Center for American Progress

Part of *Progressive Growth,* CAP's Economic Plan for the Next Administration

Responsible Investment

A Budget and Fiscal Policy Plan for Progressive Growth

By David Madland and John Irons

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Contributors

The editors and authors of *Progressive Growth* thank their colleagues, the fellows, and staff of the Center for American Progress, listed below, who work on related issues and/or contributed to select portions of *Progressive Growth*. While the ideas and analyses of these experts inspired many of the recommendations in *Progressive Growth*, the recommendations in each report are those of that report's authors and the Center's leadership, and do not necessarily represent the views of all associated with the Center.

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A list of earlier reports published by the Center for American Progress describing policy incorporated into the *Progressive Growth* plan can be found on the inside back cover.

Contents

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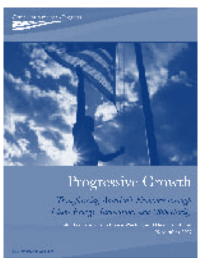
About Progressive Growth



The Center for American Progress offers a fiscally responsible investment plan to:

- *Grow our economy* through the transformation to a low-carbon economy and leadership in innovation, technology, and science.
- *Recreate a ladder of economic mobility* so that Americans may make a better life for themselves and their families, and America may be a land with a thriving and expanding middle class prospering in the global economy.

An overview of the entire plan can be found in:

Progressive Growth
Transforming America's Economy through Clean Energy, Innovation, and Opportunity
By John Podesta, Sarah Rosen Wartell, and David Madland

Other reports detailing aspects of the challenges and recommendations in the *Progressive Growth* plan are:

Capturing the Energy Opportunity
Creating a Low-Carbon Economy
By John Podesta, Todd Stern, and Kit Batten

A National Innovation Agenda
Progressive Policies for Economic Growth and Opportunity through Science and Technology
By Tom Kalil and John Irons

Opportunity and Security for Working Americans
Creating the Conditions for Success in the Global Economy
By Louis Soares, Andrew Jakabovics, and Tim Westrich

Virtuous Circle
Strengthening Broad-Based Global Progress in Living Standards
By Richard Samans and Jonathan Jacoby

Responsible Investment
A Budget and Fiscal Policy Plan for Progressive Growth
By David Madland and John Irons

Other reports developing these and other new ideas will be published as part of the *Progressive Growth* series of economic policy proposals from the Center for American Progress. The first were: ***Serving America: A National Service Agenda for the Next Decade***, by Shirley Sagawa, published in September 2007; ***New Strategies for the Education of Working Adults***, by Brian Bosworth, published in December 2007; and ***Social Entrepreneurship and Impact: Creating a Climate to Foster Social Innovation***, by Michele Jolin, published in December 2007.

Progressive Growth: A Summary

The American Dream has been a story of progressive policy establishing conditions in which individuals have been able to seize opportunities and make a better life for themselves, their children, their families, and their communities. It can be so again. The United States faces unprecedented challenges. Yet at the Center for American Progress, we are optimistic about America's economic future. We are confident that the ladder of economic mobility can be rebuilt with the right leadership and progressive policy.

Today, working Americans feel less and less secure, and their prospects for economic mobility seem more and more remote. People are working longer hours than ever before, change jobs more frequently, and have more volatile incomes. Forty-seven million live without health insurance. Few are represented by a union. Many face tough competition from lower-wage workers abroad. The land of the American Dream now has less inter-generational income mobility than many other developed countries. Family incomes have risen on average within generations only because the incomes of women have risen as their participation in the workforce has grown dramatically; incomes of men have stagnated. The additional income from the second earner is essential to cover the rising cost of healthcare, energy, and childcare, among other things.

Each of the traditional pathways to progress is littered with roadblocks. Incomes are not rising; the historical link between greater productivity and higher wages has broken down. Personal savings in the United States is near record lows. From pre-school through high school, we are failing to prepare many for college and the workplace. Those who begin degree or credential programs to improve earnings complete them at alarmingly low rates. Until recently, homeownership was a pathway to wealth accumulation, but many now see their equity slipping away. **American workers feel less secure with good reason. Their prospects for getting ahead are more limited. Working hard and playing by the rules is not enough.**

In recent years, economic growth has been relatively strong, but the economy has added jobs at a lackluster rate compared to similar times in the economic cycle. The share of the nation's income that goes to those in the middle is lower than it has been in 50 years. The benefits of economic growth have all flown to those at the very top.

Key Steps to *Progressive Growth*

Accelerate America's transformation to a low-carbon economy.

- Implement an economy-wide cap-and-trade program for greenhouse gases.
- Dedicate cap-and-trade revenues to, first, offset energy costs for low- and moderate-income consumers and support the employees and communities of carbon-intensive firms, and second, invest in innovation and the transformation to a low-carbon economy.
- Implement complementary policies to reduce emissions and increase energy efficiency in the transportation and electricity sectors.
- Create a White House National Energy Council to manage the transformation and ensure that the federal government leads the way.
- Exercise global leadership.

Spur innovation to sustain productivity growth *and* job creation.

- Make significant new investments to stimulate innovation to address our nation's grand challenges and emerging opportunities.
- Build a flexible, problem-solving workforce that includes more workers with world-class science, technology, engineering, and math skills.
- Restore the integrity of American science.

Rebuild the ladder of opportunity by restoring economic security and mobility.

- Guarantee quality, affordable *health care* regardless of employment or life circumstance.
- Expand access to effective *education* for our children and adult workers to ready the workforce for 21st century jobs in the global innovation economy.
- Make work pay and *incomes* keep pace with growth through the minimum wage, expansion of the Earned Income Tax Credit and Child Tax Credit, the right to organize, and reforms to unemployment insurance and adjustment assistance.
- Provide greater opportunities to build and secure *wealth* through work, retirement savings, affordable and safe financial services, and home ownership.

Create a virtuous circle of rising economic fortunes for a growing global middle class—future consumers of U.S. products and services.

- Refocus the three main elements of our international economic policy—trade, aid, and monetary policy—on achieving progressive growth around the globe.
- Enlist all the international institutions—the International Labor Organization, the International Monetary Fund, the World Bank, the World Trade Organization, and regional multilateral development banks—in a coordinated strategy to promote decent work: quality jobs, fundamental rights at work, social protection, and social dialogue.
- Support construction of the laws and institutions that will enable middle-income nations to share new growth widely within their populations.
- Support low-income nations in meeting basic human needs, advancing decent work, moving more workers into the formal economy, eliminating trade barriers to their exports, and supporting the creation of trade-related infrastructure.

Adopt a responsible fiscal policy to finance needed investments in national priorities.

- Make needed investments in economic growth and restoring economic mobility.
- Dedicate cap-and-trade revenues to ease the transition to a low-carbon economy and invest in policies to spur innovation and the energy transformation.
- Adopt a tax system that is fair and rewards human capital by:
  - Rewarding work and wealth equally.
  - Expanding the Earned Income Tax Credit and Child Tax Credit to help make work pay for low-income workers.
  - Providing tax breaks to employers and employees to encourage more investment in credentialed and portable education of adult workers.
  - Improving retirement security through matching contributions for lower-wage workers in a new Universal 401(k) plan.
  - Lifting the cap on which the employer pays social security taxes while maintaining the employee cap.
  - Permanently reforming the estate tax so that only a tiny fraction of the wealthiest heirs would be subject.
  - Closing loopholes and improving tax enforcement.
- Put America on course to reduce our debt as a share of our Gross Domestic Product.

The prospects for long-term growth are also weak. Our economy is increasingly reliant on unsustainable, debt-driven spending (by consumers and the federal government), instead of innovation and investment. Between March 2001 and March 2007, 84 percent of economic growth came from consumption spending, while less than 4 percent came from investment. The United States has fallen behind many countries when it comes to equipping the workforce with the education and training necessary for individual and national success, doing a mediocre job especially of preparing our children for careers in the innovation economy. Younger cohorts moving into the workforce in coming years will be smaller and have less education than the older generations leaving the workforce.

Globalization and technology have changed the rules of the game. Unsustainable appreciation in the housing market buoyed the economy for too long. And we face a clear and present danger to our economy and the earth itself from global warming. As Rajendra Pachauri, Chairman of the Intergovernmental Panel on Climate Change and recipient of the 2007 Nobel Peace Prize, said recently, "If there's no action before 2012, that's too late. What we do in the next two to three years will determine our future. This is the defining moment." America needs policymakers with a plan for restoring U.S. economic leadership in a global and carbon-constrained economy, making it possible, once again, to dream that our children can look forward to a better future.

The next administration can offer a new vision of America as an economic leader with a growing middle class in a vibrant global economy. America's economy could be driven by ongoing invention and the production of high value-added goods and services. America could lead a global energy transformation based on more efficient technologies and clean, renewable fuels. These forces could fuel the creation of good jobs and good prospects for workers at all skill levels. America's students and workers could be readied to meet the demands of the innovation economy. Moreover, we could ensure the economic security necessary, so that people can take risks and generate wealth for themselves and our country. America could put globalization and change to work for American workers and for millions around the globe.

At the center of this vision is a strategy to address the greatest moral and economic challenge of our time—climate change—and turn it into our greatest opportunity. Left unchecked, the economic disruption caused by climate change will sap our resources and dampen our growth. But with low-carbon technologies and clean, renewable energy, we can capture a new global market, drive American economic growth, and create green jobs for American workers, offering new skills and new earnings opportunities up and down the economic ladder.

CAP's economic blueprint for a new administration would also leverage our creativity, entrepreneurial culture, and a restored leadership in science and technology to create an innovation economy and spur economic growth. It would seek to enhance economic security and mobility for American workers by creating the conditions in which they could protect and improve their own health, education, incomes, and wealth. It would refocus our international economic policy on promoting decent work and higher living standards around the globe, helping to generate additional demand for American products and services, restoring American leadership, and ensuring that the rising tide produced by economic integration lifts all boats. Finally, CAP's plan offers a responsible pro-growth fiscal policy that would value work and fairness and support necessary investments in our economic future while setting us on a course to reduce the debt as a share of GDP and ready ourselves for the additional demands of the aging baby boom generation.

Restoring economic mobility for Americans, sustaining economic growth in a global economy, and combating global warming are great challenges, but America is up to the task. From sweatshops to segregation to the space race, the progressive commitment to fairness, human dignity, and what FDR called "bold, persistent experimentation" has driven our country to overcome obstacles as great as these we face today.

Introduction and Summary

The economic transformation envisioned in the *Progressive Growth* series—accelerating America's transformation to a low-carbon economy, spurring innovation to sustain productivity growth and job creation, rebuilding the ladder of opportunity by restoring economic security and mobility, and creating a virtuous circle of rising economic fortunes for a growing global middle class—will not only help ensure future U.S. economic prosperity but also is affordable and can be paid for in a way that supports the progressive values of work, fairness, and simplicity. In short, our progressive economic program is fiscally responsible as well as pro-growth.

To grow our economy and ensure that everyone has an opportunity to benefit from this growth, we need to rebuild our infrastructure to support the transformation to a low-carbon economy, invest in human capital, and help support greater economic security. We believe our nation cannot afford to wait to make these necessary investments—in universal health care, education and lifelong learning, science and technology innovation, new green energy job training programs, and new wealth-creating opportunities for all Americans—if we want our economy to remain thoroughly competitive in the global marketplace. But we also believe the federal government must undertake these investments in the context of an overall fiscally responsible package that supports progressive values. In this report, we demonstrate that this is possible.

With sensible priorities it is possible to invest in our future. In fact, the goals of *Progressive Growth* are well within our reach and can be achieved with spending and revenue levels that have been met by recent administrations.

Right-wing naysayers believe that the United States cannot afford to make these investments and rebuild our infrastructure. They are wrong, and in fact have demonstrated that they are not careful stewards of the nation's finances. The Bush administration came to Washington in the midst of historical budget surpluses, but through a combination of tax cuts for the wealthy and a misguided and exceedingly expensive war in Iraq, plunged the national pocketbook into debt.

For the past six years, President Bush has touted his tax cuts as an economic cure-all. Yet the tiny tax cut received by middle-income workers hasn't been enough to pay for burgeoning debt payments, higher gas prices, tuition increases, and exploding medical costs—even as wealthy taxpayers have enjoyed ever-higher incomes taxed at stunningly lower rates.

Bush's budget priorities have prevented spending on necessary public investments and undermined prospects for long-term economic growth. As former Treasury Secretary Lawrence Summers pointed out in testimony before Congress earlier this year:

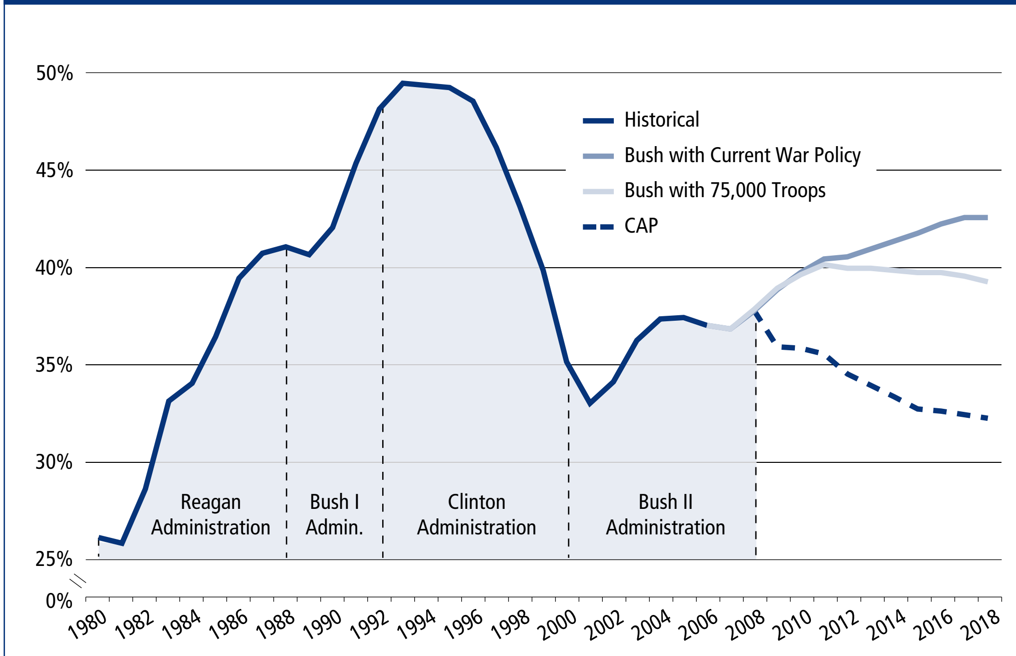
> The nation's finances are not now on a sustainable basis. While projections vary, few observers believe that without significant policy changes the debt-to-GDP ratio of the United States will increase quite rapidly in the next decade and beyond.

Summers reflected the consensus of mainstream economists on the left and the right when he explained to congressional policymakers that the U.S. government had to take two essential steps—increase the stability of the nation's financial position and assure adequate future economic growth.

As we work to limit the damage of Bush's budget priorities, we need to address the budget gap as well as the national investment gap created by years of neglect. We can do this through a strategy that seeks, over the long-term, to reduce our nation's debt as a percentage of Gross Domestic Product. Meeting this debt reduction goal is achievable, and can be done with revenue and spending targets that are in keeping with recent history

Taking steps towards reducing national debt as a share of the economy is sound policy. As the economy grows, we will have an increased capacity to pay off our national debts. So long as the national economy is growing faster than our debt, we are enhancing our ability to meet future needs. As we enter 2008, the housing crisis, the possibility of a recession, and the potential need to stimulate the economy may temporarily result in a short-term increase in our nation's debt. Over the

FIGURE 1: DEBT AS A PERCENTAGE OF GDP



Source: Congressional Budget Office, Historical Budget Data. For further explanation, please see footnote #1.

long-term, however, reducing our debt-to-GDP ratio is a strategy that will get our government's fiscal house in order and allow for wise investments in our economy.

Figure 1 shows the historical experience with the national debt.[1] Improvement occurs when the deficit is small as a share of the economy—rapid economic growth combined with small deficits—or surpluses—lead to declining debt levels. Under *Progressive Growth*, the nation's debt would drop to 32.3 percent of GDP at the end of 2018, down from the projected 36.0 percent of GDP as of the end of 2008. A slightly larger, but similar drop occurred during the Clinton presidency, when our country's debt-to-GDP ratio fell from 45.3 percent at the beginning of 1992 to 39.8 percent by the end of 1999. Our *Progressive Growth* plan for the economy would thus place our national debt below averages from the last forty years. Debt as a share of GDP from 1967 to present has averaged 35 percent, and since 1980 has averaged nearly 40 percent.

In total, our proposals outlined in this economic strategy call for a combination of responsible investments and tax reform to make our tax system fair, simple, and fiscally responsible. We make the tax code fairer, simpler, and better able to meet the challenges of the next decade and beyond by taxing work and wealth equally, closing loopholes, enhancing enforcement, and modifying the payroll tax. By combining these and other changes—such as expanding the earned income tax credit and boosting retirement savings through a new universal 401(k) pension savings program— we begin to tackle both short-term and longer term budget imbalances.

Budget Calculations

The projections for the Center for American Progress budget use as their baseline the Congressional Budget Office's August 2007 estimate of the current law baseline. In addition to the policies detailed in this and other *Progressive Growth* reports we make several assumptions about the path of outlays and revenues.

On the spending side, we assume that overall discretionary spending levels will grow faster than inflation. Specifically, we assume that it grows at a rate halfway between inflation and nominal GDP growth. In addition, we also assume outlays consistent with a drawdown of U.S. armed forces deployed in Iraq and redeployed to Afghanistan and bases in the Middle East so that the number of troops engaged in military operations and support in Afghanistan and the Middle East is 40,000 above the level it was at the start of fiscal year 2002. This estimate is based on CBO's scenario that reduces troop levels to 30,000 by 2010.

We also extend the marginal tax rates, child tax credit, and tax brackets of the Economic Growth and Tax Relief Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003. Under the CBO baseline, these provisions expire in 2010.

Our estimate for President Bush's budget is based on CBO's March 2007 estimate of Bush's proposed budget for 2008. We assume that President Bush will be able to enact the policies of his choosing, including extending all of his tax cuts and making significant reductions in domestic discretionary spending.

We have augmented the CBO's analysis of Bush's policies in two ways. First, we assume that the Alternative Minimum Tax will be indexed for inflation over the full 10-year horizon, rather than the temporary fix included in the official budget. Second, we include the costs of continuing the wars in Iraq and Afghanistan, instead of assuming (as Bush does) that war spending will end in 2009.[2] We present projections for Bush's budget based on two alternative spending paths for the wars in Iraq and Afghanistan: one which uses CBO's baseline for military operations in Iraq and Afghanistan based on current troop levels, and a second which is based on CBO's estimates for a reduction of troop levels to 75,000 by 2013.

This fiscally responsible program includes tax changes that not only help pay for needed investments, but are also good policy in themselves. These fiscal measures will broaden economic opportunity for all Americans—not just the wealthy—and help improve our nation's long term finances so that all Americans can enjoy a secure retirement while helping to lower our reliance on foreign investors to purchase our public debt.

Reducing our debt as a percentage of GDP is well within our reach, and in fact, can be achieved with spending and revenue levels that have been met by recent administrations, as can be seen in Figures 2 and 3 on page 5. We raise less revenue as a share of GDP than the average during President Clinton's term. We spend the same amount, as a share of GDP, as President Bush did in 2006, which is far less than President Reagan spent, and less than the 25-year average. As a result, we feel confident that our economic plan can be implemented by the next administration (see sidebar on page 3 for details of our budget projections).

In tandem with these necessary and pragmatic measures to put our fiscal house in order after the disarray of the Bush years, our financing plan will invest $746 billion over 10 years from the creation of a carbon cap-and-trade marketplace for carbon emission credits. This money will help ensure our nation's scientists and entrepreneurs, businesses and workers can all meet the challenges of global warming and declining economic productivity and economic opportunity due to the rapid, information technology-fueled globalization of our economy.

Our proposal for financing these investments will spur economic growth and productivity while being equitable.

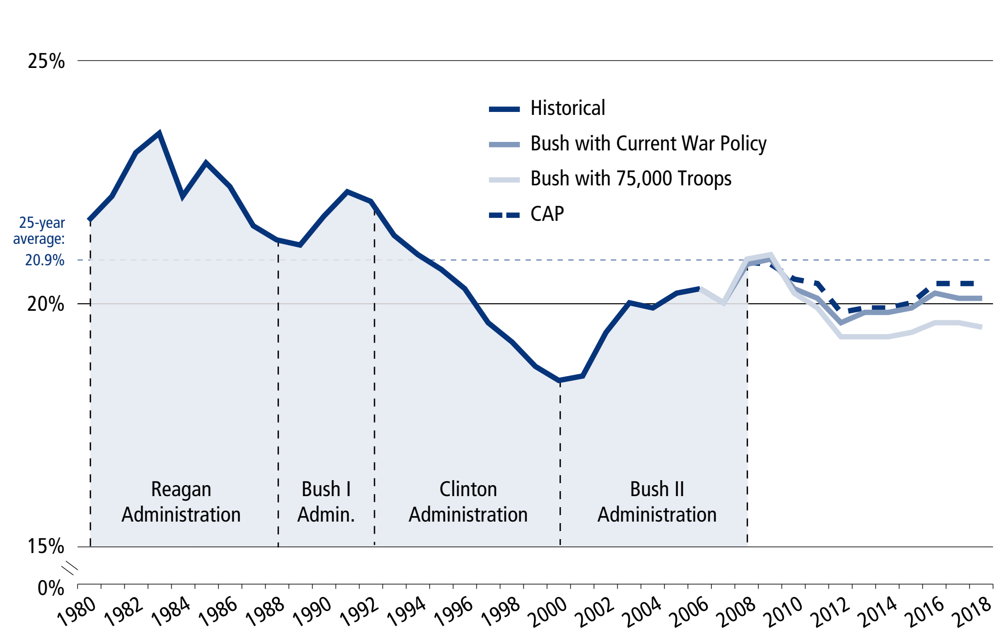
How? By letting the marketplace set the price of carbon credits through a carbon cap-and-trade program with auctioned permits, which we will generate $746 billion in revenue over the next 10 years and which we propose to reinvest in energy and innovation in order to achieve two key economic goals:

- Offset energy costs for low- and moderate-income consumers and support the employees and communities of carbon-intensive firms.
- Ensure we have the complementary policies to spur innovation and renewables and new low-carbon technologies so our low carbon goals can be achieved.

This is an ambitious investment plan that mirrors the serious problems faced by our nation today. *Responsible Investment* outlines the costs and revenue changes to the federal government of the proposals set out in the national economic strategy, highlighting key revenue changes not described elsewhere in *Progressive Growth*, and the double-dividend strategy of the carbon cap-and-trade marketplace.

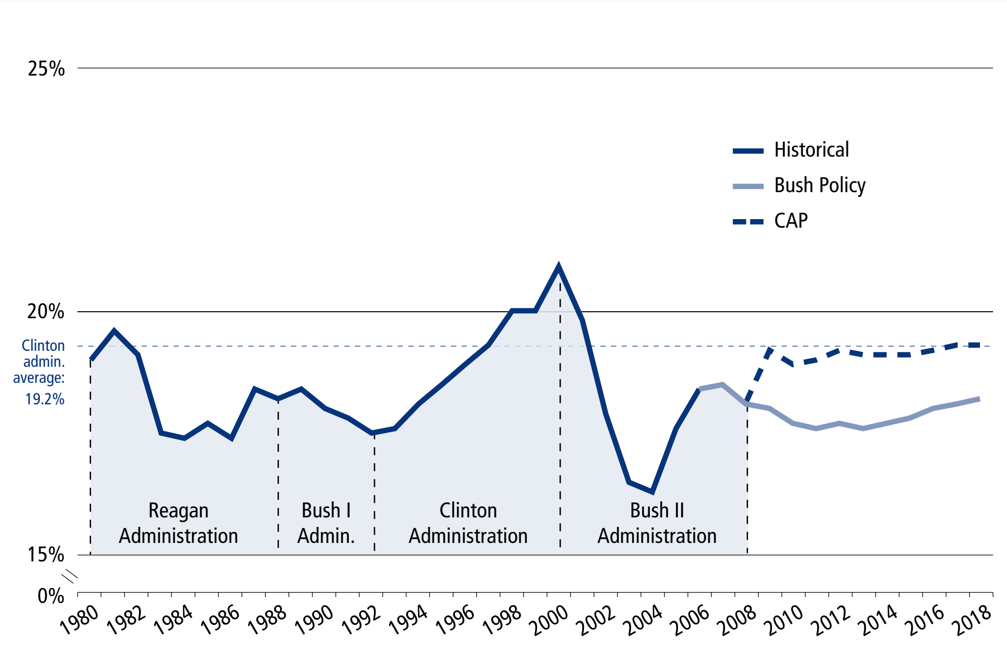
Most importantly, this part of our national economic strategy for the next administration demonstrates that this comprehensive program is within our national reach. Our aggressive economic policy prescription is imminently feasible, affordable, and fiscally responsible. We have the means, we only need the will.

FIGURE 2: EXPENDITURES AS A PERCENTAGE OF GDP



Source: Congressional Budget Office, Historical Budget Data. For further explanation, please see footnote #1.

FIGURE 3: REVENUE AS A PERCENTAGE OF GDP



Source: Congressional Budget Office, Historical Budget Data. For further explanation, please see footnote #1.

A Responsible Tax Plan

America deserves a fair, pro-growth tax system that rewards work, creates opportunity for all, and allows the nation to meet vital national challenges. While the tax code should raise adequate revenue to fund national priorities, it is far more than just a way to raise funds. Tax policies can also be a powerful incentive to spur the economy in desirable directions. The tax code can and should be aligned with progressive priorities to value work and thrift and invest in human capital and innovation.

The Earned Income Tax Credit, for example, is a valuable tool to increase work incentives while at the same time enhancing the take-home pay of low-income Americans. A targeted universal 401(k) defined-contribution pension plan can help increase retirement savings for low- and moderate-income savers. And research-and-experimentation tax credits can help prod business innovation.

Perhaps the most important way the tax code can spur the economy in desirable directions and value work is to reverse the trend of unfairly lower tax rates on the capital income of the wealthiest Americans.[3] The modern economy is increasingly driven by jobs in which advanced skills play an important role, and in which "human capital" is as important as physical capital, if not more so. A tax system that rewards wealth and accumulated capital at the expense of work and skill flies in the face of this fundamental economic change.

As a result, we would tax all forms of income according to the same rate schedule. This change would end preferential treatment for income from capital (wealth) over income from work by setting capital gains and dividend taxes equal to the tax rates on ordinary income. We exclude from taxation half of the first $25,000 a person earns in capital gains. This exemption would promote thrift and maintain very low rates for the savings of the vast majority of Americans.[4]

The changes listed below would make the tax code fairer, reward work, and help expand our nation's domestic savings pool. Among the steps we would take to reform our tax system:

Capital Gains and Dividends

For most people, the majority of their income is taxed at the federal level at one of several marginal rates: the current income tax brackets range from 10 percent to 35 percent. In addition, earned income is also subject to a payroll tax of 7.45 percent, plus an additional 7.45 percent the employer pays on behalf of the employee. The tax rates on capital gains and dividends for any given individual, however, is significantly lower than the tax on wage income, with marginal rates generally set at 5 percent or 15 percent, depending upon income level.

This preference for income earned from capital has two important implications. First, it provides a significant incentive for high-income individuals to avoid their tax obligations by receiving compensation in the form of capital gains rather than ordinary income. Many hedge fund managers and private equity executives, for example, face far lower tax rates than their secretaries because they have been able to have much of their income considered capital gains instead of ordinary income.[5,6]

Second, the preferential rates for capital income provide a substantial tax break to those who have significant wealth. More than half of all capital gains and dividends subject to preferential rates are realized by those making over $1 million per year.[7]

Proponents of the preferential rates believe that lower rates would yield additional savings, greater investment, and hence higher economic output and living standards in the future. This logic fails on a number of fronts because:

- Savings appear to be relatively insensitive to after-tax rates of return.

- Domestic investment is not purely driven by domestic savings in a global economic environment.

- Empirical evidence and recent experience suggest that the economic effect of lower tax rates on overall economic output is very small.[8,9]

A fair tax system would tax the income derived from wealth at the same rate as income derived from wages for high-income individuals. Such a change would value work and human capital as well as be very progressive since the vast majority of capital income flows to the very wealthiest. In order to continue to provide savings incentives for low- and moderate-income families, our fiscal plan would exempt half of all capital gains up to $25,000 per year. This exemption would maintain low rates for the vast majority of savers.[10]

Estate Tax

Currently, the amount of wealth that can be exempted from the estate tax is $2 million per individual, while married couples can pass on $4 million tax free. As a result, less than two percent of all estates own any tax.[11] Under current law, the estate tax is set to be eliminated in 2010, only to return in 2011 when Bush's tax changes expire. In 2011, the federal estate tax will revert back to being assessed on property valued in excess of $1 million.

We propose setting the exemption and marginal tax rates at the 2007 levels, indexing the exemption for inflation, and making the law permanent, since financial planning should not be a guessing game about tax code. Under this reform, only a tiny fraction of estates would be subject to the tax, and the vast majority of small businesses and family farms would be exempt from the tax. We retain the estate tax as part of an overall more fair tax code that ensures income from wealth is taxed.

Keeping Income Taxes Low

We support extending some of the provisions of tax relief measures enacted in 2001 and 2003, including the 10 percent bracket, the rate reductions for middle-class taxpayers, the marriage penalty relief, and an expanded child tax credit. We only support extending lower rates for high-income earners if they are accompanied by the other proposals included in this section, so that we are assured adequate revenue and a sufficiently progressive tax structure.

Close Loopholes and Enhance Enforcement

The tax code is full of holes that allow individuals and corporations to avoid paying taxes, which undermines the fairness of the system and places undue burdens on those that pay their full obligation. In 2006, there were a total of $911 billion in tax expenditures included in the tax code.[12] While some of these provisions contain valuable incentives to businesses and individuals, there are also many provisions that are simply used to reduce tax obligations.

In addition to this legal avoidance, billions of dollars are owed to the federal government, but are never collected. Under-reporting—and non-reporting—of income and other forms of illegal evasion amount to uncollected revenue, creating the so called "tax gap," which was estimated by the Internal Revenue Service to be approximately $345 billion in 2001.[13] While the IRS expects to recover a portion of this—around $55 billion—it is still estimated that nearly $290 billion will go uncollected. The non-collection of this amount of revenue essentially means that the tax rate necessary to fund the government is higher than it need be.

Closing the entire gap would be difficult, but there are some simple steps that could be taken to collect more of the revenue, such as requiring the reporting of stock purchase prices to be used in the calculation of capital gains revenue. While financial firms are already required to report stock sales, dividends, and interest payments, they are not currently required to report the purchase price, which is essential to calculate capital gains tax liability. The tax gap for capital gains under-reporting is at least $11 billion.[14] Further, it is estimated that individual taxpayers use offshore tax schemes to evade between $40 and $70 billion in taxes every year.[15]

For purposes of the national economic strategy, we assume that Congress and the president can work together to improve enforcement and to close loopholes amounting to $50 billion annually. This is just one-sixth of the net uncollected tax gap (from 2001), and just one-twentieth of the total annual tax expenditures. This should be an obtainable goal.

Social Security Payroll Tax

Under current law, Social Security is financed through the payroll tax system that places shared responsibility on workers and business. Employees and employers each pay taxes on wage income equal to 6.2 percent—up to a threshold (currently $97,500).[16] Because of this payroll tax cap, businesses and employees pay a lower effective tax rate on earnings above $97,500.

We propose eliminating the payroll tax cap on the employer side to make businesses pay Social Security taxes on all of the income of the highest paid employers, just like they do for those earning less than $97,500. This is the fairest way to help shore up the finances of Social Security. This change would impact the taxes that businesses pay for only the top 6.5 percent of earners (couples and individuals), yet would yield significant additional revenue to reduce the deficit and bring the Social Security system closer to solvency.[17]

According to the Social Security and Medicare Board of Trustees, the long-range, 75-year actuarial deficit is equal to 1.95 percent of taxable payroll.[18] Eliminating the cap on *both* the employer and employee side would be more than enough to bring the system into long-range balance.[19] Removing the cap on the employer side would thus go a long ways toward restoring solvency as well as help ensure greater progressivity and fairness in the payroll tax.

Alternative Minimum Tax

One of the most fiscally daunting challenges that must be faced over the next 10 years is the growing reach of the alternative minimum tax. The AMT, unless fixed, will affect more than 30 million people by 2010.[20] The reach of the AMT is growing. Under current law the amount of income that can be excluded is not indexed to inflation. What's more, tax changes in 2001 and 2003, which lowered income tax rates, did not adequately adjust the AMT. The result is that an increasing number of primarily upper-middle income taxpayers will be subject to the AMT unless changes are made.

In addition to increasing tax rates on upper-middle income taxpayers, the AMT imposes a second parallel tax code on those who are subject to the AMT. The tax code should be simple and transparent. The AMT is neither.

AMT reform should follow the following principles.[21] First, the vast majority of Americans should not have to pay the AMT. A simple test should be used to exclude couples that make less than $250,000, and to exclude individuals making half of this amount.

For individuals and couples making more than this threshold, we must not abandon the ideals of the AMT: that each taxpayer should pay their fair share. This means that we should limit the deductions, credits, and loopholes that high-income individuals are able to take advantage of. One approach would be to begin to phase out virtually all deductions and credits above a certain income threshold.[22] This would broaden the tax base for upper-income individuals, and insure that they cannot escape their tax obligation through creative accounting.

Finally, any reform must be crafted so as to retain adequate revenue. For budgeting purposes, we must be realistic in our assumptions about the cost of AMT reform—a revenue-neutral reform (relative to current law) that meets the above criteria will be difficult to achieve. Thus, we assume a level of revenue that is consistent with an AMT which is indexed for inflation over our 10-year horizon in the same way past "patches" have been used to limit the reach of the AMT.

Delay Certain Tax Rules

To fund our proposal to improve Trade Adjustment Assistance, discussed in detail in our forthcoming Progressive Growth

Tax Reforms Discussed in Other *Progressive Growth* Reports

In addition to the tax policies mentioned in this report, we call for a number of other tax reforms in the reports comprising the *Progressive Growth* series.

In *Opportunity and Security for Working Americans,* CAP supports:

Modifying and Expanding the Earned Income and Child Tax Credits. Our plan would triple the Earned Income Tax Credit for childless workers and expand it to help larger working families, as well as make the Child Tax Credit refundable and so increase its potential to help the poorest families who pay payroll taxes but have no income tax liability.

Incentives for Serving the Unbanked. Our plan would initiate a tax credit to a bank, thrift, or credit union for every checking account offered to a previously unbanked consumer.

Create a Universal 401(k). Creating a Universal 401(k) system would ensure Americans a dignified retirement with government match of savings for initial savings of low-income families.

In *Lifelong Learning*, CAP supports:

Lifelong Learning Tax Incentives. Creating an employer tax credit for 50 percent of certain educational investments would help finance basic skill training, ESL training, and credentialed postsecondary education for their employees, as well as expand and make refundable the Lifetime Learning Tax Credit to help individuals finance their own training.

In *A National Innovation Agenda,* CAP supports:

A Permanent Research & Experimentation Tax Credit. Our plan would make permanent the R&E tax credit to encourage business investments in innovation.

Higher Alcohol and Tobacco Taxes. Our plan would increase the federal taxes on cigarettes and alcohol to support increases in funding for the National Institutes of Health.

In *Capturing the Energy Opportunity,* CAP supports:

Fuel Efficiency Tax Credits. Reforming the current tax credit in the following ways would encourage the purchase of fuel-efficient hybrid vehicles. First, the tax credit should be increased to $4,000 per vehicle, and this tax credit should be made refundable. Second, the tax credit should be made available for the most fuel-efficient vehicles, regardless of vehicle technology. Third, the fuel efficiency tax credit should not phase out once a manufacturer has sold 60,000 eligible units, as is now the case with the hybrid tax credit.

Incentives for Advanced Plug-In Hybrids. Our plan would initiate a refundable federal tax credit of $8,000 to purchasers of the first million plug-in hybrids to dramatically accelerate the production of these vehicles by all of our automakers.

Manufacturer retooling incentives. Our plan would create a facilities conversion investment tax credit, or alternatively a federal revolving loan fund, for manufacturer investments in efficiency.

Updating the Volumetric Ethanol Excise Tax Credit. Our plan would extend and update the existing volumetric ethanol excise tax credit to make the VEETC variable, based on the price of oil, to encourage adoption of alternative fuels, as well as manage the costs to the federal government.

Tax Credits and Low-Interest Loans. Increasing the time frame for production tax credits on all types of renewable energy would allow businesses to make sound investment decisions.

Repeal Tax Breaks to the Oil and Gas Industry. Our plan would cut tax breaks to the oil and gas industry to limit subsidies for fuels that promote climate change.

paper *Opportunity and Security for Working Americans: Creating the Conditions for Success in the Global Economy,* we support delaying the implementation of tax rules related to the allocation of interest expenses (see sidebar on page 10).

Summary

Our revenue and spending targets are eminently achievable. Including all the changes together, total revenue as a share of GDP would increase from 18.8 percent of GDP in 2007, to average 19.1 percent of GDP from 2009 to 2018. This is less than the average of 19.2 percent of during President Clinton's terms.

Our spending figures are also in line with the record of previous administrations. We spend 20.3 percent of GDP—the same amount as President Bush did in 2006—and far less than the 25-year average of 20.9 percent. As a result, we feel confident that our economic plan can be implemented by the next administration.

Double Dividend

The Energy and Innovation reports in our *Progressive Growth* strategy detail how the United States can create a globally competitive low-carbon economy powered by investments in science, technology, and innovation. Taken together, recommendations in those two chapters form a deficit-neutral package of measures that will help finance this critical economic transition.

These proposals involve a substantial increase in federal outlays, but they would be fully offset by an increase in revenue from a carbon cap-and-trade program that limits its carbon emissions while at the same time setting aside revenue to compensate low- and moderate-income consumers for higher energy prices. As part of this package, we would also repeal tax breaks and subsidies to the oil and gas industry, helping limit the promotion of greenhouse gas emissions while generating additional revenue to be used for our strategic energy transformation.

Our proposal for financing these needed investments is based on doing what is required to spur clean growth while being equitable. The clear environmental necessity of putting a price on carbon emissions would generate the needed revenue. But giving the permits away to incumbent users of energy is a wasteful reward for those industries slowest to adapt, and would result in windfall profits for these companies.

In fact, a recent Congressional Budget Office study reports that it would take less than 15 percent of the carbon permit value under a cap-and-trade system to offset net losses in stock values for energy intensive industries such as suppliers of coal, natural gas, petroleum, electricity generators, petroleum refiners, and metal and machinery manufacturers.[23]

We estimate that an economy-wide cap-and-trade program with auctioned permits would generate at least $75 billion per year, with the price of emissions permits in the near term likely to fall in the range of $10 to $15 per metric ton of CO_2e.[24] Thus, the use of auction revenue would involve a transfer of substantial resources and must be handled wisely to ensure equitable and efficient distribution. We describe in detail below how to manage the system to limit the impact on low- and middle-income consumers as well as on business.

Carbon Cap-and-Trade Program

A comprehensive economic strategy must recognize the critical importance of controlling carbon emissions. As noted in the energy section of *Progressive Growth*, a national carbon cap-and-trade program would limit these emissions while raising revenue and providing incentives for both businesses and consumers to reduce energy usage and address climate change.[25] Moreover, a portion of the revenue raised by a cap-and-trade system could be used to fund research and innovation in a variety of areas including basic science, energy efficiency, and alternative energy technologies. A substantial portion of the revenue should be dedicated to offsetting the effects of a cap-and trade program on low- and middle-income households.

Cap-and-Trade Revenue

The revenue implications of a cap-and-trade program are highly uncertain. To determine the potential value of carbon permits, one must consider the appropriate emissions target, the economic cost of abatement, and the likely market impact of higher costs.

According to climate change experts, a cap-and-trade program, together with comprehensive energy policy reform should aim to stabilize emissions at levels to limit the increase in average global temperature to approximately 2.0°C (3.6°F) above pre-industrial levels.[26] With that objective in mind, we support a steadily declining cap on emissions that reaches 80 percent below 1990 levels by 2050.[27]

For budgeting purposes, we have assumed that a moderately aggressive cap-and-trade system could create emissions permits initially valued at $75 billion annually.[28] A cap-and-trade program of this size would be conservative in the context of the range of proposals now under discussion in Congress. A Congressional Budget Office's review, for example, finds revenue estimates to be in the range of $50 billion to $300 billion annually.[29]

Overall, we feel that the assumption of a $75 billion valuation for emissions permits is consistent with a policy that puts us on a more sustainable path. A more aggressive approach would likely yield additional revenue (and hence additional funds for conservation, research, or deficit reduction), but we have chosen to err on the side of caution in our revenue assumptions.

Allocation and Distribution

A successful cap-and-trade program would induce a variety of price and resource changes throughout the economy.

ALLOCATION OF CAP AND TRADE REVENUE

	2009–2018	PERCENT
Revenues from Auction	$746 billion (+)	100%
Support for Low Mod Consumers and Carbon Intensive Firms	$411 billion (–)	55%
Investments to Spur Energy Transformation and Innovation	$336 billion (–)	45%
Net Revenue	**0***	**0%**

*Does not equal zero due to rounding

Indeed, that is the very purpose of the program—to take into account the costs that greenhouse-gas pollution places on the economy and the environment. In order to smooth the transition to a new, low-carbon economy we must also consider the impact of this new program on individuals and businesses. From a program-design perspective, we must strive to maintain the price signals from the cap-and-trade system but at the same time limit the impact of higher energy prices on the welfare of individuals and the economy.

We recommend auctioning off 100 percent of the carbon permits available under a cap-and-trade system, creating an incentive to reduce emissions as well as generating revenue to offset energy cost increases and improve energy efficiency. We dedicate the majority of the revenue to easing the transition. To ensure that low- and moderate-income Americans are protected from short-term increases in energy costs, we commit an estimated $336 billion over 10 years to tax rebates and other income support to offset their higher costs.

About $75 billion in auction revenue should be invested over 10 years to help carbon-intensive businesses in order to protect the workers and communities where these firms operate. We invest the remainder of the auction revenues in policies that spur greater innovation and will drive the transition to a low-carbon economy.

While the auction structure and specifics (such as the frequency of auctions, and what kinds of entities are responsible for buying permits) of a cap-and-trade system can be debated, it is important that 100 percent of permits should auctioned rather than given away in order to generate revenue to fund national energy priorities and help reduce the potentially harmful regressive impacts of the cap-and-trade program on consumers.

We support dedicating 10 percent of the auction revenue to help compensate businesses hit heavily by the new program. This level of auction revenue is sufficient to compensate shareholders in these sectors for investments existing prior to implementation of a cap-and-trade marketplace.[30] Anything more could result in windfall profits.

It is important to note that auctioning 100 percent of emissions permits would not be more onerous for consumers than distributing all or most of them for free. Businesses will pass onto consumers the price increases implied by the supply limitation on emissions permits, *whether or not* they are given the permits or must purchase them in the market.[31] This is precisely the lesson learned from the European cap-and-trade experience, where free allocation resulted in higher retail energy prices and windfall corporate profits.

As a result, consumers are likely to experience similar price increases under a cap-and-trade system that gives away permits as they would under a system that auctions them. Under the give-away scenario, businesses would profit greatly; they could raise prices because of restricted supply without paying for the cost of the permit. This is why we believe auctioning off 100 percent of the permits and allocating approximately 10 percent of the revenue to businesses operating in energy intensive sectors is the best course of action.

After-Auction Market

A liquid trading market should complement the government's periodic permit auctions. Such a market would allow companies to buy and sell permits as needed while increasing efficiency and sparking the deployment of alternative technologies as businesses adjust to energy limitations.

Use of Auction Proceeds

The revenue generated by cap-and-trade auctions should be used to promote the transition to a low-carbon economy as well as to compensate low and moderate income families for higher energy prices.

The transition to a low-carbon economy requires investments in transportation, alternative energy, energy efficiency, and green jobs. Making these investments in our energy infrastructure is a critical component of rebuilding our public infrastructure and addressing our infrastructure deficit.

Investment in public infrastructure has been shown to provide one of the most reliable long-term growth strategies for building a strong and vibrant economy and is also a critical tool for providing stimulus in times of economic downturn. The American Society of Civil Engineers estimates that upwards of $1.6 trillion of productive infrastructure investments has been neglected or deferred in our nations' communities, with real costs to our wealth and productivity.

Investing in the building blocks of a low-carbon economy today by constructing the energy infrastructure that will drive a competitive economy well into the coming century is of critical concern as we map a strategy for reversing decades of neglect of our infrastructure and reinvest in our cities and rural communities. Specific policy details can be found in both the Energy and Innovation reports of the *Progressive Growth* series.

Lower income households spend more of their income on consumption than higher income households do, and are therefore more sensitive to energy price increases. As a result, a cap-and-trade system would be regressive in that lower income households would see their expenses rise by a greater percentage than households at the higher end of the income spectrum.[32]

That's why a substantial portion—one-half of the portion not returned to companies, their employees, and communities, or $336 billion under our assumed revenue impact—of cap-and-trade revenue should be used to compensate low- and moderate-income families for higher energy prices. For instance, these funds could be used to fund a $325 rebate for low and middle-income families that would entirely offset cost increases for most households.[33]

While households at the high end of the income spectrum would bear the full cost of the policy, the cost increases for these households would represent a relatively small percentage of their post-tax income. While we expect the cap-and-trade program to increase the unit price of energy consumption, we also fully expect that the proposed new incentives for energy efficiency would work to lower overall energy expenditures.[34]

This has been the experience in California, where energy policies have reduced per capita CO_2 emissions by 30 percent 1975.[35] Implementing these energy efficiency programs has cost the state less than half of what it would cost to increase electricity generation in the absence of such programs and has added over $4 billion to California's economy.[36]

Conclusion

Progressive Growth is a fiscally responsible strategy to ensure our economy remains vibrant and productive in a low-carbon, innovation-driven, global marketplace. Necessary investments—in universal health care, education and lifelong learning, science and technology innovation, new green energy job training programs, and new wealth-creating opportunities for all Americans—are not only affordable but also embrace pragmatic policies that will ensure future U.S. economic prosperity.

Restoring economic mobility for Americans, sustaining economic growth in a global economy, and combating global warming are great challenges, but America is up to the task. From sweatshops to segregation to the space race, the progressive commitment to fairness, human dignity, and what FDR called "bold, persistent experimentation" has driven our country to overcome obstacles as great as these we face today. As the Center for American Progress has demonstrated, it is possible—and financially responsible—for the next administration to offer a new vision of America as an economic leader with a growing middle class in a vibrant global economy.

Appendix

The following tables display the budgetary impact of our recommended policies. Policies not detailed below are either revenue neutral or cost less than 10 million from 2009 to 2018.

NATIONAL INNOVATION AGENDA: POLICY COST DETAILS (IN BILLIONS)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2009–2013	2009–2018
Programmatic Expenditures												
Federal Investment in R&D												
National Science Foundation	$0.39	$0.83	$1.33	$1.89	$2.53	$3.26	$4.07	$4.98	$6.01	$7.16	$6.96	$32.44
National Institute of Health	$0.87	$1.83	$2.89	$4.07	$5.36	$6.79	$8.36	$10.09	$11.98	$14.05	$15.01	$66.28
Department of Energy	$0.12	$0.26	$0.41	$0.57	$0.75	$0.95	$1.17	$1.42	$1.68	$1.97	$2.11	$9.30
Expanded R&D Capacity at Other Agencies	$0.40	$0.42	$0.44	$0.46	$0.48	$0.51	$0.53	$0.56	$0.59	$0.62	$2.20	$5.00
Grand Challenges	$1.19	$1.25	$1.31	$1.38	$1.45	$1.52	$1.60	$1.68	$1.76	$1.85	$6.59	$15.00
Prizes	$0.40	$0.42	$0.44	$0.46	$0.48	$0.51	$0.53	$0.56	$0.59	$0.62	$2.20	$5.00
Build a Workforce for Innovation	$1.19	$1.25	$1.31	$1.38	$1.45	$1.52	$1.60	$1.68	$1.76	$1.85	$6.59	$15.00
Promote an Information Society	$0.80	$0.83	$0.88	$0.92	$0.97	$1.01	$1.07	$1.12	$1.17	$1.23	$4.39	$10.00
Build Thriving Regional Economies	$0.80	$0.83	$0.88	$0.92	$0.97	$1.01	$1.07	$1.12	$1.17	$1.23	$4.39	$10.00
Subtotal	**$6.14**	**$7.92**	**$9.88**	**$12.05**	**$14.45**	**$17.09**	**$20.00**	**$23.20**	**$26.72**	**$30.58**	**$50.44**	**$168.01**
Targeted Tax Cuts												
Federal Investment in R&D												
R & E Tax Credit	$6.75	$7.09	$7.44	$7.81	$8.20	$8.61	$9.05	$9.50	$9.97	$10.47	$37.30	$84.90
Revenue Enhancements												
Federal Investment in R&D												
Alcohol and Tobacco Tax to Support NIH	$0.87	$1.83	$2.89	$4.07	$5.36	$6.79	$8.36	$10.09	$11.98	$14.05	$15.01	$66.28
Impact on Surplus (+) or Deficit (-)												
Federal Investment in R&D: Subtotal	-$9.24	-$10.26	-$11.36	-$12.58	-$13.91	-$15.36	-$16.95	-$18.69	-$20.60	-$22.69	-$57.35	-$151.64
Build a Workforce for Innovation: Subtotal	-$1.19	-$1.25	-$1.31	-$1.38	-$1.45	-$1.52	-$1.60	-$1.68	-$1.76	-$1.85	-$6.59	-$15.00
Promote an Information Society: Subtotal	-$0.80	-$0.83	-$0.88	-$0.92	-$0.97	-$1.01	-$1.07	-$1.12	-$1.17	-$1.23	-$4.39	-$10.00
Build Thriving Regional Economies: Subtotal	-$0.80	-$0.83	-$0.88	-$0.92	-$0.97	-$1.01	-$1.07	-$1.12	-$1.17	-$1.23	-$4.39	-$10.00
TOTAL BUDGETARY IMPACT	**-$12.03**	**-$13.18**	**-$14.43**	**-$15.80**	**-$17.29**	**-$18.91**	**-$20.68**	**-$22.61**	**-$24.71**	**-$27.00**	**-$72.72**	**-$186.64**

OPPORTUNITY AND SECURITY FOR WORKING AMERICANS: POLICY COST DETAILS (IN BILLIONS)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2009–2013	2009–2018
Programmatic Expenditures												
Rewarding Work												
Trade Adjustment Assistance and Unemployment Insurance Reform	$0.81	$0.89	$0.93	$0.94	$0.96	$0.96	$0.94	$0.96	$0.99	$1.02	$4.53	$9.41
Adjustment Assistance Initiative	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$5.00	$10.00
Opportunity Housing Vouchers	$9.29	$9.50	$9.71	$9.92	$10.14	$10.36	$10.59	$10.82	$11.06	$11.30	$48.55	$102.69
Education and Training												
Expanded Access to Preschool and Universal Kindergarten	$2.18	$4.35	$6.53	$8.70	$8.89	$9.09	$9.29	$9.49	$9.70	$9.91	$30.45	$77.93
Expanded Learning Time	$1.20	$1.23	$1.25	$1.25	$1.31	$1.34	$1.37	$1.40	$1.43	$1.46	$6.24	$13.23
Targeted Science Initiatives	$0.00	$1.00	$1.00	$1.00	$1.00	$1.00	$0.00	$0.00	$0.00	$0.00	$4.00	$5.00
Teacher Excellence for All Children Act	$5.00	$5.11	$5.22	$5.34	$5.45	$5.57	$5.70	$5.82	$5.95	$6.08	$26.12	$55.25
Fast Track to College	$1.00	$1.02	$1.04	$1.07	$1.09	$1.11	$1.14	$1.16	$1.19	$1.22	$5.22	$11.05
Graduation Promise Act	$2.50	$2.56	$2.61	$2.67	$2.73	$2.79	$2.85	$2.91	$2.98	$3.04	$13.06	$27.63
State Grants to Support Life-Long Learning	$0.20	$0.20	$0.20	$0.20	$0.20	$0.20	$0.20	$0.20	$0.20	$0.20	$1.00	$2.00
Regional Workforce Partnerships	$0.01	$0.01	$0.01	$0.01	$0.01	$0.01	$0.01	$0.01	$0.01	$0.01	$0.05	$0.10
Wealth Building												
National Mortgage Foreclosure Assistance Fund	$0.25	$0.26	$0.26	$0.27	$0.27	$0.28	$0.28	$0.29	$0.30	$0.30	$1.31	$2.76
Subtotal	**$23.44**	**$27.12**	**$29.76**	**$32.36**	**$32.86**	**$33.72**	**$33.36**	**$34.07**	**$34.80**	**$35.55**	**$145.54**	**$317.05**
Targeted Tax Cuts												
Rewarding Work												
Modify and Expand EITC and CTC	$38.02	$38.86	$39.71	$40.59	$41.48	$42.39	$43.33	$44.28	$45.25	$46.25	$198.67	$420.17
Education and Training												
Life-Long Learning	$2.00	$4.09	$6.27	$8.54	$10.91	$11.15	$11.39	$11.65	$11.90	$12.16	$31.80	$90.06
Wealth Building												
Incentives for Serving the Unbanked	$0.15	$0.15	$0.16	$0.16	$0.16	$0.17	$0.17	$0.17	$0.18	$0.18	$0.78	$1.66
Universal 401(k)	$13.29	$13.58	$13.88	$14.18	$14.49	$14.81	$15.14	$15.47	$15.81	$16.16	$69.41	$146.81
Subtotal	**$53.46**	**$56.68**	**$60.01**	**$63.47**	**$67.05**	**$68.52**	**$70.03**	**$71.57**	**$73.15**	**$74.75**	**$300.67**	**$658.69**
Revenue Enhancements												
Rewarding Work												
Lift Payroll Tax Cap on Employers	$56.16	$57.39	$58.65	$59.94	$61.26	$62.61	$63.99	$65.40	$66.83	$68.30	$293.41	$620.54
Tax Capital Gains and Dividends as Ordinary Income (with an exemption for half of gains up to $25,000)	$63.69	$50.72	$59.27	$61.74	$64.03	$66.57	$69.35	$72.45	$75.81	$79.33	$299.44	$662.94
Delay interest standard to fund TAA and UI Tax Policies	$2.25	$3.93	$2.83	$1.45	-$0.59	-$0.56	-$0.44	-$0.29	-$0.17	-$0.06	$9.87	$8.36
Subtotal	**$122.10**	**$112.04**	**$120.75**	**$123.13**	**$124.70**	**$128.63**	**$132.90**	**$137.55**	**$142.47**	**$147.57**	**$602.72**	**$1,291.85**
Impact on Surplus (+) or Deficit (-)												
Rewarding Work: Subtotal	$72.98	$61.79	$69.40	$70.68	$71.11	$73.91	$77.04	$80.49	$84.16	$88.00	$345.97	$749.58
Education and Training: Subtotal	-$14.09	-$19.56	-$24.13	-$28.78	-$31.40	-$32.26	-$31.94	-$32.64	-$33.36	-$34.09	-$117.96	-$282.25
Wealth Building: Subtotal	-$13.69	-$13.99	-$14.29	-$14.61	-$14.93	-$15.26	-$15.59	-$15.94	-$16.29	-$16.65	-$71.50	-$151.23
TOTAL BUDGETARY IMPACT	**$45.21**	**$28.24**	**$30.98**	**$27.30**	**$24.78**	**$26.39**	**$29.51**	**$31.91**	**$34.52**	**$37.27**	**$156.51**	**$316.10**

VIRTUOUS CIRCLE: POLICY DETAILS (IN BILLIONS)	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2009–2013	2009–2018
Programmatic Expenditures												
Middle Income Countries												
ILO technical assistance and monitoring	$0.30	$0.31	$0.31	$0.32	$0.33	$0.33	$0.34	$0.35	$0.36	$0.36	$1.57	$3.32
Economic institution building	$0.50	$1.00	$1.50	$2.00	$2.04	$2.09	$2.13	$2.18	$2.23	$2.28	$7.04	$17.96
Clean energy investment framework	$0.50	$0.51	$0.52	$0.53	$0.55	$0.00	$0.00	$0.00	$0.00	$0.00	$2.61	$2.61
Low Income Countries												
Basic health care												
AIDS/TB/malaria	$5.00	$5.11	$5.22	$5.34	$5.45	$5.57	$5.70	$5.82	$5.95	$6.08	$26.12	$55.25
Child/maternal health	$0.40	$0.80	$1.20	$1.60	$1.64	$1.67	$1.71	$1.75	$1.78	$1.82	$5.64	$14.37
Family planning/ reproductive health	$0.33	$0.65	$0.98	$1.30	$1.33	$1.36	$1.39	$1.42	$1.45	$1.48	$4.58	$11.67
Primary education	$0.63	$1.25	$1.88	$2.50	$2.56	$2.61	$2.67	$2.73	$2.79	$2.85	$8.81	$22.45
Water and sanitation	$1.30	$1.33	$1.36	$1.39	$1.42	$1.45	$1.48	$1.51	$1.55	$1.58	$6.79	$14.37
Aid for Trade	$2.50	$2.56	$2.61	$2.67	$2.73	$2.79	$2.85	$2.91	$2.98	$3.04	$13.06	$27.63
Subtotal	**$11.45**	**$13.51**	**$15.58**	**$17.65**	**$18.04**	**$17.88**	**$18.27**	**$18.67**	**$19.08**	**$19.50**	**$76.22**	**$169.62**
Impact on Surplus (+) or Deficit (-)												
Middle Income Countries: Subtotal	-$1.30	-$1.82	-$2.34	-$2.85	-$2.92	-$2.42	-$2.48	-$2.53	-$2.59	-$2.64	-$11.22	-$23.89
Low Income Countries: Subtotal	-$10.15	-$11.69	-$13.24	-$14.79	-$15.12	-$15.45	-$15.79	-$16.14	-$16.49	-$16.86	-$65.00	-$145.73
TOTAL BUDGETARY IMPACT	**-$11.45**	**-$13.51**	**-$15.58**	**-$17.65**	**-$18.04**	**-$17.88**	**-$18.27**	**-$18.67**	**-$19.08**	**-$19.50**	**-$76.22**	**-$169.62**

CAPTURING THE ENERGY OPPORTUNITY: POLICY COST DETAILS (IN BILLIONS)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2009–2013	2009–2018
Programmatic Expenditures												
Support for Low/Moderate Income Consumers	$30.38	$31.04	$31.73	$32.42	$33.14	$33.87	$34.61	$35.37	$36.15	$36.95	$158.71	$335.66
Support for Carbon Intensive Firms	$6.75	$6.90	$7.05	$7.21	$7.36	$7.53	$7.69	$7.86	$8.03	$8.21	$35.27	$74.59
Transportation												
Fuel Economy Standards	$0.00	$0.00	$0.02	$0.06	$0.15	$0.31	$0.54	$0.84	$1.21	$1.24	$0.22	$4.36
Health Care for Hybrids	$0.53	$0.53	$0.53	$0.53	$0.53	$0.53	$0.53	$0.53	$0.53	$0.53	$2.66	$5.32
Alternative Fuel Standard	$1.26	$1.41	$1.57	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$4.24	$4.24
Renewable Fuels Certification Program	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.01	$0.02
Investing in Low-Carbon Transportation Infrastructure	$5.18	$5.29	$5.41	$5.53	$5.65	$5.77	$5.90	$6.03	$6.16	$6.30	$27.06	$57.23
Electricity												
Grid Improvements	$0.18	$0.19	$0.19	$0.20	$0.20	$0.20	$0.21	$0.21	$0.22	$0.22	$0.96	$2.03
Upgrade Efficiency Standards for Residential, Commercial and Federal Buildings	$0.60	$0.69	$0.79	$0.91	$1.05	$1.21	$1.39	$1.60	$1.84	$2.11	$4.05	$12.18
Coal Capture and Storage Demonstration Projects	$0.11	$0.12	$0.12	$0.12	$0.13	$0.13	$0.13	$0.13	—	—	$0.60	$0.99
Emission Performance Standard	$2.00	$2.00	$2.00	$2.00	$2.00	$2.00	$2.00	$2.00	$2.00	$2.00	$10.00	$20.00
Requiring Federal Action to Reduce Global Warming												
Federal Purchasing Power	$0.38	$0.39	$0.40	$0.41	$0.42	$0.42	$0.43	$0.44	$0.45	$0.46	$1.99	$4.21
More than Double Low Carbon Energy RD&D	$5.00	$5.11	$5.22	$5.34	$5.45	$5.57	$5.70	$5.82	$5.95	$6.08	$26.12	$55.25
Clean Energy Investment Administration	$0.01	$0.01	$0.01	$0.01	$0.01	$0.01	$0.01	$0.01	$0.01	$0.01	$0.03	$0.07
Clean Energy Jobs Corps	$0.92	$0.94	$0.96	$0.98	$1.00	$1.02	$1.04	$1.07	$1.09	$1.11	$4.79	$10.13
Advancing International Global Warming Policies												
Developing Country Adaptation Assistance	$1.00	$1.02	$1.04	$1.07	$1.09	$1.11	$1.14	$1.16	$1.19	$1.22	$5.22	$11.05
Subtotal	**$54.29**	**$55.63**	**$57.04**	**$56.77**	**$58.18**	**$59.69**	**$61.32**	**$63.08**	**$64.84**	**$66.45**	**$281.92**	**$597.31**
Programmatic Reductions												
Reduce Oil and Gus Subsidies for Research and Development	$0.36	$0.36	$0.36	$0.36	$0.36	$0.36	$0.36	$0.36	$0.36	$0.36	$1.80	$3.60

CAPTURING THE ENERGY OPPORTUNITY: POLICY COST DETAILS (IN BILLIONS) (CONTINUED)	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2009–2013	2009–2018
Targeted Tax Cuts												
Transportation												
Fuel Efficiency Tax Credits	$0.60	$0.60	$0.60	$0.60	$0.60	$0.60	$0.60	$0.60	$0.60	$0.60	$3.00	$6.00
Incentives for Advanced Plug-In Hybrids	$0.00	$0.16	$0.21	$0.27	$0.35	$0.46	$0.59	$0.77	$1.00	$1.31	$0.99	$5.12
Manufacturer retooling incentives	$0.55	$0.56	$0.57	$0.59	$0.60	$0.61	$0.63	$0.64	$0.65	$0.67	$2.87	$6.08
Electricity												
Renewable Electricity Tax Credits and Low-Interest Loans	$0.05	$0.20	$0.42	$0.69	$0.92	$1.02	$1.06	$1.09	$1.13	$1.16	$2.27	$7.74
Subtotal	**$1.20**	**$1.52**	**$1.80**	**$2.15**	**$2.47**	**$2.69**	**$2.88**	**$3.11**	**$3.39**	**$3.73**	**$9.14**	**$24.94**
Revenue Enhancements												
Economy-wide Carbon Emissions Cap-and-Trade Program	$67.50	$68.99	$70.50	$72.05	$73.64	$75.26	$76.91	$78.61	$80.34	$82.10	$352.68	$745.90
Repeal Tax Breaks and Other Handouts to the Oil and Gas Industry	$5.96	$5.96	$5.96	$5.96	$5.96	$5.96	$5.96	$5.96	$5.96	$5.96	$29.80	$59.60
Subtotal	**$73.46**	**$74.95**	**$76.46**	**$78.01**	**$79.60**	**$81.22**	**$82.87**	**$84.57**	**$86.30**	**$88.06**	**$382.48**	**$805.50**
Impact on Surplus (+) or Deficit (-)												
Transportation: Subtotal	-$8.12	-$8.55	-$8.92	-$7.57	-$7.89	-$8.29	-$8.79	-$9.41	-$10.17	-$10.65	-$41.05	-$88.36
Electricity: Subtotal	-$2.95	-$3.19	-$3.52	-$3.92	-$4.29	-$4.56	-$4.78	-$5.04	-$5.19	-$5.49	-$17.87	-$42.94
Requiring Federal Action to Reduce Global Warming: Subtotal	-$6.30	-$6.44	-$6.58	-$6.73	-$6.88	-$7.03	-$7.18	-$7.34	-$7.50	-$7.67	-$32.94	-$69.66
Advancing International Global Warming Policies: Subtotal	-$1.00	-$1.02	-$1.04	-$1.07	-$1.09	-$1.11	-$1.14	-$1.16	-$1.19	-$1.22	-$5.22	-$11.05
Crosscutting Policies: Subtotal	$36.70	$37.36	$38.05	$38.74	$39.46	$40.19	$40.93	$41.69	$42.47	$43.27	$190.31	$398.86
TOTAL BUDGETARY IMPACT	**$18.33**	**$18.15**	**$17.98**	**$19.45**	**$19.31**	**$19.19**	**$19.03**	**$18.74**	**$18.42**	**$18.24**	**$93.22**	**$186.85**

Endnotes

1 We have taken President Bush's budget at face value, with two exceptions. We assume that the AMT will be indexed to inflation. The president has expressed a desire to extend this AMT "fix" but did not include the costs in his budget estimation. We also assume that the wars in Iraq and Afghanistan will continue and provided two alternative estimates for war spending. The president's budget assumes that there will be no spending for these wars after 2008, despite his support for their continuation. There are many other policy proposals (and gimmicks) that could be adjusted as well–for example, the president includes impacts of social security privatization, significant Medicare savings, changes to the tax treatment of health care, etc. Making these adjustments would generally make the president's fiscal path worse.

2 Congressional Budget Office, "The Budget and Economic Outlook: An Update," 2007, at: http://cbo.gov/ftpdocs/85xx/doc8565/08-23-Update07.pdf

3 The changes proposed here are not meant to be a fully-comprehensive tax reform plan, but rather several changes that would represent incremental improvement. For a more comprehensive approach, see "A Fair and Simple Tax System for our Future" Center for American Progress, January, 2005, at: http://www.americanprogress.org/projects/progressivepriorities/taxes.html

4 Henry J. Aaron, Leonard E. Burman, and C. Eugene Steuerle, *Taxing Capital Income* (Washington: The Urban Institute Press, 2007).

5 See Sarah Lueck, Jesse Drucker, and Brody Mullins, "Congress Hunts For Tax Targets Among the Rich: Revenue Search Looks Beyond Private Equity" *The Wall Street Journal*, June 22, 2007 at: http://online.wsj.com/article/SB118247664712544353.html.

6 Former Treasury Secretary Robert Rubin was quoted as saying: "It seems to me what is happening is people are performing a service, managing peoples' money in a private equity form, and fees for that service would ordinarily be thought of as ordinary income," at *New York Times* DealBook: "Rubin Urges Scrutiny of Private-Equity Tax Treatment" June 13, 2007, at: http://dealbook.blogs.nytimes.com/2007/06/13/scrutiny-on-tax-rates-that-fund-managers-pay/. See also Peter Orszag, "The Taxation of Carried Interest", Statement before the Committee on Finance, U.S. Sentate, July 11, 2007, at http://www.cbo.gov/ftpdocs/83xx/doc8306/07-11-CarriedInterest_Testimony.pdf

7 Joel Friedman and Katharine Richards, "Capital Gains and Dividend Tax Cuts: Data Make Clear That High-Income Households Benefit The Most," Center on Budget and Policy Priorities, January 30, 2006, at: http://www.cbpp.org/1-30-06tax2.htm.

8 Further, capital gain tax reductions that are not offset will increase the deficit, and thus potentially reduce national savings. See Joel Friedman and Aviva Aron-Dine "Economic Evidence for Extending Capital Gains and Dividend Tax Cuts Is Weak" Center on Budget and Policy Priorities, November 2005, at: http://www.cbpp.org/11-9-05tax.htm.

9 On the recent dividend experience, see also Alan Auerbach and Kevin Hassett "The 2003 Dividend Tax Cuts and the Value of the Firm: An Event Study," NBER Working Paper #11449, June 20095; and Mihir Desai and Austa Goolsbee, "Investment, Overhang and Tax Policy" Brookings Papers on Economic Activity, 2004. For a summary of the empirical evidence following the 2003 tax change, see Aviva Aron-Dine, "The Effects of the Capital Gains and Dividend Tax Cuts on The Economy and Revenues: Four Years Later, a Look at the Evidence," Center on Budget and Policy Priorities, July 10, 2007.

10 Henry J. Aaron, Leonard E. Burman, and C. Eugene Steuerle, *Taxing Capital Income* (Washington: The Urban Institute Press, 2007).

11 David Joulfaian, "Estate and Gift Tax, Federal," Tax Policy Center, Urban Institute and Brookings Institution, at http://www.taxpolicycenter.org/taxtopics/encyclopedia/Estate-and-Gift-Tax.cfm

12 Jason Furman, Lawrence H. Summers, and Jason Bordoff, "Achieving Progressive Tax Reform in an Increasingly Global Economy," Brookings Institution, June 2007, at http://www3.brookings.edu/views/papers/furman/200706bordoff_summers.pdf.

13 Government Accountability Office "Tax Compliance, Multiple Approaches Are Needed to Reduce the Tax Gap" Statement of Michael Brostek Director, Tax Issues Strategic Issues, February 2007, at http://www.gao.gov/new.items/d07488t.pdf.

14 Government Accountability Office "Requiring brokers to report securities cost basis would improve compliance if related challenges are addressed" Washington, DC (June 2006), at www.gao.gov/new.items/d06603.pdf.

15 See Minority and Majority Staff Report, Permanent Subcommittee on Investigations, "Tax Haven Abuses: The Enablers, The Tools and Secrecy," August 2001, available at http://www.senate.gov/~levin/newsroom/supporting/2006/PSI.taxhavenabuses.080106.pdf, and Joe Guttentag and Reuven Avi-Yonah, "Closing the International Tax Gap," in Max B. Sawicky, ed., *Bridging the Tax Gap: Addressing the Crisis in Federal Tax Administration Economic Policy Institute*, 2006.

16 There is also a Medicare payroll tax equal to 1.45 percent on both employers and employees, with no earnings cap.

17 Citizens for Tax Justice, "An Analysis of Eliminating the Cap on Earnings Subject to the Social Security Tax & Related Issues," Nov 30, 2006 at http://www.ctj.org/pdf/socialsecuritytaxearningscapnov2006.pdf

18 See Social Security and Medicare Boards of Trustees "Status of the Social Security and Medicare Program: 2007 Annual Report," at http://www.ssa.gov/OACT/TRSUM/trsummary.html

19 See Social Security Actuarial Publications, Summary measures and graphs at http://www.ssa.gov/OACT/solvency/provisions/charts/chart_run124.html.

20 Tax Policy Center.

21 Some, including the Center for American Progress, have proposed eliminating the AMT altogether. If done in isolation, such a change would be extremely costly and would benefit primarily upper- and upper-middle income taxpayers while significantly adding to the deficit. A better approach is to eliminate the AMT as part of a more comprehensive reform. In absence of a broader tax overhaul, an AMT reform ought to stick to the principles outlined above.

22 Perhaps the one deduction that should be retained is for charitable giving.

23 Congressional Budget Office, "Trade-Offs in Allocating Allowances for CO2 Emissions," 2007, at http://www.cbo.gov/ftpdocs/80xx/doc8027/04-25-Cap_Trade.pdf

24 This estimate of auction revenue is based on the following studies: Energy Information Administration, "Energy Market and Economic Impacts of S. 280, the Climate Stewardship and Innovation Act of 2007," (Department of Energy, 2007) available at http://www.eia.doe.gov/oiaf/servicerpt/csia/emi.html (last accessed October 2007); Environmental Protection Agency, Office of Atmospheric Programs, "Analysis of The Climate Stewardship and Innovation Act of 2007" (Environmental Protection Agency, 2007) PowerPoint Presentation, July 16, 2007, available at http://www.epa.gov/climatechange/downloads/s280full-brief.pdf (last accessed October 2007); Tellus Institute, "Analysis of the Climate Stewardship Act" (2004); Massachusetts Institute of Technology, "Emissions Trading to Reduce Greenhouse Gas Emissions in the United States" (2003); Energy Information Administration, "Analysis of Senate Amendment 2028, the Climate Stewardship Act of 2003" (Department of Energy, 2004); Energy Information Administration, "Energy and Economic Impacts of H.R.5049, the Keep America Competitive Global Warming Policy Act" (Department of Energy, 2006); National Commission on Energy Policy, "Economic Analysis of Updated Commission Recommendations" (2007), available at: http://www.energycommission.org/files/contentFiles/NCEP_Technical_Appendix_June_2007_4683bf3e2ca9b.pdf (last accessed October 2007); Mark Lasky, "The Economic Costs of Reducing Emissions of Greenhouse Gases: A Survey of Economic Models" (Washington: Congressional Budget Office, May 2003) available at http://www.cbo.gov/ftpdocs/41xx/doc4198/2003-3.pdf (last accessed October 2007); Energy Information Administration, "Energy Market and Economic Impacts of a Proposal to Reduce Greenhouse Gas Intensity with a Cap and Trade System" (Department of Energy, 2007); and Anne E. Smith and Martin T. Ross, "Allowance Allocation: Who Wins and Loses Under a Carbon Dioxide Control Program?" (Boston, MA: Charles River Associates, 2002).

25 While there is general consensus on the need to control emissions, the question of how best to do this is much debated. To date, this discussion has focused on two policy approaches to controlling emissions: quantity mechanisms (e.g. cap-and-trade) and price mechanisms (e.g. carbon taxes). While, on balance, cap-and-trade appears to be the better choice for the United States, carbon taxes and well-designed hybrid mechanisms would also be positive and appropriate steps towards controlling greenhouse gas emissions.

26 John P. Holdren, "The Energy Innovation Imperative Addressing Oil Dependence, Climate Change, and Other 21st Century Energy Challenges," *Innovations* 1 (2) (Spring 2006): 3-23, at http://www.belfercenter.org/publication/765/energy_ innovation_imperative.html (last accessed October 2007).

27 This level of reduction is also required by legislation introduced by Rep. Henry Waxman (D-CA) and Sens. Barbara Boxer (D-CA) and Bernie Sanders (I-VT).

28 A program of this level is consistent with a permit price of approximately $10/ton of CO2. Scientists and economists have estimated the price threshold needed to jumpstart the clean energy transition, including the widespread use of carbon capture and storage. Pacala and Socolow, the authors of the "wedge" analysis, give an estimate in the range of $27-54 per ton of CO2. The UN IPCC takes a different perspective, estimating that $50/ton of CO2 would engender a global reduction of 21-34 percent against the higher BAU estimates, or and 29-47 percent against the lower BAU estimates. The $10/ton estimated price may ultimately be too low to be consistent with aggressive emission targets. However, we have taken a conservative approach to revenue estimation.

29 Terry Dinan,. "Trade-Offs in Allocating Allowances for CO2 Emissions," Congressional Budget Office, April, 2007.

30 "Allowance Allocation: Who Wins and Loses Under a Carbon Dioxde Control Program?" Charles River Associates/Center for Clean Air Policy, 2002.

31 See for example, "Energy Market and Economic Impacts of a Proposal to Reduce Greenhouse Gas Intensity with a Cap and Trade System," Energy Information Administration, January 2007.

32 Terry Dinan, "Who Gains and Who Pays Under Carbon-Allowance Trading? The Distributional Effects of Alternative Policy Designs," Congressional Budget Office, June 2000.

33 These estimates are based on Congressional Budget Office estimates of the distribution of energy costs increases due to a cap-and-trade policy.

34 The estimates of energy cost increases includes only the effect of cap-and-trade, and does not include the potential impacts. To the extent that efficiency gains help consumers lower costs, consumers will be better-off than noted here.

35 California Energy Commission, "2002-2012 Electricity Outlook Report" (February 2002), p. 40, available at http://www.energy.ca.gov/reports/2002-02-14_700-01-004F.PDF (last accessed October 2007).

36 Based on calculations in Audrey Chang, "California's Sustainable Energy Policies Provide a Model for the Nation" (Washington:Natural Resources Defense Council, 2005).

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