going to become worse. So, if we just go through a few figures.

When the Obama administration was coming in, we had done a figure that the economic team used. We projected state short-falls of $350 billion over the next 2.5 years. The Obama administration proposed fiscal relief of $200 billion, closing modestly over half of the short-fall.

They were concerned -- I think, reasonably -- that if you closed -- if the Feds closed close to 100 percent of the states' short-fall, you could have a moral hazard problem. But if you provided $200 billion out of a $350 billion debt, there's $150 billion states still have to close. There's not a moral hazard problem with $150 billion.

Well, what happened was, first, Congress reduced it in the Recovery Act to $140 billion. This summer they added another $25 billion, which raises it to 165. But our $350 billion initial figure was only a 2.5 year figure. And as we all see, as the last panel discussed, the downturn is extending longer than had been expected.

Our current figure is that over four years, including the coming two, the total state short-fall will be $600 billion.

The Congress has made clear that the $25 billion in relief it just provided is it -- no more. So, we're going to end up with relief that's a little over a quarter, rather than a little over a half, of the total.

I mean, states are laying off, on average, 13,000 more workers a month. Since the recession began -- Nick (ph) just gave me these figures an hour ago -- since the recession began, state and local governments combined have reduced their workforce by over 280,000 jobs. So, we're looking for this to continue. The amount of short-fall states have to close may actually go up a bit, because the federal fiscal relief is running out.

So the net left for states to close through budget cuts and tax increases is going up. Plus, in the first year or two, the rainy day funds to reduce the amount of budget cutting states have to do, they're largely gone. Some states did some one-time accounting things. Those are used up. Some of them, indeed, will start to reverse in the next year or two.

So, actually, the problem is that, at the very point we need more relief, the state drag is probably going to get bigger rather than smaller.

KLEIN: And one of the frustrations about this, it seems to me, is that in the private sector there are things -- we tried to do things we believe we can do. We can offer a tax cut. Maybe that'll help. We can offer hiring incentives. Maybe that will help.

In the state and local sector, we could actually stop the bleeding. We could just do it. We could keep people from being fired. Recent months, we would have had positive job growth, if not for a lot of Census, but also a lot of state and local job lay-offs.

But it doesn't appear we're going to do that. And in fact, we talked about this a bit earlier. It sort of seems like the opposite is going happen, right. The next couple of years, a sort of an array of new federal obligations are going to come online for states, both things that were lifted (ph) on them in the stimulus, and new things that we've passed.

You want to say a word or two about that, about what will change for them as we go forward?

GREENSTEIN: Yes. Actually, in the comment I made a minute ago, I was too sunny. It's worse than that, because I think the federal -- I hope this is wrong -- I really think the federal government is going to move in the next year from providing fiscal relief to states, as not only will that wind out, but the federal government is now going to make states' fiscal situations worse in a couple of ways.

So, if you take the part of the federal budget that is domestic discretionary spending, domestic programs that are not entitlements, right now we're operating under a continuing resolution.

But it's very clear that the best that one could do that would get 60 votes in the Senate for the fiscal '11 appropriations bills, is to put appropriations at what's called the Sessions-McCaskill level, the level proposed by Senators Sessions and McCaskill, which is billions of dollars below the levels in the appropriations bills that the various House and Senate Appropriations Committees have written.

I don't think it's yet fully understood by, among others, a number of non-profit groups who work on various areas of domestic programming, that the appropriations bills that have already been written and have moved part-way through Congress, are going to be re- opened and undone, because their total amount that they give you is significantly above the maximum allow (ph) -- that you can get 60 votes for in the Senate.

And, if, after the election, Senate Republicans block appropriations bills and force another continuing resolution until February, when they have more votes in the Congress, then the question arises, depending on the outcome of the election, as to whether we'll have a movement towards Minority Leader Boehner's proposal to cut non- security discretionary spending immediately to the nominal 2008 level, which in real terms would be a $100 billion reduction in domestic discretionary in 2011. And a very large share of that is in the form of grants and aids to state and local governments.

There's also the tax side. As you know, the administration has a proposal it recently made for temporary expensing, bonus depreciation. This would be designed at the federal level to inject a couple hundred billion dollars in tax cuts, in business tax cuts, in over the next two years.

And then some of that -- most of that money would come back in subsequent years.

What I don't think -- or I know from some conversations, I don't think the administration thought about in putting -- it didn't realize in putting this together, is that, because of linkages between federal and state tax codes, this proposal would cause states to lose up to $22 billion in state tax revenue in the next two years, which they would then have to make up for through other, most likely, other budget cuts. They could do other tax increases. But politically, they probably wouldn't.

Now that this is becoming understood, I think if the White House had its way, it would ideally probably say, fine, we wouldn't want that $22 billion -- which would pretty much offset the whole $26 billion provided in fiscal relief this summer -- we wouldn't want that to occur. Perhaps we could accompany our tax cut with some new fiscal relief for states. But that accompanying fiscal relief almost certainly wouldn't go anywhere in the Congress that's to be elected in November.

So, we have a potential for the federal government to -- for three things to happen simultaneously. The fiscal relief winds out. There are new cuts in grants and aid to states through cuts in discretionary programs. And states lose tax revenues as a result of new federal tax cuts that didn't move now, but could move. Since they're business tax cuts, there could be bipartisan support for them, once we get past the election.

KLEIN: You can all see why I wanted to talk about Top Chef.

(LAUGHTER)

So, one of the things I think is also interesting about this is that we haven't seemed to learn many of the lessons of any of this, of what the recession has done to state budgets. I mean, in particular, I think back to the financial regulation bill, which for its flaws really attempted to think through the cyclicality of the financial system, the way it tends to over-estimate good times and under-estimate bad times, the way it tends to make bubbles worse.

But we haven't done much of that. I've seen Greg before write on things like the need to make Medicaid more of a federal program, so it doesn't collapse onto states when their revenues go down and need for it goes up. Certainly, similar concerns are raised about unemployment insurance.

But let's talk about that for a minute. What could we do? I mean, if we were thinking a little bit more blue sky here instead of just pumping 20 more billion into it, what could we do so we don't continually face these types of issues every time the economy turns down?

I mean, the fact that every time we go down the states end up in this type of a crisis is not good, because when you combine it with the way our Senate works and the way our system works, it creates a lot of chance for us to fail to respond. How can we make it a little bit more -- a little bit more automatic, less of a perennial problem?

GREENSTEIN: Well, I think many people, including ourselves, have thought it would be wise to modify the Medicaid law to have an automatic counter-cyclical provision, so that the federal matching rate automatically goes up when the economy goes down.

And that was included -- I'm looking at Andy Schneider sitting over here -- that was included in the original version of the House health reform bill. And when the bill had to be shrunk down to the $900 billion gross spending target, that fell out.

It should be recognized, though, there is some improvement in counter-cyclicality as a result of the enactment of the health reform bill. Because now, you have a downturn, people lose their health insurance -- they lose their jobs and they lose their health insurance, and they're uninsured. And under the bill, under the health reform law, when people lose their jobs and their health insurance, they'll be able to get subsidies to go buy coverage in the exchange, or a larger number of them will be eligible for Medicaid.

And so, there is some not insignificant improvement in counter- cyclicality there. It's just unfortunate we weren't able to hold onto the Medicaid provision, as well.

But there's another one that really isn't being thought about yet that I think deserves substantial thought. And that, ironically enough, is the unemployment insurance program.

I'm not talking about the additional federal benefits that are provided. What I'm talking about is the fact that states are supposed to -- this is one area where I do think there is legitimate criticism of states, and it's because of pressure from employers -- states are supposed to build up their unemployment insurance trust funds to adequate levels during recoveries. And when downturns come they draw on them to pay that first 26 weeks of unemployment benefits, which is entirely state funded.

States did not raise enough funding. They didn't have their unemployment taxes at a level in the last recovery to build those trust funds to adequate level. They would have been depleted anyway, given how deep and long this recession is, but they were depleted faster than they otherwise would have.

So, what happens when those trust funds are depleted is that states borrow money from the federal unemployment trust fund. To- date, they've borrowed $40 billion. By 2013, they will have borrowed $65 billion.

Here's the point. Federal law requires every dollar to be paid back with interest.

So, and under the timing of federal law, the repayment begins, I think, within the next 12 months.

GREENSTEIN: So, in addition to all the other problems on states, when unemployment is still, based on the last panel, over 9 percent, the economy is still really weak, states are already in this hole, on top of everything else, we're going to see them starting to raise employer taxes and cut unemployment benefits in order to come up with money to start repaying the tens of billions they'll owe the feds while the economy is still weak.

And eventually, assuming some better recovery comes, they'll continue to be paying this money back, and that will inhibit their ability to build their unemployment trust funds back up during the coming recovery, so the crisis could be even worse when the next recession hits.

So, you know, we in the National Employment Law Project are beginning to develop some proposals that would pair some partial federal forgiveness for the amounts that are owed, but for a state to get the forgiveness, it will have to meet federal standards under what we're thinking about, federal standards for adequately funding its state unemployment trust funds.

I think that would be a rational policy. I think it will face an uphill battle in the Congress that's going to get elected in November. But all of these problems, I think, are out there.

But, you know, for both Medicaid, health insurance, and being more countercyclical on unemployment insurance, it's really not too early. The unemployment insurance is, you might argue, the most countercyclical part of the safety net and the part that works the best. And there now are real danger signs on the horizon as to where it would be in the next recession, given these huge unemployment insurance financing issues that are going to start hitting states in about a year.

KLEIN: So then granting your point that, come November, we are not likely to see a much more compassionate state-oriented mood dominating the Congress, and it's not likely to be moving much faster, what are we -- are we seeing any interesting on the level of state governance or state response?

I know that there is currently a...

(AUDIO GAP)

KLEIN: ... test among putative Republican presidential candidates to see who can cut state budgets the most, you know, sort of a -- Mitch Daniels will cut 20,000 jobs, and Chris Christie will raise them to 30,000, and Bobby Jindal will throw all the chips on the table, no -- no state government at all. But is there anything sort of encouraging going on? Are we seeing sort of reforms or general responses that should give us hope?

GREENSTEIN: I think there have been some encouraging developments I'll express in an odd way, which is to say if you had told me two or three years ago, here's the magnitude of the fiscal holes that states will face, what do you think will happen?

(AUDIO GAP)

GREENSTEIN: ... bad, and they've been bad, as a lot of the budget cuts have been in -- in education and a bunch of basic services and a variety of things for people in need. Bad as they have been, I would have predicted they would be significantly worse.

If you had asked me in, what, early, mid-2008, faced with these budget holes, how many states will raise revenues as part of the efforts they'll take to balance their budgets, I certainly wouldn't have guessed about 33 or so, and the number is about 33. So we've seen more states willing to adopt what we call the balanced approach. Don't do it all on the budget cut side.

I mean, incidentally, there's -- the point that was made in the last panel by Paul Krugman about how if you let the taxes go up for -- if you let the Bush tax cuts expire for people at the top of the income scale, there's not a big macro effect, the same point is true at the state level.

If you were to temporarily or more than temporarily raise taxes at the top of the income scale, that has a much less of a drag effect on state economies than like firing teachers and -- and cutting basic services. And we've seen a number of states who have moved in that direction as part of their larger packages.

Now, the question is what happens in the next two years. A lot of governor's houses are going to change. Control of both state houses -- that the state legislatures and the governor's mansions is going to move on average to more conservative, more anti-tax forces, so I think there are some serious questions there as to -- as to what lies ahead.

KLEIN: And imagine that, come November, that the point of yours I just granted was wrong, that John Boehner comes in and -- or doesn't come in, and, you know, folks in Congress say, "You know, this is really important. I read a CBPP report last week and then an EPI report and a Century Foundation report, and it was a -- and a Demos report, I'm sorry. And this is really a problem. What should we do?" What should they do?

GREENSTEIN: Well, I see little chance of the following being done. You know, I was listening to the last panel and thinking about this panel. And needless to say, if the Bush tax cuts -- I agree with Paul Krugman that if the Bush tax cuts do not expire at the end of this year, it's not clear they ever will, at least for the foreseeable future.

If you took the cost, the money you would save by having the tax cuts at the top expire rather than be extended, and you said I'm going to inject that money back into the economy, you know, one of the top uses for it would be more state fiscal relief.

If you use the CBO, Congressional Budget Office estimates of the bang for the buck, if I remember the figures correctly, $13 billion in state fiscal relief...

(AUDIO GAP)

GREENSTEIN: ... so that would be a logical thing to do...

(AUDIO GAP)

GREENSTEIN: ... but, in fact, the very high likelihood, even if Boehner isn't the speaker, there's a significant chance we'll do the reverse, no more fiscal relief and an extension for perhaps the two years that Marty Feldstein mentioned of all of the tax cuts, following which my fear would be they'd all just be extended again.

And, as I mentioned, I think they should start looking -- it's time to start looking at things like the unemployment insurance issues. The Recovery Act has a provision in it that suspends temporarily state payment -- state interest payments on the unemployment insurance amounts that the state U.I. trust funds have borrowed from the federal.

The thinking at the time the Recovery Act was passed was, we need more stimulus. Why do we want states to be making interest payments to us when the unemployment rate is so high? The logic still holds, but the moratorium on the interest payments -- I forget if it expired September 30th or if it expires on December 31st, but it's about to expire. A number of us have suggested it be extended for at least another year. Went nowhere on Capitol Hill.

So there are some things they ought to do, but I -- I don't see much -- much chance that they're going to happen.

KLEIN: Well, after they -- after they see this panel, that'll -- that'll probably change, I think. So you've also had the emergence, not of the narrative that the states are in a short-term problem and going to create a massive anti-stimulus that will drag the economy down and destroy us all, but, in fact, that they are the sort of ticking time bombs for the next problem.

Saw a long report by -- I hope I don't get her name wrong -- Meredith Whitney, making this point on, I believe, was municipal bonds. You certainly see pensions enter into the conversation in a very robust way. What is your take on that? Even going past the next couple of years, what is sort of the long-term state outlook? And what -- and if -- and if there's a problem here, what needs to be done for it?

GREENSTEIN: Our biggest midterm concern -- let me back up. At the federal level, we're used to seeing 10-year budget figures from the Congressional Budget Office. States don't have those. They -- they typically have figures for this year and the next year and generally not beyond.

So the fear is that when -- whether it's two years from now, four years from now, whenever -- when we finally begin to get some state...

(AUDIO GAP)

GREENSTEIN: ... the economy starts to come back more, we begin to get some state revenue growth, even though it's growth from a very low level, states will have more revenue than they had the year before. What do they do with it?

(AUDIO GAP)

GREENSTEIN: There's no question that there will be pushes in many states for tax cuts with the additional revenue, precisely the wrong way to go. First, we've had some very deep cuts in important services, education and other places, that really need to be filled in.

States will badly need to refill their rainy-day funds, which are, you know, pretty much on empty at this point. Both of those would be much -- they need to undo furloughs and a variety of maneuvers like that. Those all really should come way ahead of something like tax cuts, but it's more fundamental than that.

There are some significant long-term structural problems that I think states really need to do more to address. There are a number of them in the tax system.

State sales taxes mainly are on goods, not very many services, but the proportion of the economy and of consumption that consists of services, rather than goods is rising. In part due to the role of the federal government in standing in the way, most states can't get any significant revenue off of sales that are done through the Internet, which also has a regressive effect, because people who buy through the Internet on average have higher income than people who buy in bricks- and-mortar stores.

So as more consumption moves to services and more sales moves to the Internet, state sales taxes don't keep pace with state economic growth and with need. Aggravating that, you had many state income taxes -- I think a majority of state income taxes -- entirely exempt from the tax, either all Social Security income, all 401(k) pension income, or both, which will be a huge problem as the population ages. This is...

(AUDIO GAP)

GREENSTEIN: ... regardless of income level. The federal government -- the federal level...

(AUDIO GAP) GREENSTEIN: ... that's not true at all, right? You get money out of your 401(k). It's taxable income. If you're in the income bracket of probably...

(AUDIO GAP)

GREENSTEIN: ... that corporations are increasingly able to book their profits in states like Delaware and Nevada and evade the state income tax in the states they're in.

And then, of course, in addition to this, you have the pension liability issues and whether they're adequately funded for the long term, which in many states they're not.

And states really need to -- you know, there will be a lot of discussion of pension reforms, but even after all the reforms are done, states really will need to contribute more on an annual basis to their pension funds.

GREENSTEIN: So if you put all of these factors together, in many ways, a worst-case outcome from the state policy-making area would be for states to start looking at revenues three, four years from now as they begin to return and say, "More revenues? Let's do new rounds of tax cuts," rather than beginning to address these long-term structural issues.

KLEIN: So Greg is telling me that we're coming to end here, so one final question that I'm not sure you'll actually answer. Which state do you think is being best governed? Which state have you been most impressed with throughout the recession?

(LAUGHTER)

(AUDIO GAP)

(UNKNOWN): ... makes a state well-governed these days is having a whole lot of natural resources under the ground that you can pump up...

(AUDIO GAP)

KLEIN: ... thank you to North Dakota for -- for giving us something to look towards.

(UNKNOWN): Great. Thanks.

(APPLAUSE)

(UNKNOWN): I think we all could use a break, so there are refreshments out there, and we will start promptly at 11:15.

END

Panel 4:
The Medium-Term Challenge:
Replenishing Revenues and Modernizing the Tax Code

11:15 am – 12:15 pm

Moderated by:
Ezra Klein, *Washington Post*

Panelists:
Leonard Burman, Maxwell School, Syracuse University
John Irons, Economic Policy Institute
Henry Aaron, Brookings Institution, CBPP

[*] (UNKNOWN): All right. We're going to head on and talk about taxes, and I'll just turn it right back over to Ezra. There you go.

KLEIN: Well, I'm back. Unfortunately, I used my best introducing a panel -- depressing-panel-about-difficult-fiscal-choices jokes in the last introduction to a depressing panel about difficult fiscal choices, so please just pretend I had some good ones.

But I'm glad to be joined here by John Irons and Len Burman and Hank Aaron, who know more about taxes than -- certainly than I do, but then also than most people do, I think.

And I'm going to just of begin it here. In a few short sentences, what would you do with the Bush tax cuts?

(UNKNOWN): I think the recipe is easy, I think. I think you repeal the Bush taxes for the high-income earners. I think you extend the rest of them permanently. And I think you put the money that you would have spent on the high-income earners, put that towards much more effective stimulus, be it infrastructure, be it social supports, be it aid to states, we just heard is incredibly important.

I think that's the right recipe. And politically, I think it's a tough question. Politically, there are some obstacles, but I think that's the right answer.

(UNKNOWN): I -- I would also extend the middle-class tax cuts, but I'd only do it for a few years. It's not really plausible that we could have such a low level of revenue going forward, given the spending trajectory.

And I think there ought to be a major effort at tax reform. We ought to have the tax cuts expire maybe at the end of 2013, so it's not right in an election year, and reform the tax system to be one that is adequate to financing the government, is more fair and more conducive to economic growth and is simpler.

(UNKNOWN): I think E.J. Dionne in a column a couple of weeks ago pegged this exactly right when he said that he thought we were having the wrong debate, that the right debate shouldn't be about whether to cut taxes or leave taxes low for the majority of taxpayers and raise them for a few. It should be whether to use the revenue from the ending of the high-income tax cuts to continue tax initiatives that the Obama administration put in place for stimulus reasons when it took office.

The right debate shouldn't be whether to raise taxes on a few. It should be, on whom to cut taxes? And it would be possible to vastly better target tax relief than is possible simply debating which of the Bush tax cuts to allow to expire.

KLEIN: One of the things I found interesting and disheartening about the debate is that Democrats are often caught by surprise on things, right? They're caught by surprise on something that appears on Fox News or caught by surprise on something Ben Nelson would like to do in the future. But this wasn't really a surprise. There was a piece of law that said the Bush tax cuts are going to expire pretty much right about now. They knew about this 10 years ago.

And yet at no point prior to the recession and at no point after the recession, when they sort of could see the new fiscal reality, was there an effort to offer an alternative to some variant of either extending all or extending most of the Bush tax cuts that was more targeted to the moment.

And so I'm curious, in a more blue-sky fashion, if any of you would have one, if you were -- you know, you're looking at this money, and there appears to be some willingness in Congress to, you know, spend whatever it is, $4 trillion or so over the next 10 years, on some type of tax change. But if you don't have to be bound by the Bush tax cuts, which were clearly designed for a different moment, what sort of tax policy change would you like to see? Let's have the right debate.

(UNKNOWN): Well, I think that both Paul Krugman and Bob Greenstein put their finger on the right strategy, which is not to think about the tax policy simply in isolation from the rest of what government does. There's a desperate need to provide additional support to state and local government. Otherwise, some very bad things are going to happen.

There are a number of other expenditure activities that could do more to help fight the recession than simply scattering tax dollars around indiscriminately. And, of course, focusing tax cuts on those who are most likely to spend them gives you the biggest bang for the buck.

Bob Greenstein, in his comments, referred to the CBO study that ranked the relative effectiveness of different kinds of fiscal stimulus. And it was clear from that study, I think, that the high- income tax cuts came in just about last place in bang per dollar spent. One could put together a vastly more effective program with those dollars that would do more for the economy than simply extending them, even for two years, as Marty suggests.

IRONS: The concern I have is that the current system is just completely irrational and it's -- everybody -- everybody agrees it's overly complex. Everybody thinks it's unfair. Although it's a very progressive tax system overall, it's ridden with loopholes that probably hurts economic growth, because the corporate tax rates are high relative to the relative that are raised. And -- and, you know, we have this debate about what the top tax rate should be, and part of the problem we have now is that high-income people, you know, kind of like the current system, which is a very narrow base, ridden with loopholes and relatively low rates. The ideal thing would be to look for a system that had broad base and relatively low rates and maybe, you know, come up with an additional revenue source, like a value-added tax, which could be designed in such a way that it was actually providing an economic stimulus. Hank pointed out at the break that he had -- he had written an op-ed about this...

AARON: With Belle Sawhill.

IRONS: .. with Belle Sawhill that a value-added tax, phased in over -- over time, would actually give -- it would build in inflationary expectation. Part of the reason people don't want to spend money now is that they think prices are going to go down.

IRONS: If you know that a VAT is coming, you'll speed up your spending, and it could raise revenue in a way that over the long term could be -- could -- could encourage savings, which -- even though it's not what we need right now, that's something that we will need in the future.

BURMAN: Jim Leese (ph) had a couple of points here.

I mean, I think that you're right. Democrats knew this was coming. We all knew that this was coming. And a lot of us who spend a lot of our time on tax policy thought that 2010 was going to be the golden year of tax reform, because we knew something had to change.

And I think the recession through somewhat of a monkey wrench into that system, but we still had, I think, hope for a number of years, and it just didn't turn out that way.

And part of what's going on is that because of the design of the Bush tax cuts, the fact they're expiring this year, and the debate is about extending them are not, I think that has thrown out a lot of very valuable discussions that needed to happen on tax policy.

So when I said that we should expand all the Bush tax cuts except for those at the top, part of my logic was let's get these off the table. Let's make these permanent. Let's repeal permanently those at the top. Don't have another two-year extension where we have to revisit all of them again in two years. Let's just put in place those items that everyone knows has a huge amount of popular support.

Put those in place, repeal those at the top, and then have a discussion about tax reform. Then have a discussion about adequacy, have a discussion about whether or not the system is progressive. And we know that the top income earners have seen their incomes grow dramatically, yet the tax code does not recognize that.

So I think we need to have all these debates about the AMT, about the tax base, about the corporate tax. And they simply aren't happening in part because we have the debate over exactly the wrong debate -- the debate over the current Bush tax cuts. And that's not the right debate to have.

KLEIN: Well, let me -- let me then open the debate that I think would -- most people aren't very interested in having, both because it's boring and because it's painful, but Len likes to have.

(LAUGHTER) And I like that. And that's about tax expenditures.

The Center for American Progress, which is sort of the only left wing think tank not co-sponsoring today's events, but...

(LAUGHTER)

... but they do some good work, had a report on how will you cut your way to -- to a balanced budget. And basically, what they said is if you're going to look at doing that and you're really primarily trying to look at discretionary spending, you've got to bring tax expenditures into the game. You can't just do anything but.

So talk for a minute about that, because tax expenditures seem like this place where they're in this part of the -- of the federal budget, but we don't look at that much, and people don't realize we're spending money on, but they're-- they're big part of the game. They're a big part of our money goes.

IRONS: Right. And there's -- there's actually a huge amount of money that goes into spending programs that are run through the tax system. And these are -- these are subsidies, some of which probably makes sense, a lot of which don't work particularly well.

The mortgage interest deduction, I think, is the biggest single tax expenditure. And you say, well, that's good, you know. It encourages home ownership, and this is -- this is something maybe we need right now. But it's so, so poorly designed.

The people who get the benefit from this are the people who are most likely to own their homes anyway. Low and middle-income people -- lower income people are probably worse off, because it probably, at least during normal times, probably pushes up housing prices, and they don't get any benefit from the deduction. And it costs an enormous amount of money -- over $100 billion a year.
The total -- total tax expenditures, all of these spending programs together, cost over $1 trillion, and they're growing

at a faster rate than -- than the economy. You know, we look at health care as this big driver of deficits over the long term. It's actually growing faster than the economy. Well, so do these tax expenditures.

Most of them are poorly targeted. Most of them benefit high- income people. A lot of them don't -- they do very little good at all. It would be nice if we could have a debate about how to control these tax expenditures, maybe to look at ways of taking that money and targeting it said that it would actually do more good.

Like, for example, if you replaced the mortgage interest deduction with a flat tax credit that everybody could take -- ideally, a refundable tax credit -- you could actually save money and actually help the people who really need help paying for -- paying for their housing expenses.

For some things it would make sense to just take the money and put it into spending programs like the -- we have a panoply of tax breaks for higher education. I once joked that the only thing that was missing was the hope to learn how to do your taxes credit...

(LAUGHTER)

... because, you know, just figuring out which ones you should take and which ones you shouldn't is -- would require a Ph.D. to start.

They probably help colleges. They do very little good for the people who really need help paying for college. If you took that money, you put into Pell Grants and subsidized student loans, you could provide so much more -- so much more help.

And, of course, these things are on autopilot. They're like entitlements, and they -- for -- for the most part, they're extended forever unless Congress explicitly takes action.

(UNKNOWN): One of my favorite parts of the health care debate -- I mean, all of the health care debate was my favorite part of the health care debate -- but one of my particularly favorite parts was you'd talked to folks, and they'd say, "Well, why should I be subsidizing poor people's health care insurance?" And you'd say, "Well, where do you get your insurance?" And they'd say, "My employer." Say, "Well, why am I subsidizing your insurance?" And they'd say, "You're not."

Well, actually, it's all in tax expenditures, which brings us to both the questions of health care -- you see how I did that -- and adequacy.

(LAUGHTER)

When we're talking about how much tax revenues we actually need over time, we're almost fundamentally talking about what our Medicare and Medicaid going to impose on the federal budget. And I think there's two things to say about that, and you probably have many more things than that, but one is that it's more complicated than, I think, the way was sort of like to think about it, right?

We like to think about the budget as an arithmetic problem. You can subtract numbers from the spending column, and you can add numbers to the taxing column, and eventually you get those columns to match up such that you're at a balanced budget.

Well, when you're dealing with something like the growth in health care costs, it's a little bit different. It becomes reforms and supposedly cuts, and -- and revenue increases become a little bit more the order of the day. So how much of this can just be done through tax policy or, even for that matter, spending cuts? And what are we really going to need to -- what are we going to need in terms of simply refocusing some of this debate on the entitlements themselves?

(UNKNOWN): Well, I'd like to make three points raised by your comment about simply trying to do things in a mechanical fashion. One of the things that frightens me most about the budget commission now at work is my fear that they may attempt to deal with a long-term fiscal imbalances by saying, you know, let's cap the growth of Medicare or Social Security.

There are two problems with it. The first is that it really doesn't involve any facing up to the true cost and structural problems that have caused expenditures to grow. It's simply a way of pretending to do something without really doing anything.

The other is that if you -- if and on the contrary, you take it seriously, capping Medicare would end it as an entitlement. It was converted into a capped payment that would require reductions willy- nilly, irrespective of the particular medical needs of the people who the program covers.

(UNKNOWN): A death panel.

(UNKNOWN): Well, I'm not going to call -- actually, I think I don't want to go there.

(LAUGHTER)

The other point is that when one -- we -- we look at the growth of -- projected growth of Medicare. It stretches out. With the aid of spreadsheets, one can go to infinity, and some people do. They measure budget problems until the sun cools.

(LAUGHTER)

But the growth of health care spending depends on certain real events. One, as Larry pointed out early on, is population aging. The other is the excess growth of health care spending, which results from something. It doesn't come out of the blue. It's new technology, new things to do, which depend on research we haven't yet undertaken that will occur 20 or 30 years hence and lead to new technologies probably we can't even dream about.

But those numbers in those projections are so real we treat them as if they were hard-edged estimates on which current policy decisions should actually be made. And that is crazy. And the reason it's crazy is that by its very nature, that research that's driving health care spending is something that we cannot know the implications of today. So taking current policy decisions based on guesses about future technology seems to me to be seriously unwise.

And finally, so much is going to depend on how health care reform unfolds. We still don't know. Health care reform is law. It is not reality yet. And it won't be in most of its major respects until 2014. Between now and then come two elections. And depending on the outcome of the elections that are going to take place in a little less than a month, the whole future of health care reform could be placed in very serious jeopardy.

It is quite possible that if Republicans gain control of either house, they will honestly deliver, try to deliver on a pledge that they have made, which is not to provide funding for the implementation of health care reform. And if one thinks about the mechanics of Congress and appropriations, that is a distinctly possible reality. Paul Krugman said he thought the odds of a government shutdown were maybe 50-50. Here is one channel through which that shut down could actually occur.

KLEIN: John, do you want to add anything on that?

BURMAN: No, I think that's right. And I think the broader point is that when you look at the revenue base that we have, the amount of revenue we're taking in as a share of the economy, you're right. It's not just an exercise of matching up 23 percent, 18 percent, and coming up with some numbers in between.

It's really discussion of what is the health care system we want to have in the future. It's a discussion of how much infrastructure spending do we want to have in the future. And so putting these questions into a broader context is what we really need to do.

And so we need to talk about adequacy and think about we have to rely on projections, because we have to. There's no other way forward. And we know that spending on health care and on other programs are likely to go up, and so in thinking about the tax code, we need to have a tax code that works, has an adequate base -- that is, you know, eliminates some of the tax expenditures that are out there, has a broad base, is maybe supplemented by other sources of income -- so that we have the funding to do what we want to do as a nation.

And that's the -- the key question, and that's true in the next five years, in the next 10 years, and over the next 35 years. So we really have to look at all these different horizons and make sure that we have a sound enough tax code that it works for all these different horizons.

IRONS: Can I just make a quick comment at night? Disagreeing at all with Henry Aaron on health care just terrifies me, but...

(LAUGHTER)

... the fact is that there are a lot of biases in the system that are -- that still encourage excess health care cost growth. And you're right that long-term projections are surely wrong. But, you know, we've got the -- you still have the unlimited tax exclusion for health insurance. And they, you know, if you include Social Security, that's the biggest tax expenditure.

IRONS: And that -- that subsidizes high-income people's health insurance, so basically, they're willing to pay for any -- any new innovations that come along, even if they're really cost ineffective.

And a lot of the specific spending restraints that people had proposed that would have slowed down the rate of health care costs didn't make it through Congress.

And the thing that's actually terrifying is, when you listen to people who want to fix health reform, basically what they want to do is, they want to take out the things that were going to -- the few things that were left that were going to slow down the rate of growth of health care costs and build in things that would exacerbate -- or keep the things that would exacerbate the problem.

So, that, you know, I think it is something to worry about, even if you're not crazy.

AARON: It's clearly something to worry about. It's why we enacted health care reform.

The uncertainties associated with projecting so far into the future are, I think, what I was trying to draw attention to. I don't disagree at all with the structural nuttiness that we have in our current health care system.

Incidentally, one of the areas of structural nuttiness in my opinion and, I'm sure, in yours, is one -- it's a tax expenditure that would divide people in this room, and that divided Democrats during the debate over health care reform. And that was whether and how much to curb the exclusion of employer-financed health insurance from tax.

Incidentally, it's one area where I think we really saw played out the tragedy of excessive partisanship in Washington. Traditionally, curbing the tax exclusion would have been a Republican issue. It would have been one where the Republican minority lined up with the position that the White House basically was endorsing. The left part -- the labor-oriented part of the Democratic Party would have been defeated.

But the Republicans elected to just say no. It was a Nancy Reagan strategy on health reform. And so, they played no role whatsoever, and the balance of forces within the Democratic majority in both houses moved this bit of reform down to a very, very low level. But my main point about the long run is, the driving force is technology -- principal force driving up health care spending. We don't know what form that will take.

The policies that we both agree are in need of correction in the current system are subject to legislation down the road. And consequently, the seemingly unbudgable excess growth of health care spending -- 2.5 percent a year faster than income growth -- is something that is very sensitive to events that are very difficult to forecast.

And therefore, given the fact we are at the front edge of health care reform which could transform our health care system, and we don't know the nature of technology, we should act on the basis of current fiscal pressures, and as we learn more about future developments, respond to them as they unfold. But I don't think we disagree on the policies.

KLEIN: You know, when I -- I'm going to tell folks a story that will relate. When I was home a couple months ago, I went with my parents, or my father, to look at porch furniture. And he's sort of crotchety about these matters. And so, he looked at it and he said, "I will never sit on this."

And then a couple of minutes later he came to me, and he said, "And also, it doesn't sit enough people."

(LAUGHTER)

And the conversation in Congress over the excise tax has been a bit like that. Right? You talk to folks on the right and they say, well, the estimates are all wrong, because the excise tax will never -- Democrats will never let that go into effect. And then you call them back a little (ph) bit (ph) later (ph), they say, also, we're going to repeal it.

AARON: Will Rogers once said of a restaurant -- he gave a restaurant review. He said, the food was lousy, and there wasn't enough of it.

(LAUGHTER)

KLEIN: Although I think I have to speak up for the Jews and say, I think that was Woody Allen.

(LAUGHTER)

But that brings us to -- one of the other questions we get into in the taxes is that, of late, there have been three or four different, fairly high-profile studies that have come out, that have pretty much carried the message that, when you begin to look at fiscal adjustment, you really don't want to do too much on the tax side.

Alberto Alesina, who's a Harvard economist, has been behind some of these. The IMF came in with some who agreed with him in their recent global economic outlook. And in the CBO, in their estimations for the Bush tax cuts, when they estimated, what would happen if you dealt (ph) with (ph) the Bush tax cuts by doing spending cuts, and what would happen if you did it by tax increases, said tax increases would be a vastly worse situation for the economy.

So, I wanted to have you respond to that a bit, given that, you know, one of the arguments in the fiscal commission that certainly progressives are worried about is that tax cuts -- or tax increases -- won't be enough of the solution, the solution won't be balanced enough.

But how balanced do we want it to be? I mean, what do you think of this evidence?

IRONS: A couple of things. Let me address the evidence first and broaden (ph) it (ph) out (ph).

The evidence out there, I think if you look at Alesina study and the IMF study that came out a couple of days ago, I think the IMF study basically put to rest the notion that you could have an expansionary austerity plan. So, in other words...

(LAUGHTER)

... I know this sounds kind of counter-intuitive, but there is thinking out there that, if you were, you know, somehow reduce the deficit, this leads to business confidence. It leads to a lower interest. And that could lead to an expansion in the near term.

I think evidence suggests that people's intuition is right, that if you have an austerity problem, it's not good for the economy in the short run.

So, I think the IMF study pretty much puts to rest that part of the Alesina. They did a different methodology that I think is better suited to answer the question.

The second point, which is the impact of taxes versus spending as a way to reduce the deficit and what is the relative impact of those two, if you look carefully at the IMF study, what they found was that the tax changes were more likely to be accommodated by the central bank, and the spending cuts were less likely to be accommodated.

So, at the end of the day, this wasn't a discussion so much of tax versus spending. It was more a discussion of the full range of policy responses that happen.

So, I think if you were to, in their study, hold monetary policy constant, hold interest rates constant, and look at what would happen with spending versus taxes, I think you'd find that it to be a relatively similar impact between the two. So, that's a more technical point on these studies out there.

I think the more important point here is in a broader context. Look at the U.S. economy, and look at where monetary policy is now. The pedal is at the floor. Right? We're going pretty much as fast as we can, looking at at least traditional interest rate policy. There might be more to be done on quantitative easing. But we're pretty much at a lower limit on interest rates.

So, in that context, I think there is a huge amount of space to be said for short-term stimulus on the spending side that I think is going to make a huge difference in a way using the traditional multipliers that other people have put out. You know, spending on infrastructure yields $1.62, I think, in returns. And tax cuts just don't yield that much.

And what's going on now is, because we have slack in the economy, the short-term fiscal situation is incredibly important, so (ph) for (ph) short-term economy. It's incredibly important for the long term fiscal situation.

The number one priority has got to be getting the economy going now. So, I think in that context, looking at the spending changes is going to have a much bigger impact on the economy, and therefore, would put us in a much better place over the long term for our fiscal situation.

BURMAN: There's a lot of kind of wishful thinking about the effects of taxes, that you'd cut taxes. If you do it on a permanent basis, that this will have a much bigger effect on the economy than if it's done on a short-term basis.

And the other argument that people make is that it will create certainty. If you just -- if you made the Bush tax cuts permanent, that that would resolve all the uncertainty that businesses have about what's going on with the tax code, and they'll be able to, you know, make investments with a lot of confidence.

Anybody who thinks that making the Bush tax cuts permanent reduces the uncertainty, I think is crazy -- try to be Henry Aaron here. I mean, the fact is that we -- right now, tax revenues are at the lowest level since 1950. Part of that is the recession, but part of that is also really big tax cuts.

And at the same time, we know that there are -- just demographics alone are going to put a lot of pressure on spending over the next 10, 20, 30 years, even if we're optimistic about the effects of health care costs overall.

If we at the same time that we were providing significant stimulus in the short term, had a plausible strategy for getting the deficit under control over the long term, I think that would do a lot more to resolve uncertainty than promising tax cuts that we clearly can't deliver.

KLEIN: But just to press you on this, putting us out of the question of uncertainty, when you look at the evidence of what different types of fiscal adjustment does to an economy, should we -- is there a reason to prefer either $100 billion in tax increases to $100 billion in spending cuts, or vice versa? Or do you see them as...

AARON: There's a reason to prefer $100 billion of good tax changes over $100 billion of bad tax changes. And the same is true of expenditures.

All three of us -- and I'm sure, many of the people in this room -- could easily come up with tax changes, or expenditure changes, that would be good for long-term economic growth. Investing $100 billion in improving roads, in encouraging scientific research, in improving the performance of schools will be good for economic growth. Spending $100 billion to subsidize oil and gas drilling in the United States probably wouldn't yield as much over the long haul.

The same is true on the tax side. There are provisions of the tax code that are inefficient in that they needlessly discourage labor supply, or needlessly discourage investment. And there are other provisions that don't have such negative effects.

So, the trick is to look at the structure, not to form blanket judgments about the one or the other.

KLEIN: And which brings us nicely to tax reform.

Yesterday, Barack Obama, President Obama really sort of opened the door to corporate tax reform. He said that he would be very open, his administration would be very interested in seeing a deal in which loopholes are closed and the overall rate brought down. He would like to see -- he would like to see it be revenue neutral.

That, I think, in theory should also open the door to a question of broader tax reform. There are similar problems across the codes, and obviously, different problems across the codes. But what nobody disagrees with is that there are problems across the codes.

So, assuming somewhat optimistically that, in 2011, one of the few issues that could plausibly attract some type of interest from both parties is some type of tax reform, what should people be thinking about as they go into that? What would you -- what are the premises you would like to see for such a discussion?

And just go -- if you could just go right through, starting with John.

IRONS: Let me say a couple of things. I mean, I think the premises, I think, when you look at the history of tax reform, I think it's fairly clear. You need a broader base. Whether or not you can use a broader base to pay down lower rates is an interesting question.

You look at, you know, the basic precepts of fairness, inadequacy and efficiency, those are, I think, very common, well-understood issues.

On the corporate tax side, I mean, I think this is interesting, because there is a Holy Grail of tax reform, which is the 1986-style, broaden the base, lower rates. Do that in a revenue-neutral way, maybe then (ph), in a distributionally neutral way.

I think when you look at the current situation, we can't be looking at a revenue neutrality. We have to be looking for more revenue. I don't think we should be looking at a distributionally neutral change, because I think that would be ratifying the distribution that exists in the Bush tax code, essentially, and I don't think that's the right distribution.

So I think the basic concepts of a broader based revenue neutrality I don't think is -- is right for future tax reform.

Now, on the corporate tax, let me mention a couple things. You know, everyone knows the U.S. tax rate is, compared to other countries, relatively high, if you look at the top statutory marginal rate, 35 percent. When you look at how much corporations actually pay, it's significantly less.

If you look at the U.S. compared with an international average, the OECD average is around -- I think it's 3.5 percent. The U.S. on average pays about 25 percent less as a share of the economy, in terms of our corporate revenue. And so I think if you're looking at -- in that situation, broadening the base, you don't need to necessarily lower rates significantly. You can do that in a way that raises revenues. It doesn't have to be revenue-neutral.

And the analogy I use is, is suppose you find out that your tax accountant has been cheating you, they've been stealing your money. And you go back to them and say, "Hey, I just caught you. You know, you're stealing my money." And you said, "But don't worry. I'm going to increase your fees."

That's a similar situation, right? There's a lot of tax loopholes out there that are being used, either legitimately or simply tax dodge, offshore tax havens. The idea that we should be out there eliminating all these loopholes and turning 100 percent of the revenue back over to the corporations in terms of a lower rate I don't think is the right approach.

And so I think we can use some of the revenue -- not necessarily 100 percent -- but use some of the revenue to increase revenue that we know that we have to do to close the deficit and to finance other priorities.

(UNKNOWN): I guess I'm going to disagree a little bit. The -- the high corporate -- 35 percent corporate tax rate just doesn't seem sustainable. And we could do everything we can to close loopholes, but it's so easy for companies to shift where they earn their income for tax purposes, and some of those things involve real dislocations, actually moving plants and -- plants overseas, corporate headquarters overseas.

I -- what I would like to do would be something like (inaudible) in the sense that I'd like to lower marginal tax rates, but I would like to do it as part of a system that actually raised enough revenue to pay for the government and that actually created a tax system that people actually perceived to be fair.

One of the problems with the current system is that a lot of people don't buy into it. They think everybody -- there are so many tax breaks, preferences that people think others are paying more -- they're paying less than their fair share, and they're not getting enough.

So I wrote a paper that was in the Virginia Tax Review where I suggested that, instead of -- in the '86 tax reform, we -- there was a significant cut in individual income tax rates. It was mostly paid for by cutting -- by the big tax increase on corporations. I don't think that's feasible now, even if we thought it was desirable.
And -- and, in fact, I think probably corporate tax revenues ought to be roughly around where they are now, so we

need another source of revenue to pay for cutting rates. One thing that's used all through the rest of the world is value-added tax. I think we're one of, you know, two or three countries that doesn't have one. It's a sales tax collected in stages.

And value-added tax is known to be regressive. It hits lower- income people more than those with higher incomes. You can deal with that through the tax code, through refundable tax credits that would offset its impact on people at the poverty level.

The other thing is if -- so if we used a VAT as part of -- as a way to cut individual income tax rates, cut corporate tax rates, and I've suggested something like 25 percent might be feasible, trimming as many tax expenditures as possible, converting as many as possible in that we wanted to keep in a credit, so that they were available more for the people who needed help, and then simplifying the tax code enough so that most people wouldn't have to file an income tax return or the information they needed to file their return could come directly from the IRS, I think it would be a tax system that people could understand.

It would -- if you -- if you sold the tax reform as -- as a way of dealing with our long-term fiscal problems -- and presumably in the context of plausible constraints on spending at the same time -- that conceivably, with very strong political leadership, that might be something that the American public might get behind.

Ideally you'd want it to be done on a bipartisan basis. That was the '86 act. And I wish I saw evidence of bipartisanship somewhere.

(UNKNOWN): Well, as far as the individual tax is concerned, what Len said. As far as business taxation is concerned, it is extraordinarily easy under the current tax code for businesses to move income around to low-tax jurisdictions. Just think of a product made under a patent and you park the patent in Ireland, in a subsidiary located in Ireland, and all kinds of royalties go to Ireland, so that the manufacture and sale of the product here in the states just doesn't make any money at all. That kind of process goes on to a significant degree.

There are -- this is one of the most horrendously complicated parts of taxation. I have come to believe that on balance the way -- the only practical way to deal with this is some kind of formula allocation based on location of employment, sales, and capital stock, which is used in some tax systems, particularly for sales taxes, but could be used for profits taxes, for corporation taxes, as well. It would change the nature of the tax.

The chief obstacle to this kind of -- or any kind of major change in corporation taxation takes one right into the swamp of distributional politics. There are huge shifts in tax liability among industries, and hence seemingly capricious shifts in the impact of the tax system on different sectors of the economy. So far, those have blocked any kind of reform.

I think Len has put his finger on it. The way forward has to be to bring revenue into the reform of a tax so that the rates most people face are lowered, and that's what happened in 1986. It was -- well, it was expected to happen. It actually didn't play out exactly that way.

KLEIN: Well, so while we're talking tax reform, then, let me ask you about some of the -- some of the bigger ideas floating around the tax debate, some of which you've touched on a bit, but let me begin with you, John, with the six-six concept or proposal.

IRONS: Yes, well, I guess the six-for-six concept was -- there was a lot of discussion about when we ought to start reducing the deficit. And I think lost in a lot of debate is the current economic context, which we heard earlier this morning is in really terrible shape. So I put forward the idea that you should not start fiscal austerity in any meaningful way until you have 6 percent unemployment or lower for six consecutive months.

And I think that this is very important to acknowledge, that a trigger like this -- I think it's an important component of any deficit reduction package you have. Otherwise, you just run the risk of running fiscal policy counter to where we really need to run policy in the short run to create jobs in the short run.

So I think this -- you know, this kind of a trigger or something similar, I think, is an essential part of the discussion that needs to happen.

KLEIN: And then let me ask you about a slightly weirder one, because you've mentioned the VAT already, and I'm going to then just instead give that to Hank, but people occasionally talk about shifting some of our taxation over to things we want less of, namely carbon, that this has come out of the debate a fair amount. I mean, it seems quite unlikely, but nevertheless it is sort of an intuitively appealing idea.

What do you think of -- what do you think (inaudible) sort of payroll to carbon or similar types of shift?

(UNKNOWN): I think that a carbon tax was something to deal with the fact that it would -- it would hit low-income people and -- and through maybe -- probably -- you wouldn't want to actually reduce the payroll tax necessarily, but maybe to -- to -- because that money goes into the -- the trust fund, but doing maybe a tax credit to offset the impact at the bottom is, from an economic perspective, it's the ideal way to deal with global warming.

It should be something that both people who care about the environment and people who care about the workings of the economy ought to support, because what a carbon tax does is it says, when you -- when you burn carbon, you put carbon into the atmosphere, you're creating this extra cost. And the problem is you're not -- you're not paying anything for that cost now.

The taxes -- the tax basically uses a market mechanism. It says there's an estimate of what that cost is. It adds it to the price, and then it leaves it to the market to find the best ways to reduce carbon emissions. And the government's track record on finding alternatives isn't really great. You know, you could come up with things like ethanol subsidies, which -- I mean, ethanol -- ethanol will never be a solution, because it takes more energy to produce ethanol than -- than -- than you actually get from burning it.

It might be that wind is a good solution. It might be that solar is a good solution. But the nice thing about the -- about putting a price on carbon is it leaves the market to decide basically -- it leaves the market to decide the best way to -- to -- to reduce carbon emissions, to find -- right now, basically, the system is biased in favor of burning -- burning hydrocarbons, and it would remove that bias.

KLEIN: Let me ask you one question about that. Usually we -- one of the reasons we tax payroll is that it's unlikely people are just going to start firing a lot of employees in order to get away from the payroll tax. But, of course, with the carbon tax, we are hoping -- the whole concept is that people will use less carbon and such the tax base, in theory, is going to go down. I mean, you can keep ratcheting it up, but that seems too difficult. Do you worry about the stability of that revenue source?

(UNKNOWN): No. I think it would be great if the revenue source disappeared. It would mean that it was successful. I mean, as people find more and more efficient ways to reduce carbon emissions, the -- the people will stop burning carbon-based fuels. And if that revenue source went away in 20 years, that would be awesome.

KLEIN: But then what happens to the programs depending on it, putting in this sort of payroll swap that people talk about? Because they sort of stopped talking about a carbon tax (inaudible) you have to hide it somewhere else.

(UNKNOWN): Well, again, you know, if the payroll tax swap is -- is basically designed to offset the cost of the -- the tax, as the -- as the -- as the tax burden goes down, as innovation basically makes it less costly, it would make sense for the payroll tax credit to be reduced, as well.

So -- I mean, and the nice thing about -- in taxation, almost all taxes you can think of entail an extra cost from the economy. Companies move -- move overseas to avoid the corporate tax. People work less, save less. The nice thing about a carbon tax is that's one case where it actually would make the economy work better.

And if -- if it does produce -- produce the kind of innovation that would make avoiding carbon basically costless, that would be fabulous, and there wouldn't be any -- there wouldn't be any need for an offset to -- for a payroll tax offset at that point.

(UNKNOWN): The likelihood that it -- the revenue is going to vanish is vanishingly small, I think.

(UNKNOWN): But it might -- it would get lower, then that would be a good thing.

(UNKNOWN): It might grow at a lower rate than it has -- otherwise would. I think directly linking to the payroll tax confuses two different things. First of all, we have a payroll tax because of a political insight 70 years ago that, if people paid payroll tax on the earnings which was used to compute pensions, and that subsequently was used to determine eligibility for health care, one would increase the political staying power of those benefits. And I think that was a sound insight, and it would be a bad idea to -- to move away from that.

Furthermore, people who don't earn and pay payroll taxes actually do use carbon. So linking the credit simply to the payroll tax seems to me to be mistargeting.

There are, of course, ways of relieving the impact of a carbon tax on low-income people. And this includes a wide range of instruments, in addition to the payroll tax credit.

You were going to go...

(CROSSTALK) KLEIN: I was also going to ask you about the VAT, some type of consumption tax. How should we think about moving towards some system with more VAT influence?

(UNKNOWN): Well, Len started on -- on this, and I think he and I pretty much agree on this. First of all, we both suggested the idea of linking VAT to something that we all very much want, namely a financing of health care. And since, as I think Len and I both agree, health care spending is virtually certain to continue increasing, by how much we can't be certain, and because I think there's something else probably we would agree on, which is that linking a fiscal discipline to how much we do spend on health care is a good idea. It's the way we go out and buy things normally, so that having a revenue source tied to the service that it's purchasing, and you have to raise the revenue in order to raise the spending, is exactly the kind of financing that, if you will, responsible progressives should embrace for -- for social insurance.

So I think the -- the linkage between a revenue source and the thing it is going to buy is a principle that deserves very serious discussion.

And we both agree that putting a VAT into effect at such time as maybe John's six-six rule gets satisfied could actually do two things for us. It could help deal with the acknowledged long-run deficit gap that we as a nation face, and it could also send the right signal to consumers: Don't put off consumption. If you buy now, you will not only get something useful for yourself, but help the economic recovery, as well.

(UNKNOWN): If I can just add another point on that, I mean, I think -- I don't disagree with anything on that. I think if you look at other developed countries, they all have VATs. And so we do stick out as an outlier in some sense.

But the caution is that you can do a VAT well and you can do a VAT poorly. And you can design a very poor VAT. The key consideration here is that a VAT can be regressive, because people with lower income spend a higher percentage of their money on goods and services, and they'd bear a relatively higher percentage of their income in taxes.

So if you implement a VAT without explicitly recognizing that and taking that into account by exempting necessities, by changing other parts of the tax code, or by dedicating the revenue to a progressive spending aspect, if you don't do any of that -- their proposal is to have a VAT and use the revenue to offset purely the corporate income tax, in that world, that is a VAT I think done poorly.

And so I think this is a big caution that there is a lot of design elements that need to be done right before a VAT becomes, I think, a desirable thing.

The other point is that the current income tax code is a mess, too. I think a lot of the people say the current income tax code is a mess, let's forget about it, let's just do a big VAT, and look at that as the way we raise revenue from now on. I think that's a mistake, as well. We need to fix the current income tax code and maybe use a VAT for these other purposes, but we can't use that to supplement our income tax code, which I think has historically been very effective. It's completely broken, but that needs to be fixed, too.

(UNKNOWN): If -- if any of you here have been waiting for a good, hard-edged disagreement, now is your moment. I want to take exception to what John just said about the VAT, having lots of exemptions for necessities. The social democracies of Western Europe that have relied on the VAT to establish a set of backstops that protect low-income people, light years better than anything we do here in the United States, typically levy a VAT on everything that doesn't walk.

And the reason they do that is that once one starts down the road to exemptions, one starts down the road to the kinds of administrative complexity that have made the income tax the nightmare that it is in many respects here in the United States.

It is far better to keep it simple, stupid, the KISS principle, with respect to the VAT and use that revenue to provide -- through the expenditure side, the targeted relief to low-income people that I think would achieve -- in my view, better achieve the objective that I'm sure John and I both share.

(UNKNOWN): Yes, well, let me erase those hard-edged differences. I think I said, you may need to exempt, and I think there are multiple different ways you can get the VAT to be more progressive. One way is to exempt some necessities.

So I think something needs to be done. If you can do it through these other mechanisms, I'm fine with that, as well. If you can't do that, those other mechanisms, then I think you do have to have some other provisions as part of it.

(UNKNOWN): The problem is that if you exempt X, then a whole bunch of other things that aren't X...

(CROSSTALK)

(UNKNOWN): ... all of a sudden start -- start looking like X. There's this great story about Canada, which had a tax break for manufacturing, a really bad idea, one that we adopted years later. And Canada is not particularly -- they're not anywhere near as creative about tax avoidance as we are, but there apparently was a -- a Kentucky Fried Chicken in Nova Scotia that was able to prove to the satisfaction of Canadian courts that the salad bar constituted manufacturing and was eligible for the credit.

It, you know, would be great for tax lawyers to have these breaks, but it's -- a clean, broad-based VAT, with some other way to offset the regressivity, is clearly a better idea.

KLEIN: And that's why when people say that our industrial economy is falling apart, I send -- I take them to lunch at Chop'd (ph). It makes them feel much better. So getting away from blue sky and back into sort of our grubby reality, what do you expect and what do you hope will come out of the fiscal commission on the revenue side, more in this sort of world of things that might be possible?

I don't know if you have terrific insight information that you'd like to reveal here for the first time on what they're considering, but also what do you -- you know, what do you think is a plausible path for them to take? How should they be thinking about this?

BURMAN: I -- I mean, I would hope that they would propose tax reform and sensible -- paired with sensible ways to limit the growth of spending. The -- the problem is that, you know, the same gridlock that -- that has kept Congress from -- from getting anything done this year is also going to affect this commission. You need 14 votes, and all -- I think all the Republicans on the commission have promised never, ever to raise taxes.

The only -- the only glimmer of hope -- you know, you asked about tax expenditures earlier -- is I think there's more recognition among Republicans and -- and Professor Feldstein, who talked earlier -- earlier today, has been talking about this for decades -- that tax expenditures are spending programs that are just masquerading as tax cuts. And maybe that might be a way of raising revenue through the tax code without explicitly violating the pledge never to raise taxes.

But it's going to be -- I -- I -- I would be delighted and very surprised if they come up with a coherent proposal to do anything serious about the debt.

(UNKNOWN): I think, from my perspective, I agree that the most likely path where they'd get some agreement is on the tax expenditure side, for reasons Len just mentioned. Remember that the tax reform -- or the fiscal commission has two mandates. There's one mandate, the 2015 target, and there's a longer-term mandate.

And I would hope -- I would be optimistic -- I shouldn't say optimistic -- I would hope that they would expressly note that we need more revenue by 2015 and also over the long run. And so I'd hope that they would say that the current tax base is inadequate, that the current level of revenues is inadequate.

And whether or not they can go down some route of coming up with a compromise that actually gets you there, I'm not optimistic about, but hopefully in whatever report they do about improving the long-run situation, they do explicitly knowledge that we will need more revenues than we're current raising as a share of the economy in 10 years and beyond that.

(UNKNOWN): I should be hopeful, I suppose, because one of the commissioners sits one thin wall -- next door to -- separates her and me, Alice Rivlin. But I have fears more than hopes.

Oddly, I think one of the areas where there may be an opportunity for agreement would be on national defense, the need for including -- for reining in the level of national defense spending in certain specific ways on which both Republicans and Democrats might agree.

Apart from that, I'd go back to what I said. I have more fears than hopes.

KLEIN: And we will finish it on this -- on this final question. Will we need to raise taxes on people making less than $250,000 a year going forward?

(UNKNOWN): Yes.

(UNKNOWN): I think it depends on your horizon. I think in the short run...

KLEIN: Twenty years.

(UNKNOWN): ... you need not do that. In 20 years, probably. But there's a lot of revenue to be had on people making more than $250,000 in the short run and long run that we are not doing now. And so perhaps in 20 years, but let's start someplace else right now.

(UNKNOWN): Yes.

KLEIN: Thank you.

(APPLAUSE)

(UNKNOWN): Good job. It's time for lunch. Head out there. Food is out that way, and you can bring it back in. We'll have -- give you a chance to chat with each other, and we'll resume our panel on retirement security and Social Security at 1 o'clock.

END

Panel 5:
The Medium Term Challenge:
Strengthening Social Security and Retirement Security

1:00 pm – 1:45 pm

Moderated by:
Robert Kuttner, *The American Prospect*

Panelists:
Nancy Altman, Social Security Works
Teresa Ghilarducci, The New School
Robert Reischauer, Urban Institute

[*] KUTTNER: Well, the first rule of -- the planners of the event organized it in such a way that you've already had your food.

(LAUGHTER)

So let's get right into it.

There are two rather different storylines that you have heard and will continue to hear about the relationship between the deficit and the recovery.

One has to do with giving priority to deficit reduction and the reduction of the debt relative to GDP.

The other has to do with giving priority to the recovery, after which the task of getting fiscal balance is less arduous because you get to fiscal balance at a relatively higher level of GDP because individuals and households and businesses are paying more in taxes again. As John Irons said at the earlier panel, recent IMF study concludes that it's not very reliable to expect that you can deflate your way to -- to recovery.

And square in the center of this debate is the role of Social Security, with the name of Willie Sutton often invoked...

(LAUGHTER)

... because that's where the money is. And it's unintentionally revealing, I think, when you think of what Willie did for a living.
(LAUGHTER)

So on that note, let me ask each of the panelists, as an opening question, what is the relationship of Social Security and the fiscal condition of Social Security to the economic mess that we're in and to the recovery from that mess.

Should we go right down the panel? Teresa Ghilarducci?

GHILARDUCCI: Well, we heard about, this morning, about automatic stabilizers or countercyclical programs, and one thing that we're finding out in the economic research is that Social Security is a much unappreciated automatic stabilizer. To say it simply, if we didn't have Social Security today, the economy would be in much worse shape.

Let's take an example from a region of our country that's in really bad shape, Detroit.

There's 3 million people in the Detroit greater area. A third of them are on Social Security or on some kind of pension system. Without those programs coming into that economy, the unemployment rate in a very distressed region would be much worse. We're also finding out that, when the economy gets worse, Social Security benefits outflow actually goes up. It's naturally triggered by a problem economy. So right now we're finding that Social Security is actually helping the economy not have a higher employment rate.

KUTTNER: Nancy, there's a medium-term and a long-term part of the story, namely that -- a lottery ticker -- the argument that even though Social Security is in surplus for a couple of decades more and then some, but in order to restore confidence in the short run we've got to make more progress on improving the 75-year time horizon now.

ALTMAN: Well, there has been the argument that we should calm bond markets by showing that we can make tough decisions, but it's hard for me to see that the bond markets are so naive that they can't see exactly what's going on. The point is that Social Security, as Teresa said, in the immediate term is actually helping to get us out of recession. It is highly stimulative. Two-thirds of the elderly receive half or more of their income from Social Security.

In the stimulus bill there was a $250 payment to Social Security beneficiaries. What wasn't said was that in January of 2009 there was also a cost of living adjustment that dwarfed the $250 payment. It also has lessened suffering because people can take early retirement. It is the largest source of income of grandparents raising grandchildren, and so it's a staple there.

When you go out to the medium or long-term, Social Security at its most expensive will be 6.1 percent of GDP, it's shown, and then it falls down to about 5.9 percent. That is completely affordable. It is about half the amount that Germany and a number of other countries are paying for their old-age programs right now.

The question is an ideological, political question. What level of benefits does society want to provide for old-age survivors, disability, this kind of wage insurance, and how do we want to fund it?
It's not a "Can we afford it" economic question.

KUTTNER: Bob Reischauer?

REISCHAUER: OK. I don't disagree with my two colleagues here, but practically speaking, some time in the next 10 to 15 years, if we're lucky; the next five years if we're unlucky, we're going to have to make a major effort to reduce the size of our deficit.

And the real question here is, well, to what extent should Social Security adjustments play a role in that?

And my answer would be not much, if any, should they or can they, because the kind of changes we want to make are the changes for the 75-or-longer-year period. These should be phased in very gradually. And what we want to do is what's right for the long run, not what's (inaudible) for the short run. Having said that, I don't think Social Security shouldn't be on the dance card. It has to make, in a sense, a cameo appearance because we want everything to be on the table. And so this, I think, is an opportune time to make those adjustments that we might think sensible for the 30, 40, 60-year period and give people the feeling that, yes, we are considering all aspects.

But when you hear the real problem here is that Social Security, Medicare and Medicaid are causing this difficulty, there's no reason why Social Security should get equal billing. I mean, it is an afterthought compared to the health care issues.

KUTTNER: Well, let's drill down a little bit. The things that one hears as possibly being on the table include raising the retirement age, raising back to around 90 percent the total percentage of payroll that's subject to taxation, coming up with other revenues, enhancement strategies and coming up with other ways of effectively cutting benefits.

Which of these should be on the table? Which of these should be off the table? And why?

Nancy Altman?

ALTMAN: Well, I can certainly say the problem, I think, is that we haven't agreed on the table yet. Historically, Social Security was seen as sound if it was then (inaudible) that was the -- traditionally the task that was applied by policymakers in both parties. And the evaluation period varied, but since 1965 it's been 75 years, three quarters of a century.

Since then, in the last couple of decades, people have talked about it and some of the time horizons (inaudible) they've talked about sustainability in the 75th year. They've talked about cash flow, which is the deficit point.

How much money is coming in and how much money is going out on a year-to-year basis?

If you can't agree on -- before you can start to look at options, I think you have to figure out what your goal is in order to have a sensible conversation.

And if I can make one other quick point on that, I was involved in the 1982/1983 -- on the staff of the Greenspan Commission. The reason that that was so successful and historically the reason that Social Security has bipartisan support has always been, whenever it's raised benefits it's raised the revenue to pay for it. It's never had any kind of shortfall, even. It's always been very conservatively managed.

There was a general agreement on the goals of Social Security and the basic structures of Social Security. If you start talking about either it's unaffordable, which raises another set of debates, or that we should privatize it, that somehow guaranteed benefits are too expensive for the federal government, you can't even start to get to options because you don't have basic agreement on what you're trying to do.

KUTTNER: Teresa, assuming that there is a smallish long-term problem, if you go out enough years and you've got pessimistic enough assumptions about the economy, what forms of adjustment, either on the benefit side or the tax side, would you favor and which ones would you discourage?

GHILARDUCCI: Well, I'll just assume that the basic structure of Social Security is the one that we're going to maintain. Most people when polled say they like the idea that they pay contributions; they get benefits. They understand the social insurance aspect of it. So I'm just going to not question the structure of, and nor will I even the question of long-term indicator of what's a sound system.

So let's just take the commonplace indicator that 75-year solvency is what we're after. They can argue that's way too conservative, that most other countries use a 35-year or 40-year. Well, let's just take the 75-year solvency. So then you have choices. Benefit cuts, or revenue enhancement. And I'll be even-handed.

What should be off the table is the benefit cut that's in the form of the so-called raising retirement age. Raising the retirement age is actually sort of a brilliant statement because it's very misleading.

It actually presupposes that if you raise the age, then people will just work a little bit longer, as if people can choose to continue with their employer to work a little bit longer. The facts show that when people work past their considered retirement age, they're doing it because they have to because of money and they actually changed jobs.

Or you ask people, did you retire when you thought you would?

Most people say no, I had to leave early; my employer fired me; the economy tanked and I was laid off or my own health or my spouse's health interfered. And this whole idea of raising retirement age, because we're living longer, therefore we should choose to live longer is this whole -- a lot of other assumptions that people are choosing when to retire and that the work is ready for them.

So raising the retirement age is really -- should appropriately be called what it is, which is cutting benefits, and cutting benefits now makes no sense at all -- so take cutting benefits off the table. Then we can talk later about how the employer-provided voluntary system has eroded and the only thing we do have for most people is Social

Security. So cutting Social Security benefits makes no sense.

Revenue enhancements -- it's really simple math and a no-brainer to raise the earnings cap to either capture 10 percent, and that's a historical number, or even capture more like Medicare has. There is no cap at all. And then state and local workers -- and some state and local workers will hate me for this and this is not -- not controversial, but state and local workers should be in the Social Security system. It defines our nation. It should truly be a universal system. KUTTNER: Bob?

REISCHAUER: I'm with Teresa on state and local workers. I'm not sure how far I'll go with some of the other ones. You were asking what should be off the table in a very broad sense, and I would say any explicit forms of means testing that people have suggested. We do a whole lot of implicit means testing. I mean tax benefits. We have a benefit formula that is modestly progressive, could be made more progressive, I think, if you want to reduce benefits -- that's where I would go -- which would be the top portion.

We need to look, when we think about policy options, at Medicare and Social Security together. It's the same population. It's the same base of financing. And of course Medicare has gone quite a long way with income-related premiums and changing the tax burden. And when you're thinking of what's appropriate, you want to lump the whole thing together.

Secondly, I would remove from the conversation any kind of benefit cuts for the bottom 50 percent, 60 percent of recipients. Of course, you can't pick it out that way, but in general. The amount that we give in way of benefits relative to living standards in America or comparable situations in other countries is really quite abysmally low. And as we all know, there's very significant portions of our elderly population that are heavily dependent on Social Security. A third receive over 90 percent of their income from Social Security.

So I think you want to be very careful on those fronts. And I won't start a food fight with a person who is...

(LAUGHTER)

... (inaudible) over whether the age of retirement should be increased in an era when people are staying in school a whole lot longer.

GHILARDUCCI: Some people are.

REISCHAUER: Well, but that was always true. And the issue is, you know, even after changes like this, we'll have a lot better system than we had 20, 30, 40 years ago. Nancy?

ALTMAN: And if I can just -- it sounds like, well, Teresa explicitly...

REISCHAUER: This is two people.

(CROSSTALK)

REISCHAUER: They probably have the sympathy of the audience, too.

(LAUGHTER)

ALTMAN: Well, we're lame-duck session here. GHILARDUCCI: It's hard to defend Social Security, right?

(LAUGHTER)

It's hard work.

ALTMAN: But Teresa explicitly said it, and, Bob, I think, you -- you implicitly said, at least for this discussion, the goal we're talking about is 75-year actuarial balance, which the August (inaudible) report put at 1.92 percent of taxable payroll, about .6 percent of GDP.

REISCHAUER: As the projected imbalance...

ALTMAN: Over 75...

REISCHAUER: ... conservative growth projections...

ALTMAN: Exactly.

REISCHAUER: ... and wage growth projections.

ALTMAN: Exactly. And the -- within that -- and I think also implicit in the comment about rejecting means testing is the concept that we want to keep the structure the way it is, that it's a universal structure.

Another important piece of the structure is a careful balancing of equity and adequacy. And you can adjust the adequacy side, but for the equity side, which is that you do want to have reasonable benefits, I think, for those who are contributing, for all contributors -- and that's something that they've tried to maintain throughout the history, just as long as we're jumping in with state and local and other things.

The public opinion polls -- with the money gone, it's very clear that the American people know what they want and has to be done, and that is, when put to a poller's choice, they'd rather see increased revenue, ideally progressively, but even if they have to pay it, and no benefit cuts, including no increase in retirement age.

KUTTNER: Let me ask a question. You've got -- I can think of three commissions, one public, two private, that are due to report fairly soon on the deficit crisis and Social Security, which I think is in surplus for the next 27 years, is at the absolute center.

Why does this idea have so much traction in this town, that there is a recession over here; there's a deficit problem over there, and that Social Security in any kind of near term has anything to do with those two things? Why is that idea so much in circulation?

ALTMAN: Well, how about the Washingtonians answer that then? I'll tell you what the rest of the country says.

KUTTNER: This is a setup. Let us say what the Beltway people wrongly think and then the American people will speak. So I concur. REISCHAUER: Well, first of all, it's relatively small, the challenge here, I ,think and there are lists and lists of possible solutions. So everyone can find something that they've put together, their five solutions, and they'll say, "I have a plan here."

KUTTNER: Solutions to Social Security or solutions to the deficit?

REISCHAUER: Well, Social Security.

KUTTNER: Why is it linked to the deficit, to the short-term economic crisis, and the deficit is where I was fishing for, in the minds of a lot of people.

REISCHAUER: I think, because we have heard for years, beaten into us, that this is one of the entitlement programs that's out of control, notwithstanding the fact that there isn't really any empirical evidence that's the case.

(CROSSTALK)

ALTMAN: ... Cato Institute.

GHILARDUCCI: No, the -- there's a real disconnect. We talk about polarization in this country around a lot of issues. Social Security is one where people are not polarized; the American people are not. We -- you know, if you -- Celinda Lake and others have done polls asking people, do they support Tea Partiers or do they have a union member in the household? Are they Republicans? Are they Democrats? It all comes out very much the same.

And the general view is that Social Security is a fund they've contributed to. It has nothing to do with the general fund deficit of the United States government.

But there is a -- the real polarization comes between that broad- based view among the -- which is like, 70 percent, 80 percent. And the conventional wisdom in Washington, of which there also is unanimity among Republicans and Democrats, many Democrats, sort of, the sensible centrists, interestingly, and that view tends -- there are several components of it.

There is a part of it of ideological conservatives. You mentioned Cato. I wrote a book called "The Battle for Social Security," with Alf Landon in 1936 calling worthless IOUs and the trust funds and so forth, that there have always been ideological opponents who thought that the federal government had no business providing middle-class benefits. And they -- they have that view and they've been opposed to it and the American people have not sided with them, but it's a legitimate position to take.

But they've changed their tactic, and in the 70s and 80s started saying it's not affordable; it's a great program, but we can't afford it, and it has all these "It's not fair to young people" and so forth.

But we also have those who see the budget as a unified holding, that was reflected in Bob's comments in the beginning. And the unified budget is a sensible way to think about this broad fiscal policy, but it's a simplified view and it's a distorted view.

Social Security is a defined benefit pension plan with add-on life insurance and disability insurance. If a CEO talked about Social Security the way policymakers talk about Social Security, they'd be accused of raiding the funds. I mean, it is -- but I think that's where it comes out. It's this -- this elitist notion that it's a unified budget, that we should be looking at all aspects of it, along with...

REISCHAUER: Yes, I think there's another important aspect, and that's the symbolic aspect of it. We're caught up in a situation where we all know there is a huge problem with our deficit and the growth of spending, in some people's views, the erosion of revenue in other people's views, and we don't know how to get off of square one.

Here's something that we've done once before, back in '83. It's something where the solutions are quite easily defined when we compare it to the solutions for the real problem, which is how do we control health care spending. And we say, boy, if we just put this together, you know, international financial markets would say, as they have said to some countries in Europe, (inaudible) hard stuff. And so the, sort of, deficit class in Washington gets fixated on this.

KUTTNER: You sound (inaudible).

You sound ambivalent about whether you buy into that view.

REISCHAUER: No, I'm not ambivalent. You know, I think, symbolically, it's quite actually important.

(CROSSTALK)

REISCHAUER: I would be all for the five or 10-year deficit reduction package, including 75-year Social Security reform that had almost no impact on outweighs or revenues in the next five, seven, 10 years.

GHILARDUCCI: Yes. No. I think we're very in agreement here. I think what we're all -- and I'm surprised, but I think...

(LAUGHTER)

I think...

REISCHAUER: I'll change my views, if...

(LAUGHTER)

(CROSSTALK)

GHILARDUCCI: But, no, I think we do agree that the Social Security does not add to a medium-term or really even long-term deficit problem, and that the reason that we're focusing on it, I think we all agree here, is because we have been focusing on it and we've been focused on it for partisan reasons ever since the beginning of the system.

So it's like -- I think I wrote this imagery -- is that we're focusing on it not because we lost our keys under the lamp posts, but because that's where the light is.

(LAUGHTER)

So we all have educated ourselves about Social Security. There's been lots of details about it, so we're looking there for a deficit problem, but the problem with the deficit is out there with the war, you know, with tax reform, with tax expenditures and with health care. It's out there in the murkiness.

I also think there's a big problem, Bob, is that people know that they have their own retirement deficit, that, when you ask people about their retirement deficit, they know they are falling way short of what they need when they reach 65 or (OFF-MIKE).

KUTTNER: Well, let's segue into that. I know Nancy wanted to respond to the last round.

ALTMAN: That's OK.

(LAUGHTER)

KUTTNER: But time is getting away from us, and I think it's really important to raise -- to situate Social Security in the context of the larger problem of the retirement income inadequacy.

Because we've got a private pension system that is ceasing to cover most people, or it's been shifted to 401(k)s, which are less reliable than traditional pensions. And then on top of that, the allegedly three-legged stool, fewer and fewer people are able to put aside money for savings and their home equity is taken a hit, whatever investments they have has taken a hit and Social Security has already been cut about 13 percent relative to lifetime income by the reforms of 1983.

So what about the larger problem of income adequacy and old age? Do you want to start?

ALTMAN: There's lots of ways to look at income inadequacy and old age. We can look at the current system and we find that only a fifth of the elderly have anything that look like a three-legged stool and they are the fifth; they are the richest. The most wealthy, the top 20 percent of the elderly, have sources of income that come equally from assets, from private pensions or employer pensions or from Social Security. So that is a metaphor that works for only the most privileged fifth.

For most of us, the appropriate metaphor is really a pyramid. You can think of the food pyramid, right, where Social Security are your vegetables and your grains, all right?

(LAUGHTER)

Your employer pensions are your fruits and proteins and the very top is your chocolate and whiskey, which is your assets.

(LAUGHTER)

And it's really those that little tip and the middle tier that have just crumbled for, you know, 80 percent of the population.

So now we look forward. We see that in 1970, when ERISA was passing, the Employee Retirement Income Security Act was passed to shore up that middle tier, that employer pension system, 50 percent of workers were covered. Guess how many people are covered now that we've expanded?

The answer is none. It's the same exact percentage of people are covered. So our tax expenditures for the retirement income has not helped expand that.

KUTTNER: And they've shifted from defined benefits to 401(k).

ALTMAN: Defined contributions -- and that actually means for projecting forward, so another way we can look at adequacy is that less income is going to come from those sources. So if you look at Alicia Munnell's Retirement Risk Index, from Boston College, we find that over 50 percent of the American population -- and those are middle-income people -- are not going to have enough money in retirement to maintain the retirement standards. (Inaudible) actually talked about that in her opening comments.

That's the first time that's happened. We could have a system where our grandchildren are going to do -- us, actually if you're past 50 -- are going to do worse than our parents and our grandparents, in terms of retirement income, and that's the deficit.

We think we can actually make up for that by working more, but that, in terms of the appropriateness of the future jobs and older workers, doesn't actually seem to be real.

GHILARDUCCI: Yes, I mean, Retirement USA, EPI and some other organizations here are involved with -- they just come out with a retirement deficit, which is $6.6 trillion, also calculated by Alicia Munnell's group.

The -- and this -- your question really ties to the panel right before lunch about taxes. It is both clear as a matter of experience and as a matter of logic that savings are not what's needed for retirement income, for -- at least for foundational retirement income, that it is -- savings are great for emergencies, but they're not good for uncertain but devastating losses like disability or death, leaving survivors.

They're also not good for -- for long-term needs, especially when there's uncertainty there, too. A 20-year-old to 30-year-old doesn't know whether he or she is going to get to retirement and if so, how long that person will live, whether the person will have a spouse and so forth. What's needed there is insurance.

The one entity in our country that can provide a nationwide risk pool without adverse selection is the federal government. It's why Social Security, to be fully portable, is extremely efficient, and private-sector defined benefit plans have weaknesses.

In a -- if we were really having just a sensible conversation, our nation would be involved in a conversation, I think, about expanding Social Security and how we pay for it. As I say, that's -- the American people, I think, sense this retirement deficit, which is why they are so dead-set against cuts in the program and want to see the program expanded on the revenue side.

And if I can make -- and this is the point about the taxes, that somehow we have developed this idea in Washington that spending money directly by the federal government costs money, but somehow a tax break -- a preferential tax expenditure is free, that it's somehow just returning money, you know, and no sense about tax equity. And it's what gets us into a box. It's what gets -- at the same time the Deficit Commission and others -- there was just a report put out by Maya MacGuineas and Bill Galston that had all these cuts and a 2 percent private account.

I've been thinking you could solve Social Security with that amount. It's -- it's this disconnect that we can give more tax expenditures for retirement, but somehow we can't do it in the most efficiently way possible.
KUTTNER: Well, let's remember that there are a lot of tax expenditures associated with encouraging people to save for retirement. And the real question is, is the revenue that we give up that way, if we were to reallocate it in some other mechanism -- you know, and I think you and I actually could go into the back room and come up with a better one.

GHILARDUCCI: Social Security.

(LAUGHTER)

KUTTNER: Well, it would probably be a little bit different.

(LAUGHTER)

But, you know, this whole three-legged stool thing was a fantasy at the beginning and it remains a fantasy, or else it remains a very unstable stool with legs of very different lengths. And we're ignoring the reality that there is at least one other, a fourth leg, which you're going to jump all over or else I wouldn't be talking about it, but half of the people over 65 get some kind of asset income but it only amounts to 13 percent of their income, so, well, that's not so great.

Government pensions and private-sector pensions -- probably a third or a little over a third, get one or the other, not both, and those come up with about 18 percent of the income. It's really not important -- and this concentrated on certain people, but 26 percent of people over 65 or couples or individuals have earnings and earnings contribute 30 percent of the total income. And some of that is people having to earn to achieve the minimal standard of living, but for a lot of people, that's not true.

And we have to ask ourselves can we put a fourth stool that sensible, that doesn't undermine or is inequitable for those who don't have the physical, mental or job opportunity capabilities of contributing in that way. A very difficult kind of thing to design something like that, but it's there and we should try and think that through, I think, more carefully than we have. So we aren't talking about people 85 or over. We're really talking about somewhere between 62 and 72, maybe.

REISCHAUER: I want to bring wages into this because there was a period in the 90s where we had full employment, or near full employment; we had wage growth; and there was a three-year period when the time horizon at which Social Security would fall (inaudible) into deficit was pushed back 13 years in a course of three years. Why? Because wage growth increased, and of course Social Security is financed by payroll taxes on wages. So shouldn't the divergence of wages and productivity growth be part of this story?

GHILARDUCCI: It's a huge part of the story because we've had most of our wage growth -- and we saw it in Larry's presentation -- happens at the very top. All that money, all that increase in wages escapes the Social Security revenue because of the cap. So we had a cap that captured about 90 percent of wages and then the other 10 percent was left untaxed, but they would get a very low rate of return for (inaudible). It's actually the decline in middle-class wages that really hurts the Social Security system, and that's the insight you get just from looking at the numbers.

If you actually raise the very bottom, the minimal wage, at least --that is a nice progressive point, let's just raise minimum wage and get more money in the Social Security system -- it doesn't help that much because it's a very progressive system. You get a very high rate of return at those lower wages. It's the devastation of the middle- class wages that have really hurt the Social Security system.

REISCHAUER: Unlike Teresa, I don't want to lower the minimum wage to help Social Security, but we should also point out that this is a problem that all roads lead back to health. We know, and total compensation or average compensation has been going up, not great but a whole lot better than the cash wages. And most of the difference is a reflection of the fact that employer-sponsored health insurance has grown very rapidly. Hopefully what we've enacted is going to turn the corner, but it's going to take a long time and a lot more legislation and a lot more angst in the health sector.

GHILARDUCCI: Let's just clarify that. What Bob is saying, if we taxed or partially taxed employer health insurance and put that revenue into Social Security and actually raised the cap it would have solved almost all the problems.

REISCHAUER: And there is a section on Medicare later, in fact.

ALTMAN: And also to reinforce what Bob and Teresa said, that the common understanding among policymakers and the general public is that it's the demography. It's the subsidy that's what the problem is, but actually the aging of the population was fully understood, fully taken into account in 1983 and in fact before. What's caused the shortfall is actually a number of factors, but the main factor we've talked about here.

Significant parts of Social Security are indexed annually to average wages. The problem is -- and if average wages are a true average of economic productivity gains that are spread across the working population, we wouldn't be talking about this at all because the trustees report would be showing a balance.

What happens, as we all know, is that we had the growth concentrated at the top end, so that's one piece of it, and the other piece of it is the one Bob has said, that covered wages are what is subject to FICA contributions, and more and more compensation, whether deferred or any kind of health care benefits, have escaped FICA.

And as they say, when you look at just -- that's why percentage of GDP is really the better way to look at it, and when you compare our benefit levels to other industrialized countries, they are quite low, and when you look at what we pay for Social Security, it's quite low compared to other countries.

KUTTNER: There's a footnote on this, which doesn't apply, maybe, to the last couple of years, but that's that a significant fraction of income, compared to the distant past, is in the form of dividends, interest and capital gains, which also were not subjected to the FICA tax.
(CROSSTALK)

KUTTNER: Go ahead.

GHILARDUCCI: I just was -- this is the medium-term portion of our conference, right?

(LAUGHTER)

In the medium-term, we're really going to have a problem with retirement adequacy. So, maybe, in the last couple minutes we can talk about expanding Social Security benefits. I think we do need savings. I think people do need to defer consumption now for their retirement later.

And we have institutions that must...

(CROSSTALK)

KUTTNER: Not now, just wait a couple of years or so. Listen to the first panel.

(LAUGHTER)

GHILARDUCCI: Well, no, I actually think there should be efficient pension institutions that people can put aside their money for future consumption. We should stimulate the economy with building a really better train from where I live here, right... (LAUGHTER)

... to New York.

But there should be efficient pension places where people can put their money at low fee, good returns, to get a steady supplement to Social Security.

Social Security is a social insurance program. We have many insurance programs. Middle-class people and above really need just a safe place to put their money, and so I'm in favor of, actually, an add-on, a supplement to Social Security.

I know we're not supposed to say "mandatory" in this town. It's much more polite to say "universal," so I'm in favor of a universal system of -- of pension supplements that are invested by a professional board of government employees, like the Federal Reserve employees have, that give a guaranteed rate of return for those -- for those savings. And if we did that, we could walk away from the retirement income security problems, just make people save more.

I have to do it at work. I'm a college professor. Most people who work for an employer have to do it. It's the 50 percent of the people who don't have those mechanisms that only have 401(k) plans. We can walk away from the retirement income security problem and pay attention to those dark, murky places away from the spotlight, which is actually health care.

KUTTNER: Let me close with a question about politics, because this is, after all, politicized. You've got the President's commission trying very hard to strike a deal between Republicans and Democrats on Social Security, which would include trimming benefits and raising taxes.

Nancy, your organization has also been helping to circulate a letter trying to get Democrats to sign a pledge.

ALTMAN: One hundred and twelve signatures.

KUTTNER: Well, I know, but what about the other 126 or 127?

(LAUGHTER)

That's what startled me. I mean, I think it's important that 112 have taken the pledge, but a majority of the Democratic caucus, which used to view defense of Social Security as akin to breathing, has not yet signed the pledge. What is the political fallout to each party if a deal is struck to cut Social Security benefits?

ALTMAN: Policymakers, I think, have been convinced that the statesmen-like thing to do, for the reasons Bob talked about, is cutting Social Security. And I always try to deliver the message, from my perspective, the best politics in this case is also the best policy, that you should be doing what the American people say you want. Social Security is a signature program of the Democratic Party for a reason. It is the -- our most redistributed program. It lifts 19 million people out of poverty. It provides important critical economic security to virtually all Americans. It is something that Democrats have in the past always embraced, always defended, always used to their political advantage in election after election. And it is, to me, shocking to see that the Democrats are -- appear to be -- not -- I shouldn't say all Democrats, but the White House seems to not either appreciate this history or appreciate the values that this program represents.

And to me, again, it -- the reason it's popular, it represents the best of American values. It's reward for hard work. It's looking after -- responsibility for your self, but also, it's family values. It's a family protection program. I don't -- think the -- I joke that the Democrats will -- Karl Rove will get his hope; the Democrats will help him make the Democrats permanently a minority party and the Republicans permanently a majority if they run away from Social Security or if they enter into a deal that cuts it when the American people are telling them, don't do it.

KUTTNER: Well, let's -- let's not end on that note.

(LAUGHTER)

Let's give Bob a chance for the last words.

REISCHAUER: I don't know if this is going downhill, so you might want to...

(LAUGHTER)

I wanted to asked Nancy, if I could come up with a deal which shaved a bit off of the benefits of the top 20 percent of recipients, myself included, and I gave you half of that to boost benefits of folks at the bottom or the very old, primarily widows or widowers, and took the other half for long-run Social Security solvency, would you say I was a traitor?

ALTMAN: I would say -- I would say let's do it, but let's do it by putting in a higher marginal income tax rate. Benefits are already taxed 85 percent. Let's tax them back through the marginal income tax rate and get the money.

(CROSSTALK)

ALTMAN: No, I would not cut benefits. I would not go into that deal as a straight cut.

GHILARDUCCI: Orszag and Diamond have a good plan to take some of the inheritance tax for the -- for the legacy benefit to pay legacy costs.

REISCHAUER: We have 300 other uses for that money, too...

(LAUGHTER) ... many of them worthy.

GHILARDUCCI: But just to end on a political note, I was -- and I think it's a feat, but it's amazing that, in 2005, no Democrat broke and signed on to partial privatization. And President Bush thought they would, and they didn't. They were completely solid.

And I think -- and that was because of this grassroots campaign we had all over the country. You were part of that, Nancy. You were writing your book furiously.

(CROSSTALK)

KUTTNER: What seems to have changed since '05 is that, first of all, partial privatization is more radioactive for Democrats than a high-minded deal that would put a little bit of cutting of Social Security benefits into a larger pot for the sake of fiscal virtue.

And I think this panel has been pretty unified in most things. That's the one little shred of difference. It sounds like Bob thinks that, on balance, that's not a significant hit, substantively or politically, to the Social Security system, and the other two do.

ALTMAN: And if I can -- if I can make one, sort of, closing policy point, and that is that I'm -- I'm involved both in Social Security discussions, and because I chair the Pension Rights Center, in private pension discussions, too.

And there are two distinct conversations that go on. Within the Social Security world, the conversation is it's an extremely efficient program. It's an extremely fair program. It covers all these hard- to-cover workers. It's extremely secure. It's the government program and so forth. But we have this projected shortfall, and let's do a compromise a little off here and a little off there.

In the private pension system, we say it's all going to the high end. It's extremely -- administrative costs can be extremely high. It's very hard to cover workers, so let's throw more money at it.

(LAUGHTER)

And I would like to get the conversation together and say, let's look at it as one system. Why don't we improve and increase and expand the part that works and that's efficient and let's not -- we don't have to cut the other part. We -- people are free to say, even -- we can even leave in IRAs and 401(k)s, tax preference, but let's not -- let's not mandate it. Let's not...

GHILARDUCCI: Not so sure.

(LAUGHTER)

ALTMAN: Well, but all I'm saying is, let's let it wither, if that's going to happen, but let's have a conversation that looks comprehensively at it all.

KUTTNER: Great. Now to end on -- we've used up our surplus time.

(LAUGHTER)

Thank you all very much.

(APPLAUSE)

END

Panel 6:
The Medium-Term Challenge:
Reassessing our National Security Goals and Budget

1:45 pm – 2:30 pm

Moderated by:
Stan Collender, Qorvis

Panelists:
Carl Conetta, Project on Defense Alternatives
David Walker, Peter G. Peterson Foundation
Cindy Williams, MIT

[*] COLLENDER: It's Collender, C-O-L-L-E-N-D-E-R, @qorvis.com, all right? I can't promise you I'm going to ask it, but it does give me an opportunity to look at my e-mails while the program is going on.

(LAUGHTER)

David, it's good to see you in Boston. How are things, now that the Red Sox are not in the playoffs? Sorry. I couldn't resist.

WALKER: Well, you know, the Patriots won big last night. They beat my Dolphins, so, you know, I guess 50-50.

COLLENDER: So OK.

Anyway, we want to make this, in spite of the subject, as much fun as we possibly can. So I'm going to ask each of the three panelists to start with one sentence, one phrase, one word, but no paragraphs. The question is when it comes to the defense budget, what's the one thing we need to think about, know about, worry about, or try to do?

Cindy, let me start with you.

WILLIAMS: I think it's time to adopt a much more restrained foreign policy.

COLLENDER: OK. Now, when we get to the defense budget -- all right, all right, we'll be back to that.

Carl?
WALKER: That's a sentence.

CONETTA: I think we need to go back to the drawing board on the defense reviews that we've conducted since 1997. All of them presume that the nation had trillions to burn. Clearly, they were...

COLLENDER: Wait, wait, wait, wait, wait. That would -- I'm going to assume there was a semicolon in there, but that -- that was -- you -- OK.

COLLENDER: David, one sentence.

WALKER: Two words: resource constraints. The current budget does not consider the reality of our fiscal constraints with regard to program planning and execution.

COLLENDER: OK. We've got Republicans saying yes, we want to -- we want to reduce spending but, by the way, you can't touch Medicare. We want to reduce the deficit, but you can't touch Medicare, can't touch defense and by the way, you can't, you know, raise taxes. So in a political environment like we're in, is it even viable for us to be having this conversation?

David, good start with you on this. What has to change to do what you were just suggesting?

WALKER: Well, first, there's a new four-letter word in Washington, D.C. It's called math, M-A-T-H. People have to have plans that were the numbers add up, clearly there's a lot of waste in defense. There's waste way beyond whatever you think about the two undeclared and unfinanced wars.

What we need to do is change the way that we go about dealing with national security strategy, national military strategy, the Quadrennial Defense Review, and other key critical elements to where it's more future focused based upon credible current and future threats, considering resource constraints.

Believe it or not, right now, stand, by law the Defense Department is not allowed to consider the affordability and sustainability of what they want to do when they come up with their requirements. That's obviously ridiculous.

COLLENDER: Cindy?

WILLIAMS: I think the first step is to get us out of these two wars. We need to get all 50,000 troops that are still in Iraq out of Iraq. We need to start winding things down in Afghanistan, because once we're out of those wars, the politics are going to swing a much different way when national security is concerned.

Once we don't have troops in harm's way, it's going to be a lot easier, and people are not going to want to go back to the situation we've had where we think we can be the world's policeman, where we think that we can make democracy happen at gunpoint. They're not going to want that. And some of the house of cards that has been built over the past decade is going to fall of its own weight.

COLLENDER: Carl? I've got a follow-up question for everybody, but I'm going to give you a shot at this one.

CONETTA: Well, yes, I mean, I think we need to recognize that with the -- the economic crisis, the -- the playing field has changed. Now when we think about national security, we've got to think in terms of three pivot points -- one, the end of the Cold War. The second one is 9/11, and the third is the crisis.

I think that this changes how we look at the budget. We need to look at it with new eyes. I think there's a recognition of that. We had the chairman of the Joint Chiefs saying that the debt is a principal problem for national security.

So the math favors change, but we need another four-letter word to go -- to go along with math, which is guts. It's going to take some guts.

COLLENDER: Excuse me. I was worried there for a moment.

CONETTA: It's going to take some guts to move on this. You know, we've just completed some months ago a report, the sustainable defense task force, who came up with a number of recommendations for -- for cuts.

And Congressman Barney Frank and -- and several other congressmen and senators have been circulating, getting signatures in support of reductions. So far they've -- they've managed to accumulate 50 or 55, which, depending on -- on how you look at it, is either a good showing or not.

It does show that -- that there is a concern on their side about the problem, but they're doing this on the eve of a contested election. So the day that we can get 150 or 180 signatures of on the eve of a contested election, that's the eve of change. That's when it begins.

COLLENDER: David, let me -- let me -- how many -- do you -- have you ever counted up the number of times you've testified in front of a congressional committee?

WALKER: No, but I was the number one most frequent witness before Congress for about eight years running.

COLLENDER: All right. So given that you're an experienced testifier, witness before congressional committees, does any of the substance that you folks are talking about make any bit of difference whatsoever?

WALKER: There's a difference between policy and politics. And in order to be able to make dramatic transformation of reforms, including in government, you have to build the case of a burning platform. You have to explain to people why the status quo is unacceptable and unsustainable.

You know, I said 5 to 10 years ago that our escalating deficits and debt, meaning the structural ones, represented a national security threat. Now finally, people are waking up to that.

You know, it's true that when you have troops in the field, the politics are very different. But even if you separate whatever we're spending on Iraq and Afghanistan, there's just huge waste in -- in the Defense Department and other aspects of intel and homeland security.

COLLENDER: Is it possible, Cindy and Carl, to propose cuts in defense -- in the defense budget in the current environment without even looking weak on defending the country or looking like -- or someone feeling as if their personal safety is being threatened? Is it possible even?

WILLIAMS: Well, there are cuts and there are cuts. And so, for example, Secretary Gates and the service chiefs have -- have taken the point of view that we can cut defense, or keep defense from going up much more, just through a series of efficiency cuts and by capping military pay raises to be equal to civilian pay raises instead of -- instead of more than civilian pay raises, by reining in the cost of military health care.

All of those things are deeply important for their own reasons, but they're -- they're what I would call trimming around the edges. They may be all that you can do as long as you have the wars in Iraq and Afghanistan going on, but I think once those wars are over, we are going to see a world in which it's totally possible to talk about the fact that the -- the way we operate our military today is actually causing more risk to the United States.

COLLENDER: Explain why.

WILLIAMS: Well, being in Iraq and Afghanistan has not made us a lot of friends, a lot of additional friends, in -- in the Middle East. Just think about our relationships with our allies for a minute. We -- we assumed that by being the -- the defense provider of first resort rather than the defense provider of last resort, we're creating a world in which our allies will be able to step up to -- to the plate and help defend themselves.

In fact, we're basically doing the opposite. We're providing so much defense on behalf of our allies that they have no big interest in providing defense for themselves. So European militaries for -- for more than a decade have spent less than half as a share of their GDPs on their militaries as compared with what the United States spends. And they're planning deeper cuts.

So what does this tell you? It tells you on the one hand that they're waiting for the U.S. to take care of them, but it also tells you that they're in a situation where it's easy for them to take risks at our expense.

So it's easy for the Georgians, who aren't even a really big, official ally -- they're not in -- in NATO -- it's easy for them to provoke the Russians, thinking we'll come help them. It's easy for Taiwan to provoke China, thinking that we'll be there to take care of them. And this is a situation that -- that isn't good for us. It's not good for our allies, and it's creating risks in the world that we don't need.

COLLENDER: Carl, is it possible -- I'm sorry to interrupt you -- is it possible to do that, what Cindy is suggesting, without some wholesale changes internally in the United States? I mean, is there a difference in attitude of what people within our borders want compared to what they see outside?

CONETTA: Well, you know, I think that -- that people are already facing economic difficulties, and they certainly want practical answers. I think...

COLLENDER: But when you say "people," you mean U.S. voters.

CONETTA: I mean the populace as a whole, right, you know. And I think that -- that, you know, when -- when we put forward strategies that people see as unrealistic, on -- on the one hand, there's no way of evading the question. Reduce defense expenditure -- I think the -- the initial response is going to be that will make us weaker. You need to engage that response and not be afraid of it, because people are of two minds. You don't see strong support for the wars in Iraq and Afghanistan. At the same time, people do have concern about terrorism, and it's realistically based. Can we provide better solutions than is -- is -- than is currently the case?

And it's a bipartisan solution that exists now in the four previous QDRs. It's a bad solution. It's a profligate solution. And it's one that doesn't apparently work very well. Can we provide alternative solutions that people will see more realistically and at the same time save money?

I think you begin to -- to convince people when you do those things, and not simply say, "Reduce spending," because the initial response you're going to get is, "Well, won't that make us weaker?" So we need to have practical solutions to the security problems and concerns that people do foresee.

How do we address terrorism? What about the problem of nuclear weapons in Pakistan? Are there better ways to approach those issues? We need to -- to provide some -- some strong to that, along with...

WALKER: Stan, can I jump in?

COLLENDER: Yes, please.

WALKER: Yes, let me jump in. Look. How much money you spend is not reflective of how much you care for how effective what you're doing is. And I'll give three examples.

This country spends by far more than any other industrialized nation in three areas per person -- health care, K-12 education, and defense. There's huge waste and ineffectiveness in all three of those systems.

It is possible to reduce defense expenditures as well as the rate of increase in -- in future expenditures without compromising national security. And in fact, it is imperative that we do so, because if we don't put our federal financial house in order, frankly, we will have much more of a national security problem down the road than if we do.

COLLENDER: All right. Let me -- I'm going to follow up on you directly, but I'd like to address this to everybody.

CONETTA: I want to respond to that, too.

COLLENDER: And knowing that there are some representatives of people who do business with the Pentagon sitting in the room, I don't want anyone to take this personally, all right? Everything you said is terrific and interesting, but isn't there also an additional question, which is reducing military expenditures or expenditures by the military reduces profits for and revenues to companies and therefore reduces employment?

I mean, in fact, can't we even broaden in that further? In the current environment, how do you get people out of Iraq and Afghanistan when you can't really take them off the payroll, because there are no jobs for them to go to?

WALKER: There is absolutely no question that a lot of the decisions that are made with regard to defense are made because of another four-letter word. It's called jobs. And in fact, if you end up looking, most of the major weapons systems, and if you go to their production facilities, you'll find -- you'll find flags of all the states who are contributing in some way -- in the case of the F-22, the Raptor, 49 of 50 states.

But in the final analysis, we need to be able to do what we have to to try to deal with short-term concerns while recognizing that the real threat to the national security of the United States and our future international standing and standard of living are the structural deficits. And so we need to have a plan that gets implemented in phases over time that doesn't undercut economic recovery or exacerbate unemployment, but puts us on a path to deal with the ice below the water that threatens our ship of state.

WILLIAMS: Can I jump in on that?

CONETTA: Good point.

COLLENDER: I promised Carl first, but then absolutely you can jump in.

CONETTA: Two words. I don't think anybody looks to defense first and defense spending first as the principal way to improve our economy. So those are economic benefits. If we were going to spend that money on a jobs program...

COLLENDER: Excuse me. Economic benefits of spending or not spending?

CONETTA: Of spending in the defense area. And people look to the -- the economic benefits that spin off from that. If our principal concern is economy, we would spend the money some other way. So in reducing the -- the fund there, I -- I would say just about anything we do that money, other than burn it, will have -- will have a better impact on the economy. That's number one.

Number two is that I think there's two avenues to -- to substantial reductions. The first one is increase efficiency. Keep on doing what you're doing in the world, but do it cheaper by paying our soldiers less, by buying cheaper equipment, or by finding efficiencies through streamlining. That's the efficiency approach.

In our report we found about 33 percent of the savings we discovered we associated with -- with various types of efficiency moves -- one of those three paths.

The other major path, which was the principal path, was to change what you do in the world. If you really want to get big reductions in defense, what you need to do is reduce structure. Bring down the size of the military. And that implies a different way of achieving security in the world, both military and nonmilitary security. So that's why we say you have to go back to the drawing board on these strategies that we've developed since the end of the Cold War. They only seemed to work when we were all wrapped up with that with the sword of irrational exuberance about how many -- how much resources we could expend this area. Now we discover we can't spend it. We need a different type of strategy.

COLLENDER: Cindy?

WILLIAMS: I agree with Carl. It's defense spending is stimulative. There's no two ways about it. It's the reason that we didn't cut defense spending just as the economic crisis hit. It's the reason that the Defense Department got $7 billion of the stimulus money.

And, you know, a lot of money even for the war has been stimulative in the United States, because a lot of the 25 percent of the -- the money for the wars in Iraq and Afghanistan has actually gone equipment off factory lines in the U.S. But that's not the point.

The question is whether you could use that money to do something that's more productive in the United States. And when I look at the $230 billion that we've spent over the past decade on equipment in the name of the wars in Iraq and Afghanistan, and I think about the number of roads we could've repaired, bridges we could have rebuilt, dams we could've taken care for that amount of money, it's -- it just seems like a -- a tragedy to have spent that money on equipment instead.

COLLENDER: You know, I should mention because those of you were here this morning, Martin Feldstein had an op-ed -- I think it was the Wall Street Journal probably back in January -- saying that the best way to stimulate the economy would be to spend more money on defense. It was an op-ed that I took -- I took my -- my professional career in my own hands by on my blog disagreeing with a Nobel Prize winner.

Oh, well, then he said he says he did. But anyway...

(LAUGHTER)

In any case, David, is this -- let me -- let me put you in a difficult spot, and then I'm going to ask the other two. Secretary Gates announced there's a bunch of changes in the defense budget several months ago. It looks like to preempt what would have otherwise been some -- some of the people proposing changes in the defense budget.

Notice I said "changes," not "reductions," just for everyone's point of view. But he announces eliminating the Central Command in -- in Virginia, eliminating 6,000 jobs, and the entire Virginia congressional delegation basically, including many who are big deficit hawks, went berserk, opposing it, signing letters. Should he have done it differently, as it was your -- is there a public...

WALKER: I think the process matters. The process that you employ in order to try to achieve, you know, these dramatic transformational reforms can make a difference between success and failure. You know, words matter.

You know, you have a situation there where on one hand people know that from a macro standpoint, we've got to make some tough choices. On the other hand, from a micro standpoint, they're trying to protect, you know, jobs in their district.

Ultimately, we're going to have to start making some decisions that are in the collective best interest of all, rather than the narrow interest of a few. And the way -- and how we go about doing that is going to be really key as to what process we employ and put communication strategies.

By the way, there are two key words that -- that we have to keep in mind. They are "opportunity costs." If you spend money in one area, you don't have it to spend another. And the question is -- is it -- what is the best resource allocation to get the best return on investment, given the fact that we have a finite amount of resources?

COLLENDER: Look, I've got to -- David, I don't mean to -- to argue with you, but I have to.

And I'd like to do this by asking the two of you this question.

Even if everything David just said is correct, can you go outside the Beltway and make that argument seriously? Can someone running for reelection, you know, go out there and say, "We've got to talk about opportunity cost and resource allocation?" Is that going to resonate with anybody?

WILLIAMS: Well, you know, it's interesting that in the -- at the beginning of the Obama administration, when Gates wanted to keep his job before he said, "I'm leaving in a few weeks," right, before Secretary Gates announced on the same day that he'd be leaving soon, he actually did work the system before he announced the cuts.

So the cuts that were announced in April of -- of 2009 had all kind of been worked on the inside. They had been worked with the service piece. Even the Army chiefs have agreed, yes, we're going to cut the -- the Future Combat System. He had even worked it with the contractors.

He had worked it with the congressional (inaudible), looked at Joint Forces Command, JFCOM, and said, "You know, this is pretty small compared to the -- the entire $34 billion footprint of work, of military work that's done in

Virginia." So he may not have thought it was as big a deal as it was to say we're getting rid of JFCOM.

That said, the whole idea that we would deliberately and knowingly structure our defense and the jobs program and still call it a national defense interest is kind of laughable.

COLLENDER: You don't think it was done intentionally? Or unintentionally...

WILLIAMS: That he intentionally tried to catch them by surprise? COLLENDER: No, no. I mean the jobs program aspect of it, that the Pentagon hasn't had a strategy for years of spreading the dollars around.

WILLIAMS: Oh, absolutely. I -- I absolutely do. But I think what Carl and Dave are both saying -- are both saying is crucial here. We're in a different world from the one we were in. We don't have that money to throw around in the way that we used to.

COLLENDER: Carl?

CONETTA: You know, I think this is not an argument for going to win by November 4th, and...

COLLENDER: Of this year?

CONETTA: Of this year.

COLLENDER: OK.

CONETTA: And November 4th is the -- is the date that most people who are out...

COLLENDER: The 2nd, right?

CONETTA: The 2nd.

COLLENDER: Thank you.

CONETTA: Who...

COLLENDER: November 4th was two years ago.

CONETTA: But that's the date that -- that our politicians have on -- have in their minds as -- as they're going out there. So I -- I think we need a longer view, and -- and we'll need some courage and some time, but sure people can hear this.

I mean, look, fear springs eternal, and we are always going to get that initial response. It may have nothing to do with -- with security problems in the world. I know where my fears come from. I have a variable rate mortgage.

(LAUGHTER)

And -- and, you know, I...

COLLENDER: That was this morning's panel, sorry.

CONETTA: But -- but the point here is that people, I think, also show a good deal of common sense. You see that in people's questioning of the wars. They don't see the wars or the idea of extending the wars into Pakistan as necessarily the best answer to dealing with terrorism or to dealing with Pakistani nuclear weapons.

So what we need to do is appeal to that common sense that does exist and recognize that it's going to take time. It means that we are going to have to put up with a little bit of pain in the meantime. In other words, we are going to have to go into that withering storm of initial criticism.

Another thing I think people understand is that we are now in the process, because of deficit reduction, we're in a process of allocating pay. That's what these processes about. The idea that every area of government should take some sort of proportionate step back I think it's broadly understood.

And for, you know, what is proportionate? Well, we might begin with the idea that -- that national defense grabs about 20 percent of overall federal expenditures and about 50 percent of discretionary expenditures, and it's gone up over the past -- over the past decade.

People can hear that. And people will want to hear that DOD is making some effort. That's one of the reasons that Secretary Gates went out with -- with these initiatives, which, by the way, do not save a single penny. They -- they offer absolutely no deficit reduction whatsoever. That is the secretary's attempts to pull the Pentagon into the budget that everybody else is trying to reduce.

COLLENDER: For those of you who are wondering, we didn't just unplug David. We're trying to get him back.

Let me -- you just said something very interesting, which I want to ask both of you. There seems to be a split within the Republican Party. There are some -- some members like a Tom Coburn, for example, a Judd Gregg, who are saying, you know, "Defense has got to be part of the equation." And there are others who say, "No way, no how. We're going to protect it. We're going to defend it." I think I heard Eric Cantor say that on CNBC yesterday.
Is this even remotely doable in the next two years? I mean, if we're going to have narrower Democratic majorities or a narrower Republican majority, the Republican Party itself is split, or seems to be. What are the prospects for actually reevaluating, not even necessarily cutting, but reevaluating how we provide defense to the country?

Anybody?

WILLIAMS: I think the (inaudible) until we're out of the wars. I think as soon as the wars are over, the prospects are great.

CONETTA: Well, we have a problem there, because General Petraeus says...

WALKER: I'm back.

CONETTA: ... that these are -- these are wars...

(LAUGHTER)

COLLENDER: That's -- that's like the voice of God coming down into... (LAUGHTER)

WALKER: Did you say a bad four-letter word, Stan?

COLLENDER: Well, you know, I thought it was something I said, and you hung up on us. I'm going to ask...

WALKER: No, no. I think it was on your end.

COLLENDER: Yes, I'm going to ask you the toughest question than I've asked anybody in a second. Hold on one moment.

CONETTA: General Petraeus has said that we're -- we're in these wars for a generation. This is not something that ends soon. And that does seem to be the inclination on the part of this administration as well as the previous one. So if we're waiting for the wars, then -- then we're in trouble. We've got to think about ways to reduce even on -- even in the case of wars, much as President Nixon did.

We -- we sought reductions in the course of -- of the Vietnam War period. One of the odd things about what's happened in the past 10 years is that the rise in spending, which is about 100 percent in real terms, was comparable to a combination of the Kennedy surge, the Johnson surge, and the Reagan surge.

We did something in the past 10 years that has never been done before. We've decided to embark on a major, ongoing, long-term modernization of our military at the same time that we were going to prosecute wars in multiple theaters. That's unusual.
But there should be in there -- there should be some room for significant reductions. And -- and if the management team can't find it, then it's time to switch out the management team.

COLLENDER: Well, David, I'm going to ask you this, because you haven't been with us for a few minutes, but everyone else feel free to chime in.

When I first got to Washington, we were talking about the Vietnam peace dividend, that as soon as Vietnam ended there'd be all this money to spend on something else. I worked for a member of Congress, who kept proposing a transfer amendment to go from defense to domestic needs.

My question is, given the -- well, given what's going on now, even if the war were to end -- wars were to end tomorrow, would there be much of a peace dividend we could count on?

WALKER: No. I mean, the fact of the matter is you have to keep in mind that the equipment that's over there has got to be replaced, refurbished, repositioned, that there are significant tail costs associated with health care and disability and a variety of other factors.

One of the things that people don't realize is the average annual total compensation for a member of the active-duty military is about two-and-a-half times the median household income in the United States. In addition to that, the Congress has taken a number of steps to increase compensation for -- for Guard and Reserve members, even when they're not called up for active duty. And so we're going to have to make tough choices.

Real quickly, coming back to what you asked before, I think Secretary Gates is right to talk in general terms about what needs to happen. He's fine to talk about specific things that he proposes for the current year budget. But as far as the very difficult transformational reforms, that needs to be a collaborative process between the executive and the legislative branches, because both are part of the problem and both need to be part of the solution.

WILLIAMS: Stanley, I want to -- I want to disagree with David on that point about the refurbishment of the military. I -- I mentioned that we've already spent $230 billion in the name of war equipment.

Now, a lot of that war equipment was -- was not -- was not aimed at fixing things that broke during the wars. It was aimed at getting the Guard equipment that it never had before. It was aimed at getting the Army trucks that they've been complaining they didn't have for decades.

When you think about the fact that the total value of equipment in Iraq is something like -- was something like $30 billion, $230 billion of replacement cost is pretty damn high, especially when you consider that very little equipment was actually blown up in either Iraq or Afghanistan. Very little of the Army's or the Marine Corps' major equipment was actually damaged to the point where it couldn't be used again.

So people who look at this has started to think that the military may be in much better shape in terms of equipment has resulted whose wars, coming out of the wars, than it was going in.

CONETTA: I think as...

WALKER: I think the...

COLLENDER: Go ahead, David.

WALKER: Pardon me. I think there's truth to that, but don't -- don't deceive yourself, you know. There is a cost associated with repositioning. There is a cost associated with refurbishment. The op tempo over there, even if it's not destroyed, is -- is very debilitating on equipment. I'm talking about commanders that are on the ground and troops that are on the ground.

And so, yes, in the aggregate we are in a better position. I'm just saying there's a cost associated with repositioning and the refurbishment.

WILLIAMS: Right. Repositioning is one thing, but refurbishing is another, because we've been keeping up with the refurbishment. And in fact, for several years in a row we were -- we were forward funding the refurbishment two years ahead at least of when we expected to need that money. So we're actually in very good shape in terms of refurbishment.

Now, in terms of bringing equipment home, there are a lot of people who think that equipment will never come home. For one thing, the Marines, if you ask anybody, they really hate the MRAPs. They don't really -- they don't really want to bring them home. So if you leave all the MRAPs in Iraq and Afghanistan, they're going to be just as happy about it.

And generally, we have been for -- for major items -- items of equipment, we've moved them forward and left them there. And there is not -- there -- there may not be plans to bring it all home.

COLLENDER: Carl, I'm going to give you the last word on this. Then we're going to move on to the final statements.

CONETTA: Well, apart from decommissioning portions of -- of the service, it's very -- it's very difficult to get savings that -- that was immediately approved, whether we're talking about pulling back from the wars or we're talking at least. So there's no -- there's no quick way to savings, I think, apart from saying that you're going to reduce the size of the military pretty significantly and immediately. You have personnel savings.

And I think that a relevant point there is with regard to the future, we've increased our military now to the point of 1.5 million, so in order to deal with the wars, and so the nation is still divided on the wars, I don't hear much opinion that says, "Well, those were good things. They really work very well. Let's think about doing that again and again in the future."

If in fact we are not looking to do that in the future, there's a good reason to roll back the increase in the Army and the Marine Corps that's accompanied these wars. And that will provide you some immediate savings.

COLLENDER: We're coming very close to the end. First of all, those of you who e-mailed me questions, thank you. We tried to get some of them out.

I'm going to ask each of you to make one kind of real quick closing statement. During this time, please feel free to give a commercial for latest research or something else like that that you'd like everyone to go to.

David, I'm going to start with you. I would be remiss in my hosting duties. Could you tell everyone quickly what hearing your new gig is and what you're going to be doing for a while?

WALKER: I'm starting a new not-for-profit called the Comeback America Initiative that will focus on the issues that are outlined in my book by the same title, "Comeback America," the need for policy, operational and political reforms in order to be able to put the country on a more prudent unsustainable path. I'll be involved in more issues, and I'll be a lot more specific about what we need to do, which I think is necessary at this time.

COLLENDER: If the book available on Amazon or iBooks?

WALKER: Yes, it is.

COLLENDER: Oh, good.

WALKER: The updated paperback came out last Tuesday.

COLLENDER: All right. Well, thank you.

Cindy?

WILLIAMS: I want to talk about something that a lot of people think just has to go up in the -- in military spending, and that's the bit of military spending called operation and maintenance. This pays for -- for training, for administration and for upkeep of military equipment and upkeep of buildings.

There's -- there's a thought in town now that because it's gone up by 2.5 percent a year per person in the military over decades, it just has to keep rising. And the thought I want to these people with is that in fact every time it went up, there was a policy reason behind that. And those policy reasons, yes, they're baked in the cake. But making it rise some more takes new policy reasons.

And we can make the policy choices that say no, we're not going to do that anymore. It's not a law of physics that this category of the budget has to go up every year.

COLLENDER: Carl, last word?

CONETTA: You know, I mentioned earlier Admiral Mullen and his statement that -- that we've got to think of the debt as a -- as a form of a -- of a threat to national security. But I need to also say that he subsequently made clear that though he supports deficit reduction, not for the Armed Forces.

And in -- in his recent discussion at a -- at a breakfast for the Christian Science Monitor down here, but what he essentially said was that unless we deal with this deficit problem, the pressure on the Pentagon will continue endlessly. We've got to bring that to an end. So he's still in the camp of -- of the Pentagon is sacrosanct.

Look, we have made a wager with the world these past 10 or 15 years about what type of power is most important to the evolution of this country, what is going to be most determine and determinant in the world in terms of the world's future major powers.

We say its military power. Others say, among them China, that its economic power. I think we're wrong. They're right.

COLLENDER: OK.

First of all, thank you all for sticking with us this afternoon.

David, thank you for joining us from Boston.

WALKER: (Inaudible).

COLLENDER: Cindy? Carl?

(APPLAUSE)

COLLENDER: And we're now going to turn to something just slightly less controversial, health care.

(LAUGHTER)

(UNKNOWN): Actually, we're going to do better than that. We're going to take our break now rather than after that session, so we'll reconvene at 2:45. Thank you.

END

Panel 7:
The Long-Term Challenge:
Next Steps for Healthcare Reform

2:30 pm – 3:15 pm

Moderated by:
Robert Kuttner, *The American Prospect*

Panelists:
Karen Davis, Commonwealth Fund
Maggie Mahar, TCF Fellow
Bill Hoagland, CIGNA

[*] (UNKNOWN): Start on our health care panel. Unlike a lot of the other topics we've been talking about today, where we've been talking about how frustrating the political process is and nothing can seem to happen that would address the problems we're facing, in this context we're talking about an environment in which something very significant has just happened.

And we're going to try to understand what its impact may be going forward and thinking about longer term reform in the process.

So I turn it back over to Bob Kuttner.

KUTTNER: Mike's not on. Mike is on now. Welcome back to the second panel on social insurance. You heard at the economists' panel this morning, it's not the Recovery Act spending -- it's Medicare. And you heard it at the Social Security panel, the problem isn't Social Security -- it's Medicare.

So I guess this is the slash-and-burn panel, or maybe it's not. And we have Karen Davis of the Commonwealth Fund and Maggie Mahar of Century and Bill Hoagland of CIGNA.

So to begin, let me ask you this: How much of the higher inflation rate in Medicare and Medicaid is a function of defects in Medicare and Medicaid per se and how much of it is a function of the fact that they are anchored in a larger health care system?

Karen, do you want to start?

DAVIS: Well, the problem isn't Medicare. The problem is the health care system and costs that are rising across the board, not just in Medicare. In fact, Medicare spending per beneficiary has gone up more slowly than private spending per person for the same set of benefits over the last couple of decades.

You know there are some things that are unique to Medicare. Certainly the aging of the American population, the baby boom generation retirement will put a strain on Medicare. Certainly the fact that we're a country that pays for the elderly out of public dollars and -- and insure the healthy working population out of private insurance means that the share of public spending will go up when the population ages.

And, furthermore, the financing for Medicare through a payroll tax for the hospital will be under strain when the number of retirees goes up faster than the number of workers.

KUTTNER: But it's -- but it's not something administrative about...

DAVIS: That's right. It's not the design of Medicare itself.

KUTTNER: Someone else want to take a shot at that?

MAHAR: Yes, I would say there's nothing unique about Medicare that creates health care inflation. And if you go back over many years and you look at inflation of health care spending in the private sector and under Medicare, you'll find there were periods of time when Medicare did better at reining in costs, periods of time when the private sector did better, mainly under managed care in the second half of the '90s.

The problem is they were rationing care. They were denying effective care as well ineffective care. And so you had an enormous backlash. That didn't work. But the real problem is systemic.

The real problem is we're the only country in the world that has chosen to make health care a largely unregulated, for-profit enterprise. And that's a very expensive way to deliver health care.

KUTTNER: That is a tee up to the private sector.

(LAUGHTER)

(UNKNOWN): That was your lead.

KUTTNER: Defend yourself.

HOAGLAND: I would say some of my -- first of all, thank you for inviting me. I guess I feel a little bit out of place here, but -- but I want to reiterate what Karen said. The issue is not Medicare. The issue is health care spending, period, overall.
Also, I would say from my perspective I really am more of a budgeteer -- have been a budgeteer than a health care

person 'til recently, jumping out of the frying pan into the fire. And I thought balancing the budget was tough. This health care stuff is really tough from a public policy perspective as we're going through this last two years.

But my perspective on this is that -- that I guess I have to say that there's two clear driving factors to the cost of Medicare -- it's demographics, let's be honest about it. I am of the post-war baby boom. I want -- I want -- I'm a child of the '60s. I'm in it. I want to live forever. I want knee replacements, hip replacements. I want -- I want to live forever.

Demographics aren't going to work that way. None of us are going to get out of this world alive. So we're going to see the increasing costs such as that.

The other thing I think is that it's not -- Medicare -- it's hard to say that Medicare contributes to rising health care costs as much as it might be a victim of rising health care costs.

And so I want to disagree slightly, I guess, with -- with the statement that Medicare isn't a contributor. Medicare is antiquated in terms of its design from my perspective. Think about we want -- I think one of the directions we have to go with health care reform is increased consumer involvement. They have to know more about what they're spending.

When you have copayments, deductibles in the Medicare program that then turn around and 90 percent are covered by outside supplemental coverage, there is no coverage -- there's no individual involvement when you have those kind of supplemental coverages, and that's antiquated.

I think the fee-for-service system is -- is really drives the amount of cost in the terms of -- you know, in terms of providing services as opposed to providing quality.

So I think there -- I don't think it's fair to say that Medicare isn't a contributor to the problems we have in the overall health care. It's not the only factor, but it is a factor. And -- well, I'll stop there.

KUTTNER: Single-payer advocates will cite the statistic that the average OECD country spends whatever it is, 9 percent or 10 percent of GDP, they cover everybody, they have better morbidity and mortality statistics -- you know the argument -- than we do.

And there seem to be -- even though the market is supposed to be more efficient when it comes to a social good like health care, there seem to efficiencies that are created when there's a universal system that -- that save money at whole orders of magnitude.

And most of these countries actually have worse demographics than we do and they have the same technology. Maybe they're a shade behind.
So the only convincing rejoinder I've heard to that is that they ration, and that's kind of an empirical question.

So I guess the big issue, for me, anyway, is are there little incremental steps that we can take, given our present system, to make it more inefficient, squeeze out costs, or is there a bigger step that we need to take that involves a real public option?

DAVIS: Well, I think you're right. The U.S. does spend twice per capita of what other countries spend. And that's true not just in the single-payer countries, like the U.K. or Canada, but it's true of those that rely mostly on private insurance, like the Netherlands or Germany or Switzerland...

KUTTNER: I meant universal. I didn't mean single-payer.

DAVIS: Well, universal. So what do they do and what could be take away from that without adopting their system, but really staying with a unique American system? And what's realistic given where we start from?

First of all, there is less reliance on fee for service. Specialists are more likely to be salaried, working in a hospital setting. Here we're talking about accountable care organizations that would include specialists and primary care physicians, many of whom would be salaried in those organizations.

Second, they put a lot more investment on primary care. So they reward primary care physicians, make it attractive for physicians to practice. And they deal with things early on before they get to be high cost. Also, in recent years they far outpaced us in the adoption of information technology.

KUTTNER: Really?

DAVIS: And many of these countries also have a system of systematically looking at the effectiveness of drugs and medical procedures and they use techniques, like in Denmark, of what we would call reference pricing but they pay the lowest price for drugs that's equally effective.

And the physician when they prescribe electronically knows what the lowest priced drug is and it drives the market toward a better value for what's spent on health care.

KUTTNER: Why do you think there's so much cognitive dissonance in this country, where people are capable of saying in the same sentence, "I'm opposed to government health care and don't you dare touch my Medicare"?

Maggie, do you want to (inaudible) on that?

MAHAR: I think people like Medicare because it's been a more stable program. Your insurance may change, what it cuts, covers, the copays. Medicare has tended to stay the same. People like that.

And everyone gets it, and they've paid for before through payroll. Though I would say also in recent years, copays and deductibles under Medicare have gotten higher and higher. Average household income, median, for seniors is

$20,000. Half of them have less than $20,000, all income. We're talking all income from any source.

Increasingly, they can't afford to use their Medicare. So when we talk about more copays and deductibles, I have to say I disagree. Medicare seniors already have too much skin in the game.

Our system, whether it's in the private sector or under Medicare, is so much more expensive for a couple of reasons.

First of all, it's totally uncoordinated. We've run health care as a cottage industry, with a doctor here, two doctors there, three doctors there, and they don't talk to each other.

health care is much better coordinated in other countries where many doctors work on salary for one institution. And we see in this country, that creates more efficient, better care -- places like Mayo, Geisinger, Intermountain. The other thing is that it's not so much that other countries ration care, we over treat. The number of surgeries in the U.S. has gone like this in the last 10 years. No evidence that we're any healthier.

No better results in treating heart disease over the last eight or nine years as a result of this incredible escalation in surgeries. The same thing with testing, same thing with procedures.

So we're doing more to patients and, as you said, we pay more for everything. So that combination of increased volume and higher prices means our health care system's more expensive.

And because we run as laissez-faire system, no government interference to speak of in terms of pricing, when someone decides to put a price on a drug or a device, or hospitals decide to charge something, there is no one on the other side of the table pushing back. There is no one representing the patient. There is just the price maker, and then we're all price takers.

And consumers aren't really in a position to bring down prices. They don't have the leverage.

KUTTNER: Let me bring Bill in on this, because this is something I've never really understood. Presumably, the insurer has an interest in not being soaked by the hospital, by the provider, by the drug company. And yet at the end of the day even insurance companies that have a lot of market power are in the position of price takers. Or is that wrong?

HOAGLAND: I think that's right. But let me -- let me go back just one -- I want to say something about payments in terms of the supplements. Ninety percent of the beneficiaries of Medicare out there today have a supplemental program either through Medicaid, through their employer retirement program or individually purchased.

So there is -- that's my issue about the copayments and deductibles, that it's basically being covered -- 90 percent are being covered. (Inaudible).

I also want to say that it just seems to me, Bob, that -- that the -- that we're overlooking one -- we'll get the fact out here, I'm sure, certain, at some point here but that 50 percent -- 43 percent of Medicare expenditures, costs, are spent on 5 percent of the population? That's -- that's overwhelming to me. And I think it's something like two-thirds over -- for 25 percent of the population.

It says something about something that's very difficult to deal with. I've gone through this -- we'll all go through this -- with an elderly parent that's passed away. The end of life expenditures are -- are -- we all want our loved ones to live forever. But it is extremely expensive.

And it's something that's not just political or economic, it's social-psychological: How do we deal with end of life because that's what's -- to me, that's what's driving the real cost of Medicare overall.

Then also I want to make the observation that in the private sector, I agree, we don't know what the prices are. Within this zip code here, I can go onto -- at least on CIGNA's website, I can go on there and show you that an MRI ranges from $1,500 to $500.

The very ability out there is astonishing in terms of the cost of some of these services that are being provided. Some -- and we take that into consideration in our recommendations in moving forward.

So I guess I'm not so certain that the market doesn't work when the information is there for the -- for the consumer to -- to examine.

MAHAR: Two things: On end-of-life care, 25 percent of Medicare dollars are spent in the final year of life. About 50 percent of Medicare dollars are spent on 10 chronic diseases -- where the spending goes is the chronic diseases.

When you get to end-of-life care, you have to realize that you're talking about somebody who's in the hospital and very sick. Not all those people will die. Some of them will walk away and spend 10 more years very happily with their grandchildren.

So how do you say well, we don't want to spend too much on this person because two years from now we'll know that he was one of the ones who died. But we don't know that now. So the sickest people in the hospital are all -- are likely to get the most care.

In the few cases of cancer, we usually know that someone's going to die in three months, six months, et cetera. Congestive heart failure, all of the other things that kill us, very hard to predict when and if the person's going to die.

The best thing we can do is offer them palliative care, hospice care, which we know is less expensive than more aggressive care and lengthens their lives. So that -- that -- and in terms of what the consumer can do, the problem for the consumer is this: Most of our money is spent when we're very sick. If I'm very sick, I cannot say I'm going to wait until prices come down to buy a cancer drug. OK?

So unlike the price of a thin-screen TV, the price never comes down for medical technology.

Secondly, if I'm very sick, I don't want to bargain hunt. If you tell me you're going to have heart surgery and I know of a hospital where you can get it for 20 percent less, I will run screaming in the other direction. I'll say, what are they using, residents, older doctors who aren't quite there every day? What are we saying?

So obviously, there's a -- patients who are very sick are not bargain hunters. And that's how they're different from other consumers, and that's why they can't bring prices down and lift quality. That's why in other countries the government plays that role.

KUTTNER: Speaking of the government, let me -- let me ask a question of our other two panelists: A lot of people who care about the deficit are putting a lot of faith in the recently enacted health reform bill in the hope that it will bend the cost curve, reduce the rate of increase in medical care costs.

To me, this is still something of a black box. How much faith should we place in this? What's the best case, what's the worst case?

Karen?

DAVIS: Well, I do think there are some important game changers in health reform. First of all, covering everybody's important both because having uninsured leads to inefficiencies in the system, but more importantly, you can't really squeeze down on health care costs when you have uninsured or they'll just stop taking care of the -- the uninsured.

I think the insurance exchanges which will have much more transparency on prices and on benefits will help bring down health insurance premiums.

More importantly, I think the innovation center that the Center for Medicare and Medicaid Services will establish to do rapid testing of new ways of paying, moving away from fee-for-service payment, moving to things like accountable care organizations and medical homes, and bundling together the hospital and the post-hospital into a single price will -- will be very helpful in getting us away from a lot of the problems with fee-for-service.

And then, finally, the legislation does establish an Independent Payment Advisory Board. And in the first decade, it really requires productivity improvements in the hospital and the other sectors by limiting their increases every year, reducing them by about 1 percent, but then charging this Independent Payment Advisory Board with hitting an expenditure target under Medicare.

My own estimates with David Cutler at Harvard estimate that total health spending will slow down by a little over a half a percentage point a year, maybe 1 percentage point a year if many of these innovations work. We ought to be aiming for 1.5, so we need to be looking ahead to -- to other things that need to be done.

In terms of Medicare, the Congressional Budget Office estimates that Medicare spending will slow by over 1.5 percentage points a year. And David Cutler and I did estimate us closer to 2 percentage points a year. But real savings built into the -- the Medicare program in the legislation.

KUTTNER: So with your and I'll -- one second, just one quick follow-up. With your estimates, do we get the rate of health care inflation down to the general rate of inflation, or is it still trending above it?

DAVIS: It's still above. CPI is still above GDP growth. If we're at 17 percent of the gross domestic product now, we're still going to be at 19 percent by 2019. Now that's better than the 21 percent we were projected to go without -- without health reform. Health insurance premiums will probably be about $2,000 less per family in 2019 than they would've been, but that's still $21,000. So it's -- it's still going to be very expensive just because of these underlying trends.

KUTTNER: Bill?

HOAGLAND: I think every estimate that was put out on the costs, whether it was done by the Congressional Budget Office or by the actuaries, always had that phrase, "subject to considerable uncertainty." And I think all of these numbers are very subject to a lot of uncertainty.

Things like Social Security, quite frankly, are easier to estimate than Medicare to -- given the nature of it. But if you believe that which we -- which Congress was looking at when they voted on this bill, it's supposed to reduce the federal deficit $124 billion.

I want to make one clear point: If I was back up on the Hill, yes, it's one thing to reduce the federal spending. It's another thing to reduce overall health care spending, because if there is a maximization of a profit motive or a individual's income motive, reducing Medicare reimbursements sometimes gets shifted out into the private sector and shows up in the rest of our premiums.

But I do want to say that when I look at the numbers, there's an awful lot of questionable savings.

You mentioned, I believe, Karen, that we would have a restriction on the reimbursement rates for Medicare subject to increased productivity. That is -- that would mean that the health care system which is very inefficient today is somehow going to become very productive comparable to the rest of the economy.

The CLASS Act -- I'll get into trouble here, I'm sure, but the CLASS Act is a budget gimmick in terms of that 10 year window with $70 billion in savings up front. Most of the deficit reduction in this bill, almost 96 percent of it, occurs before the year 2016. It's in -- in the out years and, quite frankly, there is no deficit reduction from this.

People talk about the 124 over 10 years. Look at it on a year- by-year basis. Deficit reduction goes away in this bill. I think we still have some major issues here.

I'm not going to deny that there aren't some good things in this bill -- comparative effectiveness, some of the issues -- the IPAD (ph) or IDAD (ph), or however you call it, is -- is possible; it's possible.

What's left out of this is the reimbursement rates for docs that'll be cut by 21 percent in November. That isn't even in any of these numbers.

I think we still have some serious problems on the federal spending side associated with this legislation.

MAHAR: Let me say first, to address your last point, the 21 percent cut for docs has nothing to do with health care reform legislation. It was not part of that legislation. It was passed in the late '90s.

It's a formula tied to GDP. GDP growth was much faster then. No one thought they would ever have to implement the SGR at this level, and it will never happen. Year after year, Congress has said no, we're not going to do this.

Conservatives who want to fear-monger will keep bringing it up. That's why they refused to repeal it.

Going on, what's radical about the health reform legislation -- really radical -- is that Congress has handed over a huge amount of power to HHS and Medicare.

Up until now, it was very hard to cut Medicare spending because whenever you cut waste, you were cutting into someone else's income stream. And there would be lobbyists who would go to congressmen and say, "No, no, no, we can't do this."

So, for instance, in the '90s, they had a very good pilot project that reduced spending on bypass operations by a great deal and also outcomes were better. They were packaging the -- the payments to doctors and hospitals.

Congress stopped that. They said, "No, we can't roll this out. We understand that Medicare thinks it's very successful but no, we're not going to do this."

They had another pilot project under Medicare where they required competitive bidding for durable medical equipment -- not surprisingly -- to save money -- Congress said, "No, you know, the equipment makers don't like this. We'll do it 8 years from now."

Under the new legislation, if Medicare has a successful pilot project, they can roll it out nationwide without asking permission from anyone. And Don Berwick, I assure you, will do that.

Also, under the legislation, the Independent Medicare Payment Advisory Board is charged, as you said, with making recommendations to rein in spending in any year that Medicare spending is more than about 1 percent ahead of CPI. At that point, the board has to make recommendations to rein in spending.

Congress cannot block those recommendations unless it comes up with ways to save an equal amount in Medicare without raising taxes, cutting benefits, raising copays and deductibles. OK?

Congress probably won't do that. That means the IPAB recommendations will automatically go into effect. Congress has tied its own hands so it can't interfere.

Some wise people in Congress understand that their meddling -- meddling by lobbyists really -- has kept us from saving -- reining in Medicare spending.

Finally, private insurers -- and I have this from pretty good sources -- private insurers have said, "If Medicare leads the way in cutting spending, we will follow. We want political cover. We never want to be on the 9:00 o'clock news, as we were in 1999, held responsible for this mother of three dying." OK?

But if Medicare says, "We're not going to cover X. We're going to cut fees on Y," the secretary of the HHS under the legislation has the power to cut fees for overvalued services and to raise fees for undervalued services without needing permission from anyone. Congress can't get in her way.

This is radical. This is incredible. This is buried in the legislation. It's not something that people have written about or talked about.

Final thing is, many doctors in this country understand that they're not going to be making as much 10 years from now. Many, many doctors, particularly younger ones, are very happy to go on salary, work for a larger organization where they have a lot more support.

This won't happen in the Northeast. This will happen in the rest of the country. Manhattan will be the last place where you see health care reform. But in the rest of the country, for people in Iowa, Minnesota and other places, they're going to have coordinated care provided by doctors working together on salary for larger institutions.

That's going to save us a fortune. It's very hard to say how much, because we have no way of knowing which of these projects are going to work and where. They'll work some places, not others.

Because we're doing things unprecedented, you can't score them. All you can say is, some of them we know will save money. To say none of them will save money is just to be a complete nihilist. You have to think some of them will work, some of them will save money. We can't estimate exactly how much, but the trend is definitely going toward saving -- throughout the system not just under Medicare but in the private system as well. We don't have a choice.

KUTTNER: Now suppose the Republicans pick up one house of Congress and their platform is to undo this entire reform. Presumably, they can't -- they can mess with the funding, right -- but they can't undo the entire reform without passing a bill that President Obama signs.

So someone, please, walk us through the ways in which this hopeful scenario that Maggie just laid out could be undone by political opposition.

HOAGLAND: I would -- I would -- I would start by saying that nobody knows what's going to happen. Overnight is a long time in a -- in a political cycle. But let's assume one of the houses changes. Let's assume the pundits are correct and the House of Representatives changes. I think that then we're looking at two years of stalemate, to be quite frankly with you. Very little will happen. However, that because -- if the Republicans take back control of the United States House of Representatives because they have the Pledge for America, or whatever it is, out there, they are on record of repealing this.

If they were to repeal, it will never make it through the United States House -- Senate. And even if it did make it to the United States Senate, it would be vetoed.

What I would expect is more of a targeted approach to modifying certain provisions in it, beginning with -- and you've highlighted one of them right off the front, remember that no monies shall be appropriated but a consequence of law. That originates in the House of Representatives so the Appropriation Committee would be the one with the first shot at it.

Before we even get to the Appropriation Committee, recall that if this is a switch, the chairman of the House Budget Committee will be Mr. Paul Ryan. Mr. Paul Ryan will be the first one to put together a budget for fiscal year 2012, and then that will have his, I presume his, most of his proposals to put into place some form of capitation on the Medicare program to roll back a number of the subsidies that are in this particular bill particularly the subsidies going up to 400 percent of poverty, modifications of the appropriations which would put the discretionary limitations on it.

Whether his budget then would make it through the United States Senate, I don't know, or even if there was a compromise.

But at the end of the day, the real -- it'll be -- it'll be a frustrating two years, and it'll be focused primarily on appropriations. But on appropriations, you can put on appropriation bills changes to substantive law to come in and adjust some of the provisions that are in the underlying legislation.

KUTTNER: Let me ask -- I mean, it seems to me that you can paint a picture -- if we can ever get a recovery going where debt-to-GDP stabilizes. CBO actually, using some fairly, to me anyway, overly optimistic projections about how quickly recovery is going to come, projects fairly level ratio of debt-to-GDP.

But the thing that knocks that into a cocked hat is a relentless increase in -- in Medicare costs. And I guess it seems to me anyway that we're either headed for more drastic reform on the cost side or we're headed for voucherization.

And the only way, short of even deeper efficiencies that we've been talking about, that you can cap it, is to literally cap it. And the way you literally cap it is to -- is to do a voucher.

What would be the pros and the cons of a voucher, turning Medicare to a voucher?

DAVIS: I think the main con is that it just shifts the cost to the beneficiary, shifts 100 percent of the financial risk of rising costs to the beneficiary.

Bill suggested that one of the proposals that might come out of a House Budget Committee would be capping Medicare, and that is what's called premium support, turning it into a voucher, saying Medicare now costs $10,000 a beneficiary. We're going pay $10,000, we're going to freeze at that or increase at 1 percent a year. If costs go up 5 percent, 10 percent, that's the beneficiary's problem.

So I think shifting the cost to the beneficiaries with low incomes and with high expenses, it's not going to work.

I would like to set the record straight about Medicare's benefits. Medicare's benefits are less generous than employer coverage and less generous than plans that'll be offered in the insurance exchange. Medicare covers a little over 60 percent of the expenses of the beneficiary, a typical employer plan over 80 percent, federal employees 84 percent.

The reason Medicare beneficiaries go out and buy a second policy is because it doesn't cover enough of their expenses and the deductibles are too high.

And what the elderly want with fixed incomes are predictable, fixed expenses. So they'd rather pay flat premiums, where they know what they're going to be spending, than be at risk for high out-of- pocket costs.

So I don't think making the beneficiary pay more is the solution. We've really got to do a couple of things. One, I think we have to change the way we pay providers to move toward bundle payments or capitation or global fees.

We know when we paid in the home health program for a flat rate per episode instead of per visit, the visits went down, the care was better planned and better managed. We can do the same thing with hospital and physician services.

And the second thing we have to do is stop paying for things that don't work or stop paying more for things that don't work any better. We have to get beyond this idea of death panels and really look seriously at this hip device versus that hip device. Is it really any better?

And why are we paying three times as much for a colonoscopy from this place instead of from that place?

So what's called reference pricing or linking comparative effectiveness research to what we pay and what we cover is a very important part of this.

And then the third thing, I think we really have to have an intensive period of innovation and really strengthen, not undermine, the powers of this new Independent Payment Advisory Board to deal not just with Medicare but, as we said at the beginning, with the entire health care system, and really go at what we're paying in the private sector as well as the public sector, and have more coherence and harmonization across public and private paying, and, like other countries, really leverage purchasing power to get value for what we spend.

KUTTNER: Now to use a very out-of-fashion word, you're talking about regulation. You're talking about regulating, and you're talking about government or a quasi-governmental entity doing the regulating.

In south Florida, it has become very trendy to set up day surgeries, not to make the system more efficient but to siphon money into the pockets of the surgeons who own the day surgeries, so that the same surgeons who run the day surgeries when they're exhausted, then they go to the hospital and they take on the more difficult cases.

Used to be that that was prohibited by certificate of need regulation, but that was, you know, not pro-market. That was the heavy hand of government. So they -- they abolished that.

So how do we reconcile the kind of thing that you've been talking about, that Maggie's been talking about, that sounds like it will make for much greater efficiency for the kind of anti-government, anti- regulation mood that seems to be so prevalent?

Maggie?

MAHAR: OK. I was at a conference last summer run by Don Berwick and Elliott Fisher and the former director of CMS, whose name I'm blanking on...

DAVIS: Mark McClellan.

MAHAR: McClellan. And what McClellan said is this is the first time in a long time where I've been in a conference in Washington where a lot of people are talking about bringing back certificate of need. And that was McClellan saying that. That's very interesting.

If you look at what the president has done recently, here I'm thinking of the appointment of Elizabeth Warren, just going around Congress. The appointment of Don Berwick, just going around Congress.

Warren has made it very clear that she's going to regulate, that she believes in regulation. This is a radical appointment. I can't think of anyone in a position like that in the administration in the last 20 years? More?

This president will repeal -- I'm sorry -- will veto any attempts to repeal any important part of legislation. Much of the money that's been allocated cannot be undone in the Appropriations Committee. For instance, if you wanted to change the expansion of Medicaid, you'd have to have freestanding new legislation.

Finally, the American public does not want to see Congress debating health care reform next year or the year after. The American public wants to hear Congress talking about three things: jobs, jobs and jobs. If conservatives decide to make health care their issue after they're elected in the fall, they can get -- they can look forward to being thrown out two years later. I'm quite certain of that.

The American public is just very sick of this topic. It's complicated. They don't like reading about it. It's upsetting. And that's not how they want their legislators to be spending their time.

I think you could be right that there'll just be sort of a deadlock in Congress if they decide to make that the issue. But that would really be a pointless thing to do. So one hopes they won't, one hopes they'll focus on the economy and jobs, let reform stand and see how it works.

And we'll have to make -- you know, we're going -- it's going to be a learning process. I think reform will take 10 years. And I'm very optimistic about reform changing health care. But it will take 10 years. You're talking about cultural changes.

Americans tend to think that more is better -- bigger cars, bigger houses, bigger servings, more health care. We have to change that way of thinking, both for doctors and for patients. So this is going to take, you know, time.

But the legislation really lays down a very good opening blueprint for doing that. And I just don't think the conservatives are in a position -- I think they may well have the House, but I don't think they're going to be in a position to undo it. And if the president lets them do that, then he will undone the one major thing that he's been able to do.

So, you know, he might as well just assume he's going to be a one-term president and go ahead with health reform.

KUTTNER: Bill, it -- go ahead, and then I have a question.

HOAGLAND: Maggie said a lot of things that I'd kind of like to respond to a couple of things. Number one is that you can legislate on an appropriation bill. There's some hoops and loops, but you can legislate on an appropriation bill.
Second thing is I hope the American public haven't given up on health care reform, because quite frankly we are the problem. It's not -- I'm -- I'd like to shift back to the current -- the current -- we eat too much, we drink too much, we drive too fast.

It is our cultural changes, if you want to talk about, in terms of our own taking -- we don't exercise enough. We don't -- it's our own health care. It's our responsibility to take care of our body.

And I hope the American public hasn't given up. I applaud the first lady for her focus on child nutrition. It is a critically important for the long -- we're talking about long-term issues here -- it's critical in terms that we change the way we eat and what we eat and how we eat it.

So I hope we haven't given up on that.

KUTTNER: Well isn't it -- this isn't what I was going to ask you, so let me ask you this and also the other question I wanted to ask you.

But isn't it both and -- in other words, if you -- if you shift the focus exclusively to we overeat, we don't exercise, it does tend to take the spotlight off of all the systemic problems that are part of the story too.

And, in that regard, I wonder how sympathetic you or your industry is to the kind of things that we've just been hearing about. Namely, on the one hand, the insurance industry is the victim, along with everybody else, of some of these excessive charges and over- utilizations, because you either have to eat the cost or you have to pass it on to an individual or to a corporation, and that's not good for your industry.

On the other hand, like any private sector industry you get nervous when the government gets involved as a regulator.

So are you friendly, ambivalent, unfriendly to the kind of stuff we've been hearing about?

HOAGLAND: First of all, yes, I've been -- I've been involved now with the regulation since March the 23rd. And, boy, there's been a lot of regulations coming out. And so to suggest we're not -- we are implementing the law. It is the law of the land. We will go forward.

As I think you all realize, the three most common words in that whole piece of legislation is -- it appears 1,045 times -- is "the secretary shall." There is a lot of discretion, and there's going to be a lot more regulations coming. And to some extent that concerns us.

But, no, this is the system. This is the process. It is the law of the land. We will implement it. We will carry it. We'll follow the regulation.

But those regulations, because of the extreme amount of discretion that's available to the secretary -- secretary of labor, secretary of health and human services, secretary of homeland -- secretary of agriculture -- they all have a piece of this, it seems to me that we have to be very careful about how those regulations don't create unintended consequences.

Let me give you the best example I have. And that has to do with the mandate for the employer mandate. I don't think there will be a repeal of this legislation.

But if you look at the polls of the American public out there, they don't like the individual mandate.

I am very fearful that if that were to make it out of the House, just that one provision, I'm not so certain it wouldn't make it out of the Senate. And I'm not so certain what the president would do with just a repeal of the individual mandate.

You repeal the individual mandate, this whole thing falls apart. And it -- and costs explode on us.

So I just simply suggest to you that that issue is going to become a major issue as we go forward to 2014, the legal challenges that are out there that are going on as well as what will happen in terms of the implementation of this.

The other fear that I have is that if you look at it in terms of the requirement that the employers have to provide this -- I'll be hung out by some of my colleagues on the other side of the aisle here by the fact that I would suggest that, if anything, the individual penalty should be one hell of a lot higher than it is in this law -- because what I am fearful of is those people will simply say, the employers will say, "The heck with it. Go on over." And the individual will wait until the house is on fire before they get the insurance.

If they go over to the exchange, qualify for 400 percent, then the cost of this bill is going to go a lot higher than anybody had anticipated. And if we're worried about long-term fiscal sustainability, that is a serious concern.

KUTTNER: A comeback?

MAHAR: If I could just jump in with a more optimistic scenario about how this will play out. I think the more people learn about this, the more they will love it. So covering young adults under parents' health insurance policies...

HOAGLAND: I don't have any problems there.

MAHAR: ... parents love that. Young adults love that.

Requiring coverage of everyone on the same terms whether they have a preexisting condition or not, people are going to love that.
Small business tax credits, once employers sign up for that, they are going to want to keep those. Help with retiree benefits, once they get that they're going to love that. Preventive services. Eliminating the doughnut hole for prescription drugs in Medicare.

I think every year, more and more things roll out with this legislation that, in fact, address fundamental problems in the health system, and it's going to be increasingly popular.

DAVIS: Yes, on the individual mandate, there's no way that President Obama would repeal the individual mandate, because he, like you and I, understands that without it you don't have health care reform. Without the individual mandate, you cannot ask insurers to insure people with preexisting conditions and not charge them a lot more.

That's -- those two things just go together. If you don't want insurers cherry picking, you have to have individual mandate. Here's a side note, when Obama was running against Hillary Clinton, his campaign said that they really didn't want to force an individual mandate. At the time I talked to David Cutler, his adviser, and he said Obama understands we have to have an individual mandate.

His base, many of them young people, did not like the idea, so Obama was essentially waffling on it and saying, well, if it becomes absolutely necessary, but I think people will sign up voluntarily.

What I'm saying is back then the president understood that if you don't want cherry picking, if you want sick people to be insured, you have to have an individual mandate.

Will the penalties have to be higher? Perhaps. Though I'm impressed when I look at the numbers to see that -- the people we want to sign up are young, healthy people. We need them in the pool. When you look at the numbers you find that young, healthy people of median and above median income do have insurance. The people who don't sign up are poorer young people. Under reform, they will get subsidies. There's no reason why they wouldn't sign up.

We have this idea that young people are just cavalier and foolish, and they say, "I don't need the insurance. I'm only 32." That's not the fact. If they have the money, they have health insurance. But if they don't, they don't.

Under reform, they'll have subsidies. They probably will sign up. If they don't, then we'll deal with that at the time and we'll raise the penalties, if we have to. But I don't think there's any way that we're going to lose the individual mandate. And you're absolutely right, that's key.

And also, insurers are coming forward now, and they're doing things. They're cutting administrative costs. Medicare Advantage costs are not going up this coming year. And, ideally, state regulators will make it difficult for insurers to raise premiums.

And then insurers, in turn, will do something they haven't done for 10 years, which is turn on the hospitals in their states and say, "We're not going to pay you twice as much or three times as much because you have a brand name."

And we're going to need more public exposure of what hospitals have been doing. The Boston Globe did a great job in Massachusetts showing that partners were simply putting a gun to the head of insurers. OK?

If enough state regulators push insurers and back them up on exposing hospitals overcharging, which they have been -- hospitals with huge endowments, hospitals that make a profit margin on Medicare, overcharging -- then insurers will be part of the solution, not part of the problem. And I can definitely see that happening.

KUTTNER: Last quick question: To me, my more pessimistic self says this is a series of new regulatory layers on top of a system that is inefficient in its bones. So, looking out 15 years, do you think this is going to work or do you think we are going to be driven to a universal system?

(UNKNOWN): You mean single-payer.

KUTTNER: Well, single-payer or, as Karen corrected me, some other kind of true universal system as opposed to incremental patchwork semi-universal system.

MAHAR: But this is an incremental patchwork. This is, don't you think, moving toward a universal system?

DAVIS: You know, I'm very optimistic that in 15 years we'll look back at this as one of the greatest successes since the...

(CROSSTALK)

KUTTNER: So this -- this gets us to where we need to get to?

DAVIS: ... Civil Rights and Medicare. This is going to lead to universal coverage.

MAHAR: Yes, this is universal coverage. Now what I think we may need and may well add is a public option. And that really depends on how many insurers stay in the business, how many decide there's no way we can make money under these regulations.

But if enough -- I think we -- I think we're going to revisit, let's put it that way, the option, and that could co-exist with private insurers, as it does in Europe. No reason why that couldn't happen.

And that -- that could improve the whole scenario. It's not going to happen in the next two years. It's not going to happen with this Congress we're looking at.

KUTTNER: Bill, last word?
HOAGLAND: I just think 10, 15 years from now you'll have another conference, and we'll still be talking about health care reform.

(LAUGHTER)

KUTTNER: Thank you all.

(APPLAUSE)

END

Panel 8:
The Long-Term Challenge:
Public Investment as a Foundation for Growth
3:30 pm – 4:30 pm

Moderated by:
Stan Collender, Qorvis

Panelists:
John Podesta, Center for American Progress
Robert Puentes, Brookings Institution
Eileen Appelbaum, Center for Economic and Policy Research

[*] (UNKNOWN): We're going to jump right in. We've managed to retain a very high share of our original audience and it's now 3:30, but I want to keep it that way. So we're going to jump right into the -- the final panel.

Tamara started off today's talking about how we wanted look at what kind of country we want to have looking forward into the future, and not being overly bogged down merely looking at the budget situation.

And so this final panel, I think, really gives us a chance to open up our imagination and -- and think broadly about a longer-term vision for the country, and -- and -- and ideas for public investment.

So Stan is back to lead the way.

COLLENDER: Thank you. It's -- it's nice to be back in -- here. I'm going to be here all season. So please come back next week.

Same rules as last time, you've got to remember my e-mail address. By the way, when I announced this before, I understand the staff started groaning big time in the back. They -- they had schooled me for hours: no questions from the audience.

And I -- hell with it, you guys are the ones we're here for. So you can -- you can imagine what I'm going to get screamed at before. So remember my e-mail address, scollender -- C-O-L-L-E-N-D-E-R at Qorvis -- Q-O-R-V-I-S dot-com.

I'll get it on my Blackberry. We'll try to -- we got about 10 of them last time and I tried to answer -- ask as many as I could.

All right, end of the day, thank you for sticking around with us. In many ways this is -- I know you previous panelists may not agree -- the most important panel that -- we could possibly have.

We're talking about public investment. We're talking about it as a way not just to goose-up the economy short term, but how it's a long-term strategy for growth.

And the question I have for everybody, just to begin with, and I'd like you to just -- quick short answer, just like the way we -- I started the last panel is: Isn't public investment everything? I mean, what isn't public investment?

Robert?

PUENTES: Yes, "what isn't" is a good question. I think when we think, particularly when we think about infrastructure, I think that folks have ideas about bricks and mortar, and it's probably right, particularly as it relates to the federal government and how we think about budgeting.

While the federal government invests in transportation, in energy, in environmental protection and water infrastructure, a lot of other stuff is done by other entities around the country -- states, metro areas and the private sector. So it's a -- it's a very big and broad question. But it depends, I think, on which level of government or -- who you're talking about.

COLLENDER: All right. Eileen, what -- what do we mean by bricks and mortar?

APPELBAUM: I -- I'd like to push it a little bit...

COLLENDER: OK.

APPELBAUM: ... particularly, and say that we have in this country a huge private sector that is not about public investment, but that's about investing in opportunities that they see as ability to make a profit for them. And that we have moved very much over the last 30 years in a direction of a laissez-faire economy.

And what we're talking about here, I think, is what are the ways in which we need to either supplement or rein in these private markets. What are the things that they do that are really wasteful, that are not productive, that don't contribute to long-term growth of the economy? But are more in the nature of rent-seeking and of enriching individuals on the one hand.

And on the other hand, there are many things -- the previous panel discussed some of them -- in which the private sector by itself cannot solve the problems. You need a public sector that is willing to set rules, that is willing to make standards, that is willing to create markets that allow the private sector to work its magic and to meet human needs.

COLLENDER: Right. You just said where I wanted to -- wanted you to go was -- at least I was hoping you would. We're talking about investment. Are we talking about human capital as well as bricks, mortar, structural changes, bridges, tunnels, sewers, highways?

PODESTA (?): I think the answer to that is of course. And I think that if you look back historically or look forward where there are really opportunities, you have to have a strategy that uses, I think, public authorities and public dollars to create the conditions for private sector success.

And I think you -- we've seen that in the past. The -- the creation of the conditions for private sector success has been born, you know, with -- with obvious examples like investments in science and technology that have led to important innovations in -- in the country.

But you also, I think, can think about more fundamental investments in both bricks and mortars, in higher education systems that led to great periods of growth, of wage growth, of business development. So I think there's important perspective of trying to invest for the common good that creates the conditions for private both wealth investment and wealth creation.

COLLENDER: Well, what's the problem here then? I mean, why aren't -- I mean, we had a budget with $3.5 trillion, all right.

The way you guys are talking, it includes maybe even missiles, right, as an investment -- investment in human -- you know freedom or something like that.

Why aren't we getting more of the things that you're talking about? What's -- what's the problem?

Eileen?

APPELBAUM: I think that more than infrastructure has deteriorated over the last 30 years. I think that our labor market institutions have also eroded. And that we engaged beginning in 1980 on a giant experiment in laissez-faire capitalism in this country. And that the bursting of the housing bubble, the financial crisis, and the recession has really underscored the fact that an economic model based on inequality, based on these huge differences, based on the -- the kinds of financial markets that we have seen that load companies up with debt and then go forward from there -- you can't survive this kind of a downturn in this kind of a situation.

And that we would do -- in order to be able to plan for the future, in order to be able to build a strong economy, we are going to have to have -- we are going to have to rebuild labor market institutions that make it possible for workers to join unions that provide employment protections and social protections for workers, so that we get back to a situation in which prosperity is shared, wages rise with productivity.
Those are the things that were happening. It was not just the kinds of investment that were going on. But it was the fact that we had institutions and mechanisms that enabled us to share the gains, share the growth more evenly

among the population. And this has really deteriorated and I think will need to be reinstituted, reinvented.

We can look to countries that -- you know, one of the things that's happened is the IMF has pointed out that the U.S. had one of the smallest decreases in GDP compared to the other industrialized countries in this economic crisis. But second only to Spain and Ireland, we've had the largest increase in -- in unemployment among the industrialized countries. And Spain and Ireland, like the U.S., have completely deregulated labor markets.

So I think the message is really clear. Those countries that had the institutions in place were able to take steps. They were able to expand those institutions to prevent the kind of increase in unemployment that we've seen.

The short-term -- short-time working provisions in Germany, for example, this is not like the furloughs in the U.S. This is a situation in which you become unemployed, let's say, one day a week. The unemployment insurance picks up a big chunk of your pay for that day. The employer picks up another chunk, and you take a small hit. So that you don't lose 20 percent of your pay because you're working a four-day week. You lose a very small piece of it.

And the Germans -- this was a small program in Germany, but well developed. They had 100,000 workers in it before the crisis hit. They quickly were able to gear it up to 1.5 million workers.

If we had something like that -- if we had a -- a program that guaranteed workers this partial unemployment through March of 2012 so that they and employers could plan for it, that subsidized the employers because employers had to continue paying the payroll taxes for that fifth day. The government subsidized that to make it possible for everybody.

They geared it up from 100,000 to 1.5 million. That would be equivalent here to us gearing it up to 3.5 million or 4 million. We lost 8.5 million jobs. We could have lost half -- we could have preserved half that number if we had anything like the short-time working program that they had.

And I can give other examples...

(CROSSTALK)

COLLENDER: I've -- I've got a question for you guys, but I want just a quick follow-up for you.

Is that an investment? Is that something you would define as an investment? Is that something you think the average person in the United States would think of as an investment?

APPELBAUM: Well, I'm saying we have to make investments in institutions, as well as in structures. And yes -- does it cost money? Not necessarily.
The point about the short-time working is that except for the small subsidy to the employer, this was -- just came out of the employment insurance system. It didn't raise the cost in Germany above that.

COLLENDER: Right.

Robert, John?

Question -- is there a difference between spending and investment?

PUENTES (?): Yes, absolutely, particularly when it relates to the issue of infrastructure. I think we've thought about it just as spending for so long, when clearly this is -- this is about investing in the things that are going to contribute to economic productivity over the long term. We have this big problem with thinking about infrastructure as a short-term solution, particularly as it relates to the employment crisis, when that's perfectly reasonable. We have to react and we have to figure out how we're going to put people back to work in long- term, stable jobs.

But we don't have to disconnect that from the long-term benefits that we get from infrastructure. And we've kept them apart for too long, and it shouldn't take that -- that much to connect these two things.

So a little bit of thought -- Germany's a great example of a country that's structured an economic plan around the infrastructure needs they needed to make. So they viewed their -- their -- their economic plan through the lens of infrastructure. Not the way that we do in this country, which is to spread it around like peanut butter and to deal with just the short-term problems. We need to take a lesson from some of these other countries.

COLLENDER: Well, how do we change the debate, though, from people thinking of this as government spending, to an investment in their future and the country's future?

PODESTA (?): Well, you know, it's funny. Because I think when you look and ask people whether they support the actual individual investment, the answer is you get high, you know, high support for most of the things that you might think of in the -- particularly in -- in -- in what we were describing as -- as infrastructure basket spending.

So there's -- there's high levels of support, and yet there's overall -- an overall sense that -- at least particularly in -- in -- in the way the press has covered the debate over the last year, that somehow the government's gotten, you know, too large, too big, et cetera.

And I think the way to deal with that is to connect that directly to -- to what the product and the -- and the investment strategy is that's -- that's being pursued at the national level or at the -- at the state and local level.

I know -- I agree with Eileen about what she said about investing in -- in -- in institutions, but I think the one -- one question that it raises in my mind is if you're trying to -- to prove everything is investment, then I think you kind of lose what -- what, you know, people have a hard time understanding what you're talking about.
Whereas if you -- if you're describing specific things that can be done to improve the quality of life for people, the ability to achieve high educational attainment, the ability to get the -- the sort of training that would lead to a good job, the -- the, you know, one of my issues where I think that the United States really needs to make very important

investments is to transform the energy system to go from a highly polluting, fossil-based energy system to one that's built -- built on clean energy. I think those are things that people can grasp. They can understand. They could see. They can sort of touch and feel. And -- and they will support.

COLLENDER: OK. Will they be willing to pay for it?

PODESTA (?): Well I think that...

COLLENDER: I mean, that may not be an answerable question.

PODESTA (?): I think it's -- it's -- it's -- what's happened in the past is people have been willing to pay in terms of -- I'll -- I'll relate that back to my experience in the Clinton administration.

We had a much higher level of -- of revenue as a percentage of GDP. We also had much stronger GDP growth, much stronger wage growth, much stronger job growth. People seemed pretty happy by the -- at the end of the day.

And so will they -- would they be willing to pay, you know, the -- at -- at -- revenue at the level that existed at the end of the 20th century, 1999 -- 1920 -- I figure -- you know, in 2000? I think if people could trade their economic lot today for what they were experiencing 10 years ago, they'd trade it in a heartbeat.

PUENTES: And I think it's back to what John said. You -- you hit it right on the head. When people know what they're getting for their investment, they're willing to pay.

And we've seen this with these ballot referenda that come up before voters in metro areas all across the country every November, where they've approved these things with 70 percent of the vote, 80 percent of the vote. When they know what they're getting for their investment, they're willing to do it.

The problem that we see, particularly here in Washington, look at the federal gasoline tax which we haven't raised in 25 years because of this "just trust us" approach.

Right? If you raise the gas tax, it's going to come into Washington, and then we're going to have these formulas, and you're going to see some benefit somewhere down the line. Folks are not willing to do that for lots of good reasons.

You have a process that's broken. They're not going to support that. But if they know what they're getting, and they know it's going to be sunsetted, they know how it's going to operate -- all that business -- they're willing to do it.

APPELBAUM: This also doesn't all have to come out of personal taxes either. Right? We have lots of opportunities in terms of a financial transaction tax, in terms of other kinds of corporate taxes.

I talked a little while ago about private equity and its loading companies up with debt. Well, why do we allow those interests -- all that interest and all that debt to be tax deductible? We encourage a -- a -- a kind of private sector investment that doesn't really pay off for the economy. So I think we need to think beyond just income taxes when we're thinking about it.

Although I do think that Robert's right, that when people can see what their taxes are paying for, they do not resent paying them.

COLLENDER: Right. Should there be some formula, then, that any project, whether it's education of a child or a bridge to somewhere -- not, it has to be to somewhere.

(LAUGHTER)

Does it have to have a -- a positive -- you know, on economic terms to be justified -- financial terms? I mean, is there a way to quantify the benefit to the country of educating a child from the age of one?

PODESTA (?): That's been done.

COLLENDER: Is it believable? Did anyone -- did the people delivering the information have credibility?

PODESTA (?): Well, I don't know. I mean, I -- I -- I would say that there's a -- a base -- a basic level of social justice that we ought to seek to achieve in this country. And the basic argument about having people have the capacity to live the American dream and seek to -- to -- to be productive citizens, that should be -- should be argued in those terms specifically.

I mean I think of some of the safety net programs. You could argue that -- that they create demand at a time of weak demand. And you know -- and -- and therefore they have some positive impact on stopping GDP from further retracting, et cetera.

But I think mostly the reason people get food stamps is because they're hungry, not because we're calculating what the economic return is on the fact that if we feed people, you know, they'll be more productive, their children will be more productive.

And I think, if you -- if you go too far down the rabbit hole of proving the productivity of each federal dollar, I think you lose sight of the important equity arguments that are -- that are -- that -- that should be made and that we as progressives should make.

COLLENDER: Yes, but I -- I -- just to -- to argue with everybody, to play devil's advocate for a moment, I can remember for years the arguments about the Tennessee Tombigbee Dam, which on a cost-benefit analysis didn't even come close to paying for itself; didn't provide benefits close to what it was going to cost. As I remember it, it was funded. I don't actually remember, but I think.

Is that part of the problem -- that the credibility of those -- you know, deciding the programs is -- is in question here?

APPELBAUM: I -- I think the bigger issue are the extremes of wealth in this country. So you have a situation in which people live in gated communities. They send their children to private camps. They send their children to private schools. They send their children to elite universities. And they don't have the feeling that we're all in this together.

They don't have the feeling that it's important to their community, to their children, that other children are educated, that other children have an opportunity. They don't identify.

I -- I remember a -- a world's fair where U.S. corporations did not necessarily want to be identified as U.S. corporations because they viewed themselves as citizens of the world. Well, what world were they citizens of? It's a world made up of elites just like them, who live in gated communities and send their children to private schools.

So I think the larger issue is if we can do something about the inequality in this country, if we can begin to heal that problem -- but -- Larry, you had a -- a huge graph up at the beginning that showed the -- the fact that we are back to the kinds of wealth and income inequality that we saw before the Depression.

And then we had a bunch of policies, including legislation that made it easier to join unions. We had -- we introduced a minimum wage in the middle of the Depression. Could we talk today about raising the minimum wage in the middle of a recession? It would be impossible.

Until we can address those issues, I don't really see how we can answer your question. It is a moral issue. We have an obligation to everybody's child to make sure that people have a minimum decent standard of living. But we have a group of people who do not have to pay their taxes, who pay -- I mean, Buffett -- Warren Buffett has complained himself about the fact that his taxes are lower than his secretary's. We get -- we -- yet we cannot do anything about taxing carried interest as ordinary income.

Until we address this set of questions, I think the rest of the questions are going to be impossible to deal with.

PODESTA (?): To Eileen's point, when we focused on those things, we actually...

COLLENDER: "We" being?

PODESTA (?): United States.
COLLENDER: OK.

PODESTA (?): When -- when the United States government and the United States democracy and the people in charge of the -- of the democratic institutions of the country focused on those questions and really made important investments for the middle class -- come back to it -- we had stronger GDP growth. We had stronger wage growth. We had stronger job growth. We had better business formation.

So I think this idea that you have to sacrifice strong private sector growth by investing in the public sector is absolutely ass- backwards, to -- to coin a phrase.

COLLENDER: That's the technical term?

PODESTA (?): That's the technical term...

(LAUGHTER)

COLLENDER: OK. I just wanted to make sure.

PODESTA (?): And -- and that the conditions for strong private sector -- sector success have been built around strong public sector investment.

PUENTES (?): Yes, I think that's how we're going to have to think about all these investments in the future. Those old days with their pyramid (ph), with the federal government on top and the states and localities where monies rain down. I think those days are -- are over. I think we're going to have to completely change our ideas of how we make these investments.

It's going to be collaborations with the private sector. It's going to be the federal government taking on certain roles -- the states, the metro areas, localities all doing things that -- that we're supposed to be doing. They're going to have to sort out their roles and it's not going to look like a -- like a layer cake. It's going to be -- what do you call it? -- a marble cake, all kind of mixed together. And it's just -- we have to completely change the way that we think.

We're stuck with these legacy programs. We don't kill anything in Washington. We just limp it along, you know, from year after year. We have to just remake the way that we -- we make these investments. We have to think very differently.

COLLENDER: Actually, that's not a new way of thinking. One of the books I read when I was an undergrad was Morton Grodzins' "The Marble Cake Theory of Government." Right.

PUENTES (?): Sorry...

COLLENDER: And I was an undergrad a long time ago.

Anyway -- all right, so a variety of questions here. Let me just throw out a couple of things.

I know you're answering this, so let me ask you. Energy is an investment, right or wrong? And what type of investment...

PODESTA (?): Moving to -- well, look, I mean, we can have bad investments or good investments.

COLLENDER: OK.

PODESTA (?): Right now, we're having a -- you know, we -- we -- we subsidize production of fossil fuels when we should be transitioning to a clean energy future. I consider that a bad investment -- a bad investment for today and a bad investment for tomorrow, one that threatens our -- you know, one that increases our dependency on foreign oil, one that threatens our security, one that threatens our environment, and one that threatens our economy, one that perpetuates a situation where 50 percent of our trade deficit is not just the result of currency manipulation by the Chinese -- 50 percent as a result of our -- our appetite for imported oil.

And there -- there are things we can do about that. And I think that we've seen some action just last Friday. They raised -- EPA and DOT raised the fuel economy standards for post-2017.

But I think that this is an area I think ripe for the government shaping policy both on the investment side, public dollars, but I think almost as important as setting the ground rules for shaping a market for a new energy economy that will produce high levels of innovation, high levels of scientific discovery, high levels of job creation, business development, as I said, and strong economic growth in the future. And it's time that we get on with that project.

You know, I'm disappointed by what's happened in the Congress this -- this -- this, you know, during the course of the summer. But I think if you look...

COLLENDER: On -- on which issue?

PODESTA (?): (Inaudible).

COLLENDER: OK.

PUENTES (?): But I think that that's a place, again, ripe for essentially shaping of that. Some of that comes through public dollars, through the kinds of innovations that -- that occurred in the -- through production and tax credits, et cetera, that -- that flow to important investments. Some of it, I think, could come on the financing side through the creation of -- of financing facilities to power forward with more investment in -- in clean and green technologies.

And some of it comes through -- through, as I said, market- shaping events -- putting a price on carbon, putting in place a national renewable electricity standard, creating stronger building codes. And-- and -- you know, those are all market-shaping events by the government that would produce high levels of investment and innovation, in my view.

COLLENDER: Is -- is -- does education, early childhood development qualify as an investment?

APPELBAUM: It certainly does. And I -- I -- I would suggest another market. I don't disagree with anything that's been said here. But another area of the economy that I think we have not really given much thought to and it encompasses education, but its broader than that, is what I would refer to as the "care" work economy.

I mean, one of the things that people do not realize is how large and significant a part of employment care work is. Looking to 2018, over the 10-year period to 2018, the Department of Labor estimates that one out of every six jobs in the 30 occupations that will provide the most employment will be in care work. Some of these are professional jobs -- doctors and surgeons is one. R.N.s is another. Elementary school teachers is another.

But the bulk of the job growth is going to be in professional occupations in education and in health care, everything from home health aid and nursing assistant to childcare worker and assistant teacher.

And we have to ask ourselves why we do not have an adequate supply in this country of quality care slots? Why doesn't it exist? Why the private sector hasn't produced it?

And it's not unlike what John has just been saying in the energy field. Government has got to provide the kind of stimulus to the private sector that will bring forth the kinds of things that we -- that we would like to see.

And I -- I think it's -- I think -- focusing on the care work economy is really good for seeing the relationship between training and further education, and the need for other kinds of institutions.

What makes us think that if we give childcare assistants an associate's degree, their earnings are going to rise to middle class earnings? What are the mechanisms that are going to make that possible? I don't see them out there. I think we need to think about that.

The -- so we -- we -- it's really important. This is an area both in healthcare and in education and early care, really important to upgrade the skills and the education and the training of the people who do these jobs.

The payoff in terms of the quality of care, I think, will be enormous. But we -- we are going to have to organize work so that those skills can be utilized. We're going to have to think about how folks are going to get paid, so that -- that there's a reward for these skills.

And -- and I think that this gives us a handle into a number of really serious issues in this country. So much of the poverty, of the working poverty in this country is concentrated among women. And it's concentrated among women who are in these kinds of jobs. So addressing that, addressing the care work economy, thinking about upgrading skills will begin to address that.

A second thing is I think you may not have thought about this, but there's a lot of similarities between care work and construction. And the similarity is that you can train for jobs, for skill jobs in care work through apprenticeship or work-based programs. In New Jersey, we have -- we -- I won't go into the details -- but for reasons that I won't explain here, we've had a huge increase in public expenditure on early care and education, a lot of it privately provided, but public expenditure on it. And we do not want to displace all the people who currently hold those jobs, many of whom are not going to go back to a community college or a university.

And it turns out that the Department of Labor has a well-defined apprenticeship program in early care and education. And that was implemented in New Jersey. You could get your credentials to be a credentialed childcare -- not the teacher, but the associate, either through a -- a community college or through an apprenticeship.

In The Netherlands where quality health care -- access to quality health care is written into the Dutch constitution, and they think about quality health care the way the Germans think about speeding on the Autobahn and Americans think about the right to bear arms. You cannot take this away from them.

And they did -- they also had rising healthcare costs. They went through a major healthcare reform. But as part of that, as a guarantee of the quality of care, they completely revamped the education and training of their healthcare workforce, and it includes quite a few levels that you can achieve through work-based training.

And so nobody is a nursing assistant for life. People move from nursing assistant to LPN to a general R.N. through a work-based training program. Above that, you need -- you do need...

(CROSSTALK)

COLLENDER: Quick follow-up question, I -- I have seen polling results that indicate that the average person in the United States thinks that money spent on education only benefits the person being educated, right.

How do you expand the appreciation for that? So that in -- in any of the investments you're talking about, people understand it's not just the individual being retrained, or trained, or educated, but there's actually a benefit to the community at large?

APPELBAUM: I really think that that's another good reason to begin with the care work economy. I think it's really clear to people, everybody wants their child taken care of by someone who knows something about child development.

Everybody wants their mother, their father, their elderly relative, their frail spouse cared for by somebody who has had some training. In this country, these jobs are considered unskilled. It's -- it's a crime to consider these jobs unskilled and to turn over our youngest, our oldest, and our most vulnerable members of our population to the care of people that we pay next to nothing, require no training or very little training, certainly no general training, and very little in the way of job skills.

I think that most people will understand that if you want to improve the quality of care, that it's important to invest in the education and training. I think that's where to start.

You tell me you're going to spend a lot of money on making sure that a bunch of people get MBAs and go work for finance companies, I want to know what the payoff to that is myself. (LAUGHTER)

COLLENDER: All right, but, again playing devil's advocate, putting up a bridge, people see it. They get to go home a half hour earlier. It's not just the people who put up the bridge. It's those driving across the bridge from one place to another.

I mean, is there -- isn't one of the problems here is that with at least physical capital you can see something?

APPELBAUM: I don't think so. I think working -- working families are squeezed. They're squeezed for time. They are squeezed -- we talk about the sandwich generation. You're squeezed between trying to take care of your kids, trying to take care of your elderly parents.

I think there is almost no one who cannot understand the importance of having high-quality services that take -- that take this burden off of you, that make it possible for you as an active member of the workforce to be able to do your job, to feel that your family is well cared for, and to know that -- that the people you love are in good hands.

I think this is an easy -- an easy conversation to have with the American people.

PUENTES: (inaudible) do see with infrastructure, because you're right, you put up a bridge, people will support that for the reasons you mentioned. You can see it, you can feel it...

COLLENDER: (Inaudible) where it's going.

PUENTES: But fixing it, this is what we have to do now. We have the interstate system, it's 50 years old. We have to rebuild the entire thing, and not a lot of support for doing the maintenance because they don't see how that benefits the same way a new piece of infrastructure does.

COLLENDER: Is -- I have to ask this. I'm a budget guy.

Is maintenance of a -- of a highway or a bridge or a tunnel or sewer an investment or an operating expense?

PUENTES: Depends on -- it differs on the federal, state, local level. It's all different.

COLLENDER: You sound like...

(CROSSTALK)

PUENTES: It should be -- should be an investment. I mean, we have to -- we do have to operate and maintain these systems. But we -- we know that if we don't fix them today, we're just going to have to pay more down the line.

Maintenance doesn't cost. It pays, right. We have to do this in the short-term. And we've just been pushing it off, pushing it off for long. And we see the tragedies in -- in certain places like Minneapolis. And we see the mundane problems right here on the streets outside.

So is something that we have to -- we have to deal with (inaudible).

PODESTA: One way to think about -- and I hadn't thought about that question too much before, but one way to think about it is -- and, you know, we're into proposing expensing for all business investment today, because of the poor state of the economy.

But if you were to think about that from a private sector perspective, and you did long-term maintenance that was going to pay off over a period of time, would you expense that or would you -- or would you view that as something that you had to depreciate.

And I think it'd be the latter in most accounting systems. And the IRS, I think, would -- would treat it that way. If it was going to be useful over a 20-year period, you'd think about it as something that you'd depreciate over some period.

COLLENDER: OK, well, you just got me to exactly where I wanted to go which -- thank you very much by the way.

I've gotten 12 questions. Eleven of them dealt with what I'm about to ask you.

How do we depreciate when the federal budget is on a cash basis and doesn't do depreciation?

PODESTA: Well, you served on the capital budget commission. So you...

(CROSSTALK)

COLLENDER: Actually you're the only one who remembers...
PODESTA: ... I think I'm going to -- I think I'm going to turn that around and ask you to answer the question.

COLLENDER: WE never figured it out.

PODESTA: I think to -- I think that -- I think -- I think it's a -- it's a big battleship to move at the federal level. Very difficult to get it -- you know, it ends up sounding arcane. It's hard to, I think, put in political terms.

And yet, I think, that there -- it's an important way to try to move towards a sounder budgeting strategy. And maybe we can move that way in an incremental fashion.

For example, the proposals to create an infrastructure bank or to create, you know, my pet favorite, the green bank, really begin to put resources in upfront that support capital investments, that revolve back to the benefit of the -- of the -- of the Treasury and then can be reinvested over some period of time.

So I'm skeptical that we can move at the federal level, although I think it would make some sense. I'm skeptical that we can do that in one fell swoop. But I think we can begin to perhaps incrementally move in that direction.

The experience, I suppose, in the housing sector will -- is an impediment to creating traction at the -- at the present moment because of, you know, what I -- you know, I think it's a more complicated story.

But I think the -- there's the political resistance towards creating moral hazard at the federal level through large-scale private investment is strong at this moment because of the -- of the housing bubble and the housing crisis.

But I think we got to move in that direction over time because it's more sensible to think about those kinds of things that do produce returns being valued and budgeted in a way that's going to pay back in the long term.

I think one -- one example, when you were talking to Eileen about education, you know, there was a -- there was a time in which California thought of its investment in the higher education system as really critical to the long-term common purpose and common success of the state.

That's under tremendous pressure. Maybe it's beyond tremendous pressure and it's kind of a broken system in which now we invest more in prisons than we do -- Californians invest more in prisons than they do in higher education. Is that a priority that if you sat back and looked at the overall balance sheets of the -- of the -- of the state of California, you would -- you would think they've got right?

I don't think so. But the annual budgeting process leads you to make, I think, some choices that in the long term end up creating a society that's creating a downward cycle versus a virtuous cycle of upward growth.

COLLENDER: Is the budget -- is the U.S. budget as it's currently constituted make -- doesn't it make investments more difficult?
I mean it seems to be mostly a cash budget -- it is a cash budget, excuse me -- based on operating expenses.

PUENTES: Yes, I mean, as relates to infrastructure, we build things well. We just don't maintain them that well.

And I think the capital budget is exactly right. It's a heavy lift. It's only 2.2 percent of the budget. So it would be a dramatic change.

COLLENDER: But what's only 2 -- what's only 2.2...

PUENTES: The infrastructure investments. That would be part of the capital piece of the budget. COLLENDER: OK, but...

PUENTES: So it's a very small...

COLLENDER: ... but we're talking here that -- that what might be included in a capital budget would be far beyond what we -- what you're -- what you're referring to.

PUENTES: Yes, I suppose so. (inaudible)

(UNKNOWN): You're saying bricks and mortar...

(CROSSTALK)

PUENTES: Which I think that that's how you get to the idea of the infrastructure bank, right, because that's kind of like capital budget light for all the reasons you mentioned. We can -- we choose projects on a merit basis, not spreading it around like pork in politics.

We can invest in those places that matter, metropolitan areas, our economic engine. And we can build in the maintenance and the life cycle costs of this thing over the long term. So we're not just abandoning things after we cut the ribbon in front of them.

COLLENDER: All right. Let me -- let me -- I'm going to play devil's advocate again. But in the current environment, isn't someone going to say, "Ah, capital budget, investment bank, whatever, it's just a way for the government to spend more money without saying it's spending more money," right?

Isn't -- I mean, how do you-- how do you deal with an issue like that?

PODESTA: Well, people say a lot of things.

(LAUGHTER)
You know? I mean, listen to the political debate right now. Eileen mentioned raising the minimum wage in an economic downturn. There are a lot of candidates running around today saying that we ought to get rid of the minimum wage. I think you've got to take that head on. You've got to -- and, you know, argue that that is going to take the country in the wrong direction, and make the case for why those -- those investments are -- are -- are necessary to produce jobs, private sector growth, long-term economic growth for the country and ultimately make -- make -- get us out of the current circumstances we're in, but create a path towards, you know, future success. I think it's just about politics.

If you -- if you accept what the opposition says, you know, particularly the Tea Parties, then, you know, then we'll -- we'll have revenue of 8 percent of GDP and we'll probably invest a lot in the military and do nothing else. And I don't think the country would look very good. And I think if you think of the competitive position of the United States along any dimension, you're ensuring the future diminution of U.S. power and the shrinking of U.S. influence in the world. And ultimately, the economic wellbeing of the American public going down rather than going up.

But you have to believe in that. And you have to argue for it.

PUENTES: And I think we're starting to see things that they could support. I mean, this -- we've seen this administration at the Department of Transportation, the Department of Energy, at HUD, EPA, I mean they're trying to make decisions on investments based on (inaudible).

There's a lot of competitive programs out there, they've got a lot of discretionary money -- not a lot, but they've got some discretionary money, some of it that came through the stimulus package. And this is designed specifically to change the way that we make investments, not just based on 538 members down the street, but that this is based on competition, emphasizing partnerships and emphasizing quantitative returns.

So kind of back to what we were talking about earlier. And it's not perfect. And we're making some missteps along the way, things like Race to the Top in education I think it was the right idea. We learned some lessons from that.

The Department of Transportation is trying to take that and do something similar on the transport side.

We saw the high-speed rail program which they could have just taken it right out of the stimulus package, taken that $8 billion and spread it around. They didn't do that. They waited a year and asked folks to compete, to send in applications. And they chose projects that were supposed to be based on merit.

Again, some missteps, we're going to get it better. But it's -- it's turning a battleship. We're starting to get there slowly. But trying to convince folks that this is a very different way that the federal government's going to think about how it invests in those things for the long term, I think, is a really important message for you to remember.

COLLENDER: All right, I actually have just one more question for everybody and then we'll ask each to do a little bit closing statement.
In effect, don't we have a capital budget in the United States now? I mean, we're financing about one-third of it by -- with borrowing.

PODESTA: Borrowing.

COLLENDER: I mean, if you put the capital budgets into that one- third, and the capital projects into that one-third, whatever it is, don't we don't we really have it at this point? I mean, are we -- is it just a question of semantics right now?

PODESTA: Well, I don't think it's semantics. I mean, I think if you look at -- if you look at where that borrowing -- you know, we're borrowing money from the Chinese in order to support a series of tax cuts for the very wealthiest Americans that were put in place in 2001, 2003.

I don't view that as investment or as, you know, capitalizing the future by putting the country in hock to the -- to -- you know, to foreign creditors in order to support the -- you know, an extra trip to the south of France.

And that -- you know, in -- in what way is that investment? We borrow a lot of money to conduct -- I think Newsweek now came up with a number. They probably -- except it's Stiglitz's (ph) number, of $3 trillion for the war in Iraq.

That's -- we borrowed a lot of money to do that. Was that investment in the future? It's hard for me to sit here today and think that that was about creating a stronger structure of, you know, sustainable security architecture for the future.

Now, we are where we are and we have to get out of it. But -- so I think a lot of the borrowing that we've done has been done to support policies which I would I would disagree with and I think are hard to contemplate as investments in the long-term success of the United States.

COLLENDER: Robert?

PUENTES: OK. I think that's -- that's exactly right. In the way that we -- I think we used to think about infrastructure as this kind of user-pays system is out the window. We have been moving a lot of money from the general fund to cover some shortfalls in other areas of infrastructure. So -- and a lot of that obviously is -- is coming from the general fund which is borrowed.

So again, we've got a system that's broken, and we need pretty substantial reforms in order to get back to something I think that folks are expecting.

APPELBAUM: I -- I would just say I can't really add anything on the capital budgeting piece, but on the question of borrowing, we did not set out to borrow money from the Chinese. That's not how this developed, right? We run a -- a huge trade deficit with them. We have allowed our manufacturing infrastructure -- talking about a private sector infrastructure now -- to deteriorate. We have allowed the jobs to go offshore. We have allowed American companies to set up operations in other parts of the world. We have restricted them almost not at all.

And the result of this is that -- and we've had very little in the way of wage growth, so that in fact one of the ways that we've kept peace in the country is that we have all these cheap imported goods coming in from China, so that if your wages haven't risen very much, nevertheless, you can still go to Walmart or Target and buy clothes for your kids and get ready for back to school.

So the -- the in-flow of funds, the -- the different side of the trade deficit, we don't actually have to borrow from the Chinese in order to finance a deficit or in order to finance the kind of construction that we're talking about. There's no reason that the Fed can't -- can't finance it. The Treasury sells the bonds that it needs in order to raise the money that it -- that it needs for its operations, and the Fed can easily buy it. And -- we don't have to worry about the interest burden because of course the Fed will return the -- any interest that it receives to the Treasury.

So we don't need Chinese borrowing to be able to go forward with any of the things that we are -- we are talking about. And I -- I think it's -- it's really a misnomer to say we're out there borrowing from the Chinese. I think basically we are running a huge trade deficit and we finance it by borrowing from the Chinese.

COLLENDER: All right, final question for everybody. What's the one thing we have to do to move this debate forward?

John?

I could see the wheels turning. I had to do that. You can only get one thing.

PODESTA: Well, you know, look, this is about -- this is about vision and politics. But I think -- I -- I -- I talked to some of the colleagues who were here this morning. I couldn't make it this morning to hear -- it sounded like Krugman and Feldstein actually agreed that things are bad -- -- things are bad and getting worse.

But it seems to me you have to have...

COLLENDER: They kind of started off slow, and then went downhill. Yes.

(LAUGHTER)

(CROSSTALK)

PODESTA: Just to close on -- like a slightly more optimistic note about the one thing. This is the place where -- this is -- this is a place that can be inspiring, where they're innovation, where -- where discovery really begins to kick in, where you create that -- that true virtuous cycle of investment and innovation that's going to be -- that can transform the society and -- and lift people up while you're lifting the -- the economy and -- and -- and the country up.

So I see this as -- as a place to tell a story about where -- where -- where government can be successful in building the common good. But if there's one thing that has to happen, it's that you have to get the politics right and you have to get into power in order to be able to produce that result.

COLLENDER: Or stay in power.

PODESTA: Or stay in power.

COLLENDER: Right.

Eileen?

One thing.

APPELBAUM: Yes, what I would say is that I think that most people with the housing bubble having burst and with so many people underwater in their mortgages, have come to understand the limits of debt-driven growth.

We have had an expansion that has been based on consumption, fueled by debt. And I think people have come to understand that there's a huge limit to that. And I think we need to change the conversation. We need to talk about what it would take to get back to the situation that we had in the post-war period where in fact there was rising wages at the median, rising median wages, a growing middle class, increasing economic security that was the basis for economic growth.

And I think that's a conversation that people are ready to have. And I haven't heard any of our politicians willing to take it on.

COLLENDER: Robert?

PUENTES: I think we need to set out a new vision for the next American economy. What's going to emerge from the rubble of this recession? I don't think we could think about going back to what we had before as normal, because that wasn't -- that wasn't normal. We need to be focused on productivity as opposed to a consumption-based economy.

So if we have a next American economy that is export-oriented, innovation-fueled, opportunity-rich, and low-carbon, what kind of infrastructure investments do we need to make then to support an economic frame like that?

So if we're going to double exports in five years like the president said, what kind of investments then do we need to make to support that vision? That kind of strategy has been missing particularly here in Washington for a number of years. We've got to get back to putting together investments for a purpose. And in this case, it's got to be around the next American economy.

COLLENDER: I'm going to add one more thing. I -- I -- it echoes what you were saying. Somehow, we have to be able to get across the benefits of these things, not just the costs. Right?

It's -- it's as much a P.R. effort as it is substantive. But we've got to be able to convince people that whether it's early childhood education or, you know, retraining workers or -- or energy grids, that they will benefit by this happening and not just in paying the cost.

PUENTES: This is what -- we have 37 new governors or governors coming in next -- you know, January, and this is how they're talking about this stuff. They know that they've got -- they've got to govern. They've got big fiscal problems facing them. They're talking about it not just in terms of costs, but really what they're going to get out of this.

COLLENDER: OK. Well, thank you all. Would you all thank me -- join me in thanking everybody.

(APPLAUSE)

(UNKNOWN): Thank you for sticking it out today. It's a very difficult time economically and politically, but I hope what you come away from this conference with is a recognition that there are many good ideas for dealing with the economic challenges that we're facing, and some good ideas for arguing so that we can win politically in getting those ideas to transpire.

It may not happen in the short term, but I think everybody here will go out with some energy and -- and -- and try to push forward.

The healthcare bill demonstrated that good ideas can eventually become law after many, many, many years of fighting for them.

The Economic Policy Institute, Demos, and The Century Foundation are about to launch a new website called, Ourfiscalsecurity dot-org. And we're pleased to have a chance to work with the Center on Budget and Policy Priorities for sponsoring this event.

And especially we thank again the Ford Foundation for -- for -- for paying for it.

So thank you so much everybody for coming.

END

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